

Letter of Findings: 04-20100644
Gross Retail Tax
For the Years 2005, 2006, and 2007

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ISSUES

I. Labels and Labeling Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-2-1 to -40; IC § 6-8.1-5-1(c); [45 IAC 2.2-5-14](#); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988).

Taxpayer argues that its purchases of various labels and associated labeling equipment are exempt from sales/use tax because the labels become part of the products sold to retail customers.

II. Protective Clothing – Gross Retail Tax.

Authority: [45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#).

Taxpayer maintains that its purchases of lab coats were exempt from sales/use tax because the coats are used to prevent contamination of its food products.

III. Manufacturing Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-5-3; IC § 6-8.1-5-1(c); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-8\(c\)](#).

Taxpayer states that certain items of equipment and supplies are exempt from sales/use tax because the items are directly used in the direct production of Taxpayer's food products.

IV. Refrigeration Equipment – Gross Retail Tax.

Authority: [45 IAC 2.2-5-8\(e\)\(1\)](#).

Taxpayer claims that its purchase of refrigeration equipment was exempt from sales/use tax because the equipment is used to maintain and store "work-in-process."

V. Lift Trucks – Gross Retail Tax.

Authority: General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); [45 IAC 2.2-5-8\(e\)](#); [45 IAC 2.2-5-8\(e\)\(3\)](#).

Taxpayer argues that its purchase of lift trucks was exempt from sales/use tax because the lift trucks are used to transport "work-in-process" within an integrated production process.

VI. Chemicals Consumed In Direct Production – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); [45 IAC 2.2-5-10\(c\)\(2\)\(B\)](#); [45 IAC 2.2-5-12](#).

Taxpayer maintains that its purchase of certain chemicals is exempt because the chemicals are directly used in the direct production of its food products.

VII. Boiler Chemicals – Gross Retail Tax.

Authority: [45 IAC 2.2-5-10\(c\)\(2\)\(B\)](#).

Taxpayer states that its purchase of chemicals, used to reduce "scale buildup" in its boiler and pipes was exempt from sales/use tax.

VIII. Packaging – Gross Retail Tax.

Authority: [45 IAC 2.2-5-8\(d\)](#).

Taxpayer claims that its purchase of packaging equipment was exempt from sales/use tax because the packaging equipment is used within an "integrated production process."

IX. Dehumidification Equipment – Gross Retail Tax.

Authority: [45 IAC 2.2-5-70\(a\)](#).

Taxpayer argues that its purchase of dehumidification equipment was required by the USDA, is used in the direct production of its food products, was required to comply with federal environmental quality standards, and is consequently exempt from sales/use tax.

X. Feed Mill Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-5-2; IC § 6-2.5-5-2(b)(2); IC § 6-8.1-5-5-1(c); [45 IAC 2.2-5-6](#); [45 IAC 2.2-5-6\(c\)](#).

Taxpayer maintains that its purchase of equipment used in its feed mill facility was exempt from sales/use tax because the equipment was used in the "direct production of food or commodities...."

STATEMENT OF FACTS

Taxpayer operates a turkey processing plant in Indiana and a feed mill plant in Indiana. The Department of Revenue (Department) conducted an audit review of Taxpayer's sales and use tax compliance.

The audit report contained a description of Taxpayer's food production process as follows:

Related company breeds turkeys which lay eggs. Eggs are delivered to a second related entity which operates a hatchery. Second related company hatches eggs which produce young turkeys which are called "poults."

Poults are shipped to various independent farmers which raise the poults until they are mature turkeys. The poults remain Taxpayer's property, but the independent farmers own the land, turkey houses, and equipment used to raise the poults. The longest portion of the animals' life span is spent at the independent farms. Once the poults mature, the turkeys are transported to Taxpayer's own processing plant. The processing plant produces a variety of food products.

Some of the processed food product is transferred to unrelated, third-party processors which produce such products as hot dogs and lunch meat.

