

**Letter of Findings Number: 10-0392**  
**Use Tax**  
**For Tax Years 2007-08**

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**ISSUE**

**I. Use Tax—Research and Development Exemption.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-40; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#).

Taxpayer protests the imposition of use tax on its purchase of a backhoe.

**STATEMENT OF FACTS**

Taxpayer is an Indiana corporation. As the result of an audit of the tax years 2007 and 2008, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on the purchase of a backhoe in 2008. The Department therefore issued a proposed assessment for use tax and interest for 2008. Taxpayer protests that the backhoe was eligible for the research and development exemption and that its purchase of the backhoe was not subject to sales or use tax. Taxpayer therefore protests the imposition of use tax. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Use Tax—Research and Development Exemption.**

**DISCUSSION**

Taxpayer protests the imposition of use tax on its purchase of a backhoe in 2008. Taxpayer believes that the backhoe is eligible for the research and development exemption. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. In this case, the Department determined that Taxpayer had acquired tangible personal property in retail transactions and used that property in Indiana without paying sales tax at the point of purchase. The Department therefore issued proposed assessments for use tax, as provided by [45 IAC 2.2-3-4](#).

Taxpayer protests that the backhoe is required to recreate the very specific conditions where its product will be used in order to conduct research and development of its product. Without such conditions, Taxpayer states, it is unable to conduct research on and further develop its product. Taxpayer provided documentation showing the conditions it duplicated with the backhoe. Taxpayer also points out that it would be cost-prohibitive to take its product to its customers' locations to conduct research and that it must recreate those conditions at its Indiana facility.

The relevant statute is IC § 6-2.5-5-40, which provides:

(a) As used in this chapter, "research and development activities" does not include any of the following:

- (1) Efficiency surveys.
- (2) Management studies.
- (3) Consumer surveys.
- (4) Economic surveys.
- (5) Advertising or promotions.
- (6) Research in connection with literary, historical, or similar projects.
- (7) Testing for purposes of quality control.

- (b) As used in this section, "research and development equipment" means tangible personal property that:
- (1) consists of or is a combination of:
    - (A) laboratory equipment;
    - (B) computers;
    - (C) computer software;
    - (D) telecommunications equipment; or
    - (E) testing equipment;
  - (2) has not previously been used in Indiana for any purpose; and
  - (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:
    - (A) new products;
    - (B) new uses of existing products; or
    - (C) improving or testing existing products.
- (c) A retail transaction:
- (1) involving research and development equipment; and
  - (2) occurring after June 30, 2007; is exempt from the state gross retail tax.
- (Emphasis added).

Therefore, in order to qualify for the exemption found in IC § 6-2.5-5-40(b), the tangible personal property must meet three conditions. The tangible personal property must: 1) consist of laboratory equipment, computers, computer software, telecommunications equipment, or testing equipment; 2) not have been previously used in Indiana for any purpose, and; 3) be acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development.

The backhoe in question here is clearly not a computer, computer software, or telecommunications equipment. Neither is it laboratory equipment or testing equipment, since it does not have any effect on the item being tested. The backhoe is used to create the "laboratory" itself, not to test Taxpayer's product. The backhoe therefore does not meet the requirements of IC § 6-2.5-5-40(b)(1). While Taxpayer is correct that without the specific conditions created by the use of the backhoe its product could not be tested and evaluated, also correct is the fact that the backhoe is not directly part of the testing itself. Direct use of the tangible personal property is required to qualify for the exemption, as provided by IC § 6-2.5-5-40(b)(3).

After review, the backhoe in question does not meet the requirements of IC § 6-2.5-5-40 for several reasons. The backhoe is not directly used in testing Taxpayer's product. Rather, the backhoe is one step removed from the direct testing of Taxpayer's product. Taxpayer has not met the burden of proving the proposed assessment wrong, as required by IC § 6-8.1-5-1(c).

#### **FINDING**

Taxpayer's protest is denied.

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