

**Letter of Findings Number: 04-20100634**  
**Sales and Use Tax**  
**For Tax Years 2007-09**

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**ISSUES**

**I. Sales and Use Tax—Lump-Sum Contract for Improvements to Realty.**

**Authority:** Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); IC § 6-2.5-3-2; [45 IAC 2.2-4-26](#).

Taxpayer protests the imposition of use tax on several lump-sum contracts for improvements to real estate.

**II. Sales and Use Tax—Non-Taxable Labor and Services.**

**Authority:** [45 IAC 2.2-4-2](#).

Taxpayer protests the assessment of tax on its purchases of tangible personal property.

**III. Sales and Use Tax— Non-Taxable Production Supply.**

**Authority:** Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc., 338 N.E.2d 698 (Ind. Ct. App. 1975); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); IC § 6-2.5-5-1; IC § 6-2-1-39 (repealed 1981).

Taxpayer protests the imposition of use tax.

**IV. Sales and Use Tax – Manufacturing Exemption.**

**Authority:** IC § 6-2.5-5-1; IC § 6-2.5-5-3; [45 IAC 2.2-5-8](#); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer protests the imposition of tax on purchases of tangible personal property.

**V. Sales and Use Tax—Safety Equipment.**

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

Taxpayer protests the assessment of tax on its purchases of tangible personal property.

**VI. Sales and Use Tax - Manufacturing and Environmental Exemptions.**

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

Taxpayer protests the assessment of tax on its purchase of tangible personal property.

**VII. Sales and Use Tax – Resale.**

**Authority:** IC § 6-2.5-5-1; [45 IAC 2.2-5-8](#).

Taxpayer protests the assessment of tax on its purchases of tangible personal property.

**VIII. Sales and Use Tax—Gross Invoice Amount vs. Net Invoice Amount.**

**Authority:** IC § 6-2.5-2-2; IC § 6-2.5-3-2.

Taxpayer protests the assessment of tax on its purchases of tangible personal property.

**IX. Sales and Use Tax—Loading Dock.**

**Authority:** IC § 6-2.5-5-1; [45 IAC 2.2-5-8](#).

Taxpayer protests the assessment of tax on its purchase of tangible personal property.

**X. Sales and Use Tax—Quality Control Equipment.**

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

Taxpayer protests the assessment of tax on its purchase of tangible personal property.

**XI. Tax Administration - Negligence Penalty.**

**Authority:** IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

**STATEMENT OF FACTS**

Taxpayer is an Indiana manufacturer and processor. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had purchased tangible personal property during the tax years 2007, 2008, and 2009, but had not paid sales tax on some of the items. The Department therefore issued proposed assessments for use tax, interest, and negligence penalties for those years. Taxpayer protests that some of the items which the Department included as taxable were actually eligible for various exemptions and were therefore not subject to sales and use taxes. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Sales and Use Tax— Lump-Sum Contract for Improvements to Realty.**

**DISCUSSION**

Taxpayer protests the assessment of use tax on lump-sum contracts for improvements to real estate.

Taxpayer claims that the contractors to the lump-sum contracts paid the use tax on the materials incorporated into

the building improvement projects and therefore use tax is not due from Taxpayer. 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). 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). The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992)(Internal citations omitted). Additionally "[e]xemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of government." *Id.* These standards will apply to every issue and all exemptions claimed and discussed in this Letter of Findings.

IC § 6-2.5-3-2(c) states:

(c) The use tax is imposed on the addition of tangible personal property to a structure or facility, if, after its addition, the property becomes part of the real estate on which the structure or facility is located. However, the use tax does not apply to additions of tangible personal property described in this subsection, if:

- (1) the state gross retail or use tax has been previously imposed on the sale or use of that property; or
- (2) the ultimate purchaser or recipient of that property would have been exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

(Emphasis added).

[45 IAC 2.2-4-26](#) states in relevant part:

A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used.

After the audit and prior to the hearing, Taxpayer presented additional documentation that was not available at the time of audit. After reviewing the additional documentation, the auditor agreed to make several adjustments that were presented to Taxpayer in the form of a revised spreadsheet.

#### FINDING

Taxpayer's assessments will be adjusted to reflect the items to which the auditor agreed, as reflected in the revised spreadsheets.

## II. Sales and Use Tax– Non-Taxable Labor and Services.

### DISCUSSION

Taxpayer protests the assessment of use tax on purchases Taxpayer claims qualify as non-taxable labor and services. Taxpayer asserts that it purchased services from an outside contractor to design the labels used for the marketing of Taxpayer's final product.