Taxpayer also owns an Indiana feed mill which produces a variety of feed products for turkeys.

The Department's audit began in late 2007 and was concluded September 2010. The audit resulted in the assessment of additional sales/use tax.

Taxpayer protested substantially all of the audit's findings. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Labels and Labeling Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer protested the assessment of sales/use tax on the purchase of labels and labeling equipment on the ground that the labels become an integral part of the food product being sold to retail customers.

Indiana imposes a sales tax on retail transactions in Indiana. IC § 6-2.5-2-1. The legislature has provided a number of exemptions to the imposition of that tax. See IC § 6-2.5-5-1 to -40.

One of those exemptions is detailed at [45 IAC 2.2-5-14](#) which states in part:

(a) The state gross retail tax shall not apply to sales of any tangible personal property which is to be incorporated by the purchaser as a material or an integral part into tangible personal property produced for sale by such purchaser in the business of manufacturing, assembling, refining or processing.

(b) The exemption provided by this regulation [[45 IAC 2.2](#)] applies only to tangible personal property to be incorporated as a material or an integral part into tangible personal property produced for sale by a purchaser engaged in the business of manufacturing, assembling, refining or processing. This regulation [[45 IAC 2.2](#)] does not apply to persons engaged in producing tangible personal property for their own use. (Emphasis added).

Taxpayer states that the labels are attached to the items which it sells to its customers and that the labels constitute a "material or an integral part" of the food products Taxpayer sells to its retail customers. Taxpayer contends that the failure to exempt the labels at issue was simply a "mere oversight on the [part] of the auditor."

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

[45 IAC 2.2-5-14](#), like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999).

Taxpayer addresses in writing the question of whether or not the labels are exempt as follows:

Product labels that become a component part of the product sold to the final customer.

Product labels that are attached to non-returnable corrugated combo bins containing bulk meat sold to [wholesaler].

Product labels attached to cases containing multiple units of packaged product.

There is insufficient information to determine whether the labels at issue are inventory labels, shipping labels, warehousing labels, or labels placed on the outside of containers sold to wholesale customers. There is insufficient information to determine whether the labels are attached to the food products sold to the ultimate retail customer. In order to establish that the labels are exempt, the Taxpayer must establish that the labels are a "material or integral part" of the product sold to the retail consumer.

Taxpayer describes the labeling equipment at issue as follows:

These are replacement part[s] for labeling equipment that places the product labels directly onto the traypack which stays with the product until it reaches the final consumer. The labeling equipment is an integral and essential component of the packaging process.

There is no reason to doubt taxpayer's simple averment, but there is no independent verification or evidence which substantiates Taxpayer's conclusion. Taxpayer may well be correct but there is insufficient information to establish that the labeling equipment is used for exempt or non-exempt purposes. As noted in the audit report, "Audit has not assessed tax on any label that adequate documentation was provided that the label was actually

incorporated as a material part of the finished product for resale to the final consumer." From the report, it is evident that the Department considered the issue of whether the labels or the equipment were exempt and determined the assessment accordingly. Taxpayer has failed to provide additional information establishing that the labels at issue were incorporated into the product sold the consumer. The exemption Taxpayer seeks is "strictly construed" and Taxpayer has failed to meet its burden of demonstrating that the original assessment was "wrong."

FINDING

Taxpayer's protest is respectfully denied.

II. Protective Clothing – Gross Retail Tax.

DISCUSSION

Taxpayer argues that its purchases of "[l]abcoats worn by production associates to avoid contamination of the food product by clothing fibers and other contaminants from their personal clothing" are exempt from sales tax.

Taxpayer cites to [45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#) as authority for the exemption it seeks. The administrative regulation exempts:

Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

Taxpayer states that the labcoats are used "by associates who come into direct contact with the product."

Under the circumstances described by Taxpayer, the Department is prepared to agree that the purchase of the labcoats was exempt from sales/use tax.

FINDING

Taxpayer's protest is sustained.

III. Manufacturing Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer argues that certain equipment it purchased is exempt from sales tax because the equipment is directly used in the direct "manufacture" of its food products.

A. Lung and Kidney Extraction Guns. Taxpayer purchased extraction "guns" which are connected to a vacuum hose and which perform a waste "extraction operation." The waste is removed, transported, and sold for use as dog and cat food.

Taxpayer cites to [45 IAC 2.2-5-8](#) as authority for the exemption it seeks. The regulation in part states as follows:

(a) In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

(b) The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property. (Emphasis added)

During the course of the audit, the Department's representative toured Taxpayer's facility on two occasions. In part, the audit appeared to agree with Taxpayer's explanation of the manufacturing process by differentiating between equipment used to extract the waste and equipment used to transport the waste. As explained in the audit report, "A fifty percent exemption has been allowed for the function of removing the lung and kidney from the bird as opposed to the function of transporting the waste product."

Taxpayer's representative challenges the audit's first-hand knowledge of the manufacturing facility. Taxpayer states that the Department's representative spent no more than a total of 15 minutes touring the facility and that the representative's ability to discern between what constitutes equipment used in "direct production" and "post-production" equipment should be given little weight. The audit's notes would seem to contradict Taxpayer's assertion. However whether the Department's representative spent 15 minutes touring the facility, spent 15 hours touring the facility, or spent 15 days touring the facility is of little significance at this stage of administrative review.

Taxpayer states that the Department's distinction between production and non-production is "illogical" since the extraction and disposal equipment "is integral and essential to creating the vacuum to make the extraction."

The Department is unable to agree that Taxpayer has met its burden of demonstrating that the audit's 50 percent distinction between exempt and non-exempt and between production and "post-production" was "wrong." IC § 6-8.1-5-1(c).

B. Ice Conveyor. Taxpayer purchased a conveyor belt to transport ice. The belt is used to convey ice "to the

grading areas where whole birds are iced prior to rehang as well as used to chill in-process meat heading to traypack." Taxpayer points to IAC 2.2-5-8 as authority for the proposition that the equipment is "directly used by the purchaser in the production process...."

Taxpayer's argument is conclusory; there is little to indicate that the conveyor belt has an "immediate effect on the article being produced." [45 IAC 2.2-5-8\(c\)](#). Based on Taxpayer's explanation, the ice conveyor – however necessary to the manufacture of the food product – is best categorized as "post-production" equipment. The ice conveyor may be of vital significance in producing a wholesome food product, but there is nothing to indicate that the conveyor belt has an immediate and direct effect on that product.

C. Claw, Beak, Injection Equipment. Taxpayer states its purchase of equipment used at its hatchery is exempt from sales tax pursuant to [45 IAC 2.2-5-8](#). Taxpayer has failed to establish whether any of the specific equipment at issue is or is not directly used in the direct production of Taxpayer's meat production process. Based on Taxpayer's description of the manner in which this equipment is used, these devices are better categorized as "pre-production" equipment.

However, Taxpayer cites to two invoices from a company called "Nova-Tech." Taxpayer states that a line item on each of the invoices represents a service provided by the vendor. The line items state, "Loaded on PSP System." According to Taxpayer, this particular "charge is the base charge for each poult loaded onto [a] platform."

Taxpayer has provided sufficient information to raise a legitimate question over whether the line items listed on the invoices are for services offered and provided. As such, the charges are outside the purview of sales/use tax and should be removed from the assessment.

D. Boiler. Taxpayer states that its purchase of a boiler is exempt from sales/use tax because it is used – according to Taxpayer – in the "direct production, manufacture, fabrication, assembly, or finishing of other tangible personal property."

Taxpayer points out that the audit found that the 90 percent of the boiler's use was attributable to manufacturing activities and that 10 percent of the boiler's use was intended for general heating of the manufacturing facility. Taxpayer argues that the "equipment is not fungible and use[d] principally and predominately in production facilities...."