[45 IAC 2.2-4-2](#) states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and
- (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

After the audit and prior to the hearing, Taxpayer presented additional documentation that was not available at the time of audit. After reviewing the additional documentation, the auditor agreed to make several adjustments that were presented to Taxpayer in the form of a revised spreadsheet.

#### FINDING

Taxpayer's assessments will be adjusted to reflect the items to which the auditor agreed, as reflected in the

**III. Sales and Use Tax– Non-Taxable Production Supply.****DISCUSSION**

Taxpayer protests the assessment of use tax on purchases that Taxpayer claims qualify as nontaxable production supply. Specifically, Taxpayer claims that certain cleaning compounds used to retard growth of harmful bacteria in Taxpayer's food processing operations should be exempt from sales and use tax based on the precedent set forth by *Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc.*, 167 Ind. App. 367, 338 N.E.2d 698 (1975).

In *American Dairy*, a milk processor sought refund of sales and use taxes assessed and paid for insecticides, insect spray, bird repellent, and cleaning compounds used by the dairy in and around its main processing plant to maintain a production environment conforming to standards required by the Indiana State Board of Health. The court stated that the dairy fell within the class of "other person occupationally engaged in the business of producing food and commodities for human . . . consumption" and that "[i]t is a matter of common knowledge that the direct impact of these substances is generally upon the environment or medium in or through which production occurs." *Id.* The court then acknowledged the precedent stemming from *Indiana Dep't of State Revenue v. RCA Corp.*, which held that items that do not have an immediate effect on the manufacturing production but rather upon the environment in which the processing and production takes place do not qualify for exemption. *Indiana Dep't of State Revenue v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974) (RCA Corporation contested the Indiana Department of Revenue's assessment that RCA's air conditioning and environmental equipment did not qualify for the manufacturing exemption). The court however distinguished *American Dairy* from *RCA Corp.* on the grounds that the Indiana statute IC § 6-2-1-39 (repealed 1981) "set forth specific examples of items and substances contemplated as qualifying for exemption, among them being insecticides and fungicides." *American Dairy*, 338 N.E. 2d at 372. Therefore the court found that the application of *RCA Corp.* must yield to the express language of the statute. The court then extended the exemption to cleaning compounds on the grounds that their use by *American Dairy* to retard growth of harmful bacteria is functionally similar to the use of fungicides and therefore falls within the class of exempted items.

Taxpayer's reliance on *American Dairy* is misplaced since the statute which the court referred to in ruling in favor of exemptions for cleaning compounds, IC § 6-2-1-39 (repealed 1981), has been repealed and replaced with IC § 6-2.5-5-1. This change in legislation effectively overrules the court's decision on tax exemption for cleaning compounds.

IC § 6-2.5-5-1 states:

Transactions involving animals, feed, seed, plants, fertilizer, insecticides, fungicides, and other tangible personal property are exempt from the state gross retail tax if:

- (1) the person acquiring the property acquires it for his direct use in the direct production of food and food ingredients or commodities for sale or for further use in the production of food and food ingredients or commodities for sale; and
- (2) the person acquiring the property is occupationally engaged in the production of food and food ingredients or commodities which he sells for human or animal consumption or uses for further food and food ingredient or commodity production.

(Emphasis added).

While the new statute addresses fertilizers, insecticides, and fungicides, it also limits the exemption for the use of such items by setting forth a two element test that must be met. The Department does not dispute whether Taxpayer is engaged in the production of food and food ingredients; however the use of the cleaning compounds must be for the direct use in the direct production of food, for further use in the production of food, or commodities for sale. As stated in *American Dairy*, the direct impact of cleaning compounds is generally upon the environment in which production occurs. Therefore, *RCA* compels the conclusion that these items do not qualify for exemption when the products are used for the general sanitation of the production facility and equipment. Similarly to the air conditioning equipment in *RCA*, the immediate effect of the equipment in the instant case is not upon food production but rather is upon the environment in which the processing takes place.

**FINDING**

Taxpayer's protest is denied regarding the use of cleaning compounds used on equipment.

**IV. Sales and Use Tax – Manufacturing Exemption.****DISCUSSION**

Taxpayer protests the assessment of use tax on purchases that Taxpayer claims are essential and integral to Taxpayer's integrated food production and are therefore exempt under Indiana's manufacturing tax exemption statutes IC § 6-2.5-5-3 and [45 IAC 2.2-5-8](#). Specifically, Taxpayer protests that the exemption applies for (A) Portable Radios; (B) Catwalk/Platforms; (C) Stretch Wrap Machinery and Related Storage Equipment; (D) Welding Rods and Gasket Material; (E) Cleaning Equipment; and (F) Water Wells.