The Department is not prepared to second-guess the audit's determination that the boiler was used in both an exempt fashion and in a non-exempt function and the audit's apportionment accordingly. Taxpayer has not established that the audit's determination was wrong. IC § 6-8.1-5-1(c).

E. Continuous Production. As set out in the Statement of Facts above, Taxpayer's turkeys move from facility to facility:

Related company breeds turkeys which lay eggs. Eggs are delivered to a second related entity which operates a hatchery. Second related company hatches eggs which produce young turkeys which are called "poults."

Poults are shipped to various independent farmers which raise the poults until they are mature turkeys. The poults remain Taxpayer's property but the independent farmers own the land, turkey houses, and equipment used to raise the poults. The longest portion of the animals' life span is spent at these independent farms. Once the poults mature, the turkeys are transported to Taxpayer's own processing plant.

Taxpayer states it operates one continuous, integrated facility and that the equipment used to move its food product from one facility to the next is exempt. Taxpayer explains:

If a manufacturer operates two plants, one making parts and other assembling those parts, we go not (sic) believe the exemption would be voided merely because the parts plants sent the part to an outside vendor for plating or some other fabrication prior to it arriving at the assembly plant. The part was intended for further processing.

Taxpayer's argument is apparently predicated on the assumption that its various production facilities constitute a "continuous integrated production process" as described in *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

In *General Motors*, the automobile manufacturer shipped component parts to its assembly plants and, as Taxpayer here has done, claimed an exemption for the equipment and supplies used to transport partially completed automobile parts during those inter-divisional transfers. The court held that the automobile manufacturer's packing materials were part of the integral process whereby the manufacturer produced its finished automobiles. Therefore, the automobile manufacturer's packing materials were exempt under IC § 6-2.5-5-3. The court came to its determination after finding that the automobile manufacturer's geographically separated production facilities formed a cohesive, singular production unit in which the claimant's "manufacture of finished marketable automobiles [was] accomplished by one continuous integrated production process within which the transport of parts from component plants to assembly plants [was] an essential and integral part." *General Motors*, 578 N.E.2d at 404. The court's holding, finding that the packing materials used in interdivisional transfers were exempt from the gross retail tax, included such "expendable packing materials, [] as corrugated cardboard cartons, separators, liners, pads, wrapping paper, plastic plugs, pallets, and other items to protect the parts during shipment to assembly plants...." *Id.* at 400. Similarly, the Taxpayer is making transfers of partially

completed work-in-process with the intent of producing its most marketable finished food product. Similarly, Taxpayer seeks an exemption for a variety of equipment and supplies used in the interdivisional transfers. Similarly, at the completion of its manufacturing process, taxpayer has a goal of producing its most marketable finished food product.

However, the analogy between the automobile manufacturer claimant in General Motors and Taxpayer breaks down upon closer examination; the Department is unable to agree that Taxpayer has met the standard the Tax Court established in General Motors sufficient to establish that Taxpayer's four facilities together constituted a unified production facility. See *Id.* at 402 n.3. The Tax Court in General Motors allowed the automobile manufacturer the exemption because the court found that the automobile manufacturer's "integrated production process terminates the production of the most marketable finished product, e.g., the product actually marketed." *Id.* at 404. Essentially, the General Motors court re-characterized the various separate automobile manufacturing facilities as one continuous, integrated, manufacturing process such that the automobile manufacturer's purchase of packing materials – used to facilitate the transfer of unfinished goods within that integrated production process – was essential and integral to the taxpayer's manufacturing process and, thereby, was entitled to the manufacturing exemption available under IC § 6-2.5-5-3. Among the evidence cited as relevant in determining that automobile manufacturer operated a continuous, integrated, manufacturing process, the court found that automobile manufacturer's personnel, located at its various plants, collaborated to develop new products, together designed and engineered new parts and packing materials, together planned the production processes for new parts, and together mutually solved problems and ensured product quality. *Id.* at 402 n.3. In addition, the court held that the "continuity of production exist[ed] between [automobile manufacturer's] different plants [was] demonstrated by the standard practice of shifting certain production operations back and forth between component and assembly plants when necessary for more efficient operation." *Id.*