IC § 6-2.5-5-3(b) states:

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the

direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

**A. Portable Radios**

Taxpayer protests the assessment of use tax on its purchase of replacement parts for portable radios. Taxpayer states that these purchases are essential and integral to the integrated production of Taxpayer's food products. Taxpayer utilizes portable radios to facilitate communication between manufacturing staff and others in integrated functions. Taxpayer claims that without the use of the radios, the manufacturing process could not function adequately.

[45 IAC 2.2-5-8\(g\)](#) states:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

While the fact that the portable radios may be considered essential to the conduct of the business of manufacturing, their required use by practical necessity does not itself mean that the items have an immediate effect upon the article being produced. Taxpayer's employees used the radios to communicate with each other. The use of the radios does not have an immediate and direct effect upon the product being produced.

Therefore, Taxpayer's protest for assessment of use tax on portable radios is denied.

**B. Catwalk/Platforms**

Taxpayer protests the assessment of use tax on catwalks and platforms. Taxpayer asserts that the catwalks and platforms are used by employees to safely gain access to the production equipment and claims that the catwalk and platforms are essential and integral to the integrated production process and therefore exempt from Indiana sales and use tax. Services performed by the employees on the catwalks and platforms include pulling samples for quality control, unjamming cans, and correctly reorienting cans for labeling.

While the fact that the catwalks and platforms may be considered essential to the conduct of the business of manufacturing, their required use by practical necessity does not itself mean that the items have an immediate effect upon the article being produced. Taxpayer's employees use the platforms and catwalks to gain access to the production equipment. The use of the catwalks and platforms do not have an immediate and direct effect upon the product being produced. Refer to [45 IAC 2.2-5-8\(g\)](#) quoted at Issue IV(A) above.

Therefore, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) and Taxpayer's protest for assessment of use tax on catwalks and platforms is denied.

**C. Stretch-Wrap Machinery and Related Storage Equipment**

Taxpayer protests the assessment of use tax on stretch-wrap machinery and related storage equipment. Taxpayer asserts that the replacement parts for the stretch-wrap machines are exempt because the stretch-wrap machines are used to eliminate damage to Taxpayer's work-in-process and help with storage of work-in-process until the product is placed back on the production line to be finished with the appropriate labels and packaging. Taxpayer states that the stretch-wrap machinery does not package the finished product for preparation of shipment to customers, as a separate stretch-wrap machine is dedicated to that task.

[45 IAC 2.2-5-8\(e\)](#) states:

Storage equipment. 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.

- (1) Temporary storage. Tangible personal property used in or for the purpose of storing work-in-process or semi-finished goods is not subject to tax if the work-in-process or semi-finished goods are ultimately completely produced for resale and in fact resold.
- (2) Storage containers for finished goods after completion of the production process are subject to tax.
- (3) Storage facilities or containers for materials or items currently undergoing production during the production process are deemed temporary storage facilities and containers and are not subject to tax.

–EXAMPLES–

- (1) Purchases of refrigeration equipment used in milk product production during the production process are exempt. However, refrigeration equipment used to store milk products subsequent to production is taxable.
- (2) Parts undergoing various machining operations are transported from a machine operation to a storage rack where they are held for periods of time, as required by the processing schedule for the next machine operation in the integrated production process. The length of time required for storage in the processing schedule is not determinative. As the processing schedule dictates, the parts are removed from the storage racks and transported to the next machine operation. The storage racks are exempt.

(3) Finished goods are placed in the packages in which they will be delivered to customers, and the packages are loaded onto storage pallets which are used only in a finished goods storage area. The pallets are taxable.

(4) A metal and alloy manufacturer pulverizes raw materials for use in an exempt furnace. Weigh bins utilized for the temporary storage of the exempt materials after pulverization and prior to use in the exempt furnace are exempt.

(5) Replacement parts for manufacturing equipment are kept in storage bins in the plant "store". The storage bins are taxable because they do not store work-in-process or semi-finished goods.

(Emphasis added).

The stretch-wrap machinery under protest is not used for the purpose of temporarily storing work-in-progress items currently undergoing production. Rather, it is used to create a temporary storage device, in the form of the shrink wrap which encases the work-in-process.

Therefore, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) and Taxpayer's protest for use tax on stretch-wrap machinery is denied.

#### **D. Welding Rods and Gasket Materials**

Taxpayer protests the assessment of use tax on welding rods and gasket material. Taxpayer uses the welding rods to repair manufacturing equipment. Taxpayer uses the gasket material in creating replacement parts for exempt manufacturing equipment.

[45 IAC 2.2-5-8](#)(h) states:

Maintenance and replacement equipment.

(1) Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

(2) Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax.