Taxpayer has failed to demonstrate that it is entitled to the manufacturing exemption available under [45 IAC 2.2-5-8](#) (IC § 6-2.5-5-3). In seeking the exemption, the taxpayer "has the burden of showing the terms of the exemption statute are met." General Motors, 578 N.E.2d at 404. In contrast to the burden of proof established by the automobile manufacturer in General Motors, Taxpayer has not demonstrated that its various plant facilities are operated as one continuous and integral operation. Taxpayer does not come within the purview of General Motors because it fails to demonstrate that the processing which occurs at its various Indiana locations constitutes "one continuous integrated production process." *Id.* at 404. Accordingly, the Taxpayer is not entitled to an exemption from the state's gross retail tax for the purchase of equipment involved in moving its food products from one facility to the next.

F. Air Compressor. Taxpayer states that its purchase of an air compressor was exempt because the air compressor "is used 100[percent] to operate the pneumatic processing equipment throughout the plant. The issue of whether the compressor was "directly involved in the direct production" of Taxpayer's food product was addressed during the audit. In response to the Department's questions concerning the manner in which Taxpayer used the compressor, Taxpayer's on-site representative replied as follows:

This is an air compressor used as a power source to operate all of the pneumatic processing equipment throughout the plant in accordance with [45 IAC 2.2-5-8\(c\)\(2\)\(A\)](#). Vacuum system is for the lun[g] and kidney vacuum extractor to remove the parts from the turkey as part of the process.

After receiving this initial response, the audit sought additional clarification to which Taxpayer's on-site representative replied that the air compressor was used to "operate pneumatic production equipment."

The audit sought yet further clarification finding that the initial two responses appeared contradictory. In a third response, Taxpayer's on-site representative stated that the air compressor was principally used "50[percent] for pneumatic processing equipment and 50[percent] for lung & kidney extraction."

As noted above, the audit found that the extraction equipment was used in an exempt manner 50 percent of the time and allowed a partial exemption for the extraction equipment.

Based on an analysis of the extent to which the compressor was used to operate exempt production equipment and the extent to which the compressor was used to operate the non-exempt extraction equipment, the audit determined that the compressor was 75 percent exempt and 25 percent non-exempt.

In its protest, Taxpayer indicates that there was some "confusion" and that the compressor is entirely exempt.

Having found that extraction equipment was less than 100 percent exempt, it is not possible to conclude that the air compressor used to power that equipment is entirely exempt.

G. Pipe Insulation. Taxpayer argues that its purchase of pipe insulation is exempt because the insulation is installed on equipment "directly used by the purchaser in the production process...." [45 IAC 2.2-5-8\(c\)](#). Taxpayer concludes that "[p]iping for processing equipment is exempt and the insulation is merely a component part of the piping system."

The piping at issue is used to transport waste products. Therefore, the audit concluded that the "piping was already taxable as transporting the waste material and the insulation is even further removed."

Taxpayer has failed to demonstrate that the audit's original conclusion was wrong. Both the pipe and the insulation are outside the production process by which Taxpayer manufactures its food products.

FINDING

The line item listed on the invoices from Nova-Tech as described in part "C" above should be removed from the assessment; in all other respects, Taxpayer's protest is respectfully denied.

IV. Refrigeration Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer purchased various items of refrigeration equipment. Taxpayer argues that the "items... are used principally and predominately for refrigerated storage and process chillers and are integral and essential to the manufacturing process."

As authority for the exemption, Taxpayer cites to [45 IAC 2.2-5-8\(e\)\(1\)](#). That exemption states in full as follows:

Tangible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.

Taxpayer states that the equipment is used to refrigerate food being moved from its processing plant to an out-of-state facility for "further processing." As such, Taxpayer's argument is necessarily based on establishing the contention that it operates one continuous, uninterrupted production process even though the production takes place at locations within Indiana and outside this state. The identical issue was addressed in part III.E. above. The Department's conclusion – that its different facilities do not constitute a "continuous, integrated production" production unit – remains unchanged.

FINDING

Taxpayer's protest is respectfully denied.

V. Lift Trucks – Gross Retail Tax.

DISCUSSION

Taxpayer maintains that its purchase of "lift trucks" was exempt because the equipment is used to transport its food product from one stage of production to the next.

Taxpayer cites to [45 IAC 2.2-5-8\(e\)](#) as authority:

Tangible personal property used in or for the purpose of storing raw material, work in process, semifinished or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being processed or refined from one (1) production step to another.

Specifically, Taxpayer cites to subsection three provided in the regulation. That particular portion of the regulation states:

Transportation equipment used to transport work in process or semi-finished material to or from storage is not subject to tax if such equipment is used to transport work-in-process or semi-finished materials within the production process. [45 IAC 2.2-5-8\(e\)\(3\)](#).

Taxpayer states that at the time the audit was being conducted, it was "unaware of the percent of turkey production that was related to bulk meat sent to our sister plant in [outside the state] for further processing." Taxpayer indicates that "87.7[percent] of our total plant production is product that is transported [outside the state] for further production." Taxpayer states that the lift trucks are "used primarily and predominately to transport the bulk meat rather than the finished product."

The issue of whether Taxpayer operates one continuous, uninterrupted production process was addressed in III.E. above. See *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) ("GM's manufacture of finished marketable automobiles is accomplished by one continuous integrated production process by which the transport of parts from component plants to assembly plants is an essential and integral part.") Taxpayer asks that the Department conclude that its food production process is analogous to that of the petitioner in *General Motors*. Other than Taxpayer's conclusion that it operates a "continuous integrated process" within its separate, multi-state facilities, there is little substantive upon which to sustain Taxpayer's protest; the Department's position on this issue remains unchanged.

FINDING

Taxpayer's protest is respectfully denied.

VI. Chemicals Consumed In Direct Production – Gross Retail Tax.

DISCUSSION

Taxpayer purchased "sanitizing chemicals" used in its meat processing plant. Taxpayer maintains that these chemicals were mistakenly classified by the audit as used for "general cleaning." Believing that these chemicals are exempt, Taxpayer cites to [45 IAC 2.2-5-12](#). In part, the regulation states as follows:

(a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.

(b) The exemption provided by this regulation [\[45 IAC 2.2\]](#) applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.

(c) The state gross retail tax does not apply to purchases of materials to be directly consumed in the

production process or in mining, provided that such materials are directly used in the production process; i.e., they have an immediate effect on the article being produced. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property. (Emphasis added).

Taxpayer states that the chemicals at issue "are for the same sanitizing chemicals that were charged to General Plant Administration." According to Taxpayer, these chemicals are used in the "identical exempt manner and are merely used in multiple parts of the processing plant or were merely charged to this account for budgetary reasons."

Taxpayer's reasoning is as follows; the audit exempted chemicals which it determined were involved in the direct production of Taxpayer's food products. These chemicals are used in the same way and the audit's determination that the chemicals are used for "general cleaning" was erroneous.

Taxpayer has failed to provide anything of substance which contradicts the audit's conclusion that certain cleaning chemicals are used in an exempt manner and certain chemicals are not used in an exempt manner. As with any portion of the assessment, IC § 6-8.1-5-1(c), imposes on the Taxpayer "the burden of proving that the proposed assessment is wrong rests...." In the case of the "sanitizing chemicals," the chemicals are not used in the "direct production" of Taxpayer's food product and not "directly consumed in the direct production process...." [45 IAC 2.2-5-12](#).