–EXAMPLE–

A manufacturer of sheet metal repairs and upgrades used machinery by replacing worn or broken parts and adding new elements and features available in state-of-the-art equipment. All items which become components of the upgraded machinery are exempt from tax. However, all tools and equipment used to repair or upgrade used machinery would be taxable.

(Emphasis added).

Taxpayer contends that because the welding rods and gasket material become physically affixed to production machinery and equipment, the welding rods and gasket material qualify as replacement parts and are exempt from sales and use taxation. The Department agrees with Taxpayer's contention and finds that the welding rods and gasket material should be exempt from sales and use tax to the extent that the welding rods and gasket material are used for production machinery and equipment.

Taxpayer's protest of use tax on welding rods and gasket material is sustained.

#### **E. Cleaning Equipment**

Taxpayer protests the assessment of use tax on cleaning equipment. Taxpayer uses the cleaning equipment to sanitize the processing and production facility and production machinery.

[45 IAC 2.2-5-8](#)(h) states:

Maintenance and replacement equipment.

(1) Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

Though cleaning equipment may be considered essential to the conduct of the business of manufacturing, their required use by practical necessity does not itself mean that the items have an immediate effect upon the article being produced. Cleaning equipment is used to sanitize the processing and production facility and production machinery and therefore is not directly used in direct production or processing.

Therefore, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) and Taxpayer's protest for assessment of use tax on cleaning equipment is denied.

#### **F. Water Wells**

Taxpayer protests the assessment of use tax on water wells. Taxpayer uses the water wells to supply water for its production process.

[45 IAC 2.2-5-8](#)(d) states:

Pre-production and post-production activities. "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.

–EXAMPLE–

(1) The production of pharmaceutical items is accomplished by a process which begins with weighing and measuring out appropriate ingredients, continues with combining and otherwise treating the ingredients, and ends with packaging the items. Equipment used to transport raw materials to the manufacturing plant is employed prior to the first operation or activity constituting part of the integrated production process and

is taxable. Weighing and measuring equipment and all equipment used as an essential and integral part of the subsequent manufacturing steps, through packaging, qualify for exemption. Equipment which loads packaged products from the packaging step of production into storage, or from storage into delivery vehicles, is subject to tax.

[45 IAC 2.2-5-8](#)(h) states:

"Direct production, manufacture, fabrication, assembly, or finishing of tangible personal property" is performance as a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change, and it must result in a transformation of property into a different product having a distinctive name, character, and use. Operations such as compounding, fabricating, or assembling are illustrative of the types of operations which may qualify under this definition.

Taxpayer produces various processed food items. Under [45 IAC 2.2-5-8](#)(h) direct production begins after the performance of an integrated series of operations which places tangible personal property in a form or composition different from that in which it was acquired. Under [45 IAC 2.2-5-8](#)(h) pre-production activities are not exempt from taxation. Therefore any activities performed by Taxpayer prior to an operation which places tangible personal property in a form or composition different from that in which it was acquired is not exempt from taxation. While water is used within the direct processing of Taxpayer's product, the water wells are used to draw and collect water and therefore constitute a pre-production activity. Consequently, the water wells are not exempt from taxation.

Therefore, Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) and Taxpayer's protest for assessment of use tax on water wells is denied.

#### FINDING

Taxpayer's protest for subsections (A) Portable Radios, (B) Catwalk/Platforms, (E) Cleaning Equipment, and (F) Water Wells are denied. Taxpayer's protest for subsections (C) Stretch-Wrap Machinery and Related Storage Equipment and (D) Welding Rods and Gasket Material is sustained.

#### V. Sales and Use Tax— Safety Equipment.

#### DISCUSSION

Taxpayer protests the assessment of use tax on safety equipment. Specific items that are being protested include rain suits worn by workers while cleaning the facility and production machinery, gloves worn by employees while processing the food product, hand sanitizers and hand dryers required to be used by all employees, and squeegees used to remove accumulation of water from the factory floor.

[45 IAC 2.2-5-8](#)(c) states:

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.

#### —EXAMPLES—

(1) Aluminum pistons are produced in a manufacturing process that begins, after the removal of raw aluminum from storage inside the plant, with the melting of the raw aluminum and the production of castings in the foundry; continues with the machining of the casting and the plating and surface treatment of the piston; and ends prior to the transportation of the completed pistons to a storage area for subsequent shipment to customers. Because of the functional interrelationship of the various steps and the flow of the work-in-process, the total production process, comprised of such activities, is integrated.

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

...

(F) 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.

(Emphasis Added).

Regulation [45 IAC 2.2-5-8](#)(c) allows for sales and use tax exemptions for safety clothing or equipment which is required to allow a worker to participate in the production process. Therefore, gloves worn by employees while processing Taxpayer's food product, hand sanitizers and hand dryers required to be used by all employees