Taxpayer also maintains that the purchase of "chemical added to the process chillers to prevent bacteria and to avoid contamination of the product...." is exempt from tax.

In support of this portion of the protest, Taxpayer cites to [45 IAC 2.2-5-10\(c\)\(2\)\(B\)](#). That portion of the regulation exempts:

Chemicals used to treat the water used in the production of whiskey to ensure that the water is pure or to prevent scale buildup in the boilers and pipes.

The portion of the regulation to which Taxpayer cites appears to refer to exempt chemicals used to treat water where the water becomes a component part of the product being produced. In Taxpayer's case, the chemicals at issue treat water used in its chilling equipment. Since the chemicals are not introduced into or become part of Taxpayer's meat product and because there is no indication that the chilling equipment is directly used in the production of the food product, the Department is unable to agree that the chemicals are exempt.

FINDING

Taxpayer's protest is respectfully denied.

VII. Boiler Chemicals – Gross Retail Tax.

DISCUSSION

Taxpayer purchased chemicals "used to treat water used in production to ensure that the water is pure to prevent scale buildup in the boilers and pipes." Taxpayer maintains that the chemicals are exempt pursuant to [45 IAC 2.2-5-10\(c\)\(2\)\(B\)](#) which exempts:

Chemicals used to treat the water used in the production of whiskey to ensure that the water is pure or to prevent scale buildup in the boilers and pipes.

On the issue of whether the treatment chemicals are exempt, the Department is prepared to agree to the extent that the boiler is exempt. Since the boiler is used ninety percent of the time for exempt purposes, the chemicals are entitled to a similar, proportional exemption.

FINDING

Taxpayer's protest is sustained in part; the treatment chemicals are entitled to a ninety percent exemption.

VIII. Packaging – Gross Retail Tax.

DISCUSSION

Taxpayer objects to the audit's determination that the packaging equipment is used 50 percent of the time in an exempt fashion. Taxpayer believes that the audit's conclusion was "arbitrary." Taxpayer claims that its purchase of packaging equipment was entirely exempt from sales/use tax because the equipment is within its "integrated production process." Taxpayer states that this equipment is "related to traypack packaging." Taxpayer explains that a "[t]raypack is where the processed turkey is placed on a tray, wrapped in cellophane, and vacuum sealed while injecting CO2 to preserve the product."

In support of its position, Taxpayer cites to [45 IAC 2.2-5-8\(d\)](#) which states in part, "Direct use in the production process' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required."

There is nothing in the audit report which indicates that the Department's audit ever addressed this particular equipment, or whether it reviewed the use of the equipment to determine that the traypack equipment was used in an exempt or a non-exempt manner. Contrary to Taxpayer's assertion, there is nothing to indicate the audit report made an "arbitrary" decision that the traypack equipment was 50 percent exempt.

Taxpayer purchased items from O/K Durable Packaging and from Massman Automation Design. Taxpayer also made two purchases from New Brunswick International and claims that the purchases were entirely exempt. Unfortunately there is insufficient information upon which to arrive at any definitive conclusion on this issue.

The audit division is requested to review the four invoices at issue, review the information provided by Taxpayer, and to make whatever adjustments it deems appropriate based on Taxpayer's argument that the items purchased were incorporated into or made part of the equipment used to package its "traypacks."

FINDING

Taxpayer's protest is sustained subject to review by the supplemental audit.

IX. Dehumidification Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer argues that its purchase of dehumidification equipment was required by the USDA, is used in the direct production of its food products, and is consequently exempt from sales/use tax. The audit reviewed the manner in which this equipment was used and determined that the dehumidifying equipment "does not act directly on the product being produced.... it acts on the environment." The audit concluded that the equipment is "one step removed from the production process."

Taxpayer cites to [45 IAC 2.2-5-70\(a\)](#) as authority for the proposition that the equipment is exempt. That portion of the regulation provides as follows:

The state gross retail tax does not apply to sales of tangible personal property which constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominately used and acquired for the purpose of complying with any state, local or federal environmental [quality] statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

Taxpayer indicates that the equipment is required by the USDA and indicates that the "USDA cited certain area[s] of the plant for having poor ventilation that contributed to the buildup of condensation throughout the Eviscerating, Picking and Scalding area where the meat is being processed and susceptible to contamination."

Taxpayer has not provided any documentation in which the USDA "cited" Taxpayer for poor ventilation. In addition, if the equipment was required by the USDA, it does not appear that the equipment was mandated by any "state, local or federal environmental [quality] statutes, regulations or standards...." Taxpayer's equipment seems to be more closely related to addressing general health or safety issues and not issues related to environmental quality.

FINDING

Taxpayer's protest is respectfully denied.

X. Feed Mill Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer explains that it operates "a grain storage and grain drying facility which is the main ingredient for [Taxpayer's] feed mill which processes feed for animal consumption that is sold to our contract growers."

Taxpayer faults the audit stating that it "erroneously applied the manufacturing criteria to these purchases rather than the broader agricultural exemption...."

- (a) Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.
- (b) Transactions involving agricultural machinery or equipment are exempt from the state gross retail tax if:
 - (1) the person acquiring the property acquires it for use in conjunction with the production of food and food ingredients or commodities for sale;
 - (2) the person acquiring the property is occupationally engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food and food ingredients or commodity production.... IC § 6-2.5-5-2.

The Department's regulation found at [45 IAC 2.2-5-6](#) details further the exemption;

- (a) In general, all purchases of tangible personal property by persons engaged in the direct production, extraction, harvesting, or processing of agricultural commodities are taxable. (The exemption provided in this regulation [\[45 IAC 2.2\]](#) extends only to agricultural machinery, tools, and equipment.)
- (b) The state gross retail tax shall not apply to sales of agricultural machinery, tools, and equipment to be directly used by the purchaser in the direct production, extraction, harvesting, or processing or [sic.] agricultural commodities.
- (c) Purchasers of agricultural machinery, tools, and equipment to be directly used by the purchaser in the direct production, extraction, harvesting, or processing of agricultural commodities are exempt from tax provided such machinery, tools, and equipment have a direct effect upon the agricultural commodities produced, harvested, etc. Property is directly used in the direct production, extraction, harvesting, or processing of agricultural commodities if the property in question has an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process, i.e. confinement buildings, cooling, heating, and ventilation equipment. The fact that such machinery, tools, or equipment may not touch the commodity or livestock or, by itself, cause a change in the product, is not determinative. (Emphasis added).

The exemption on which Taxpayer relies is available to those persons or businesses "occupationally

engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food and food ingredients or commodity production...." IC § 6-2.5-5-2(b)(2).

In order for the "machinery, tools, [or] equipment" to be exempt, the items must be "directly used in the direct production of... agricultural commodities." [45 IAC 2.2-5-6\(c\)](#).

Some of the items for which Taxpayer seeks an exemption are plainly not machinery, tools or equipment but represent the cost of performing "modifications" to equipment, for "work," for "labor," or for "upgrades" and the exemption to which Taxpayer cites is not applicable.

Other items would appear to be equipment such as an "SST Pump," "bucket elevator," "receiving system" but there is nothing which would indicate that these items are directly used in the direct production of Taxpayer's feed products. A decision finding that these items are exempt pursuant to IC § 6-2.5-5-2 would necessarily be based on speculation and the Department is unable to do so under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Taxpayer's protest challenging the assessment of sales/use tax on the purchase of labcoats is sustained; the two line items on the Nova-Tech invoices should be removed; the boiler chemicals are entitled to a ninety-percent exemption. The audit division is requested to review the four invoices purportedly related to the purchase of parts incorporated into Taxpayer's traypack packing machine and to make whatever adjustments are warranted. In all other respects, Taxpayer's protest is denied.

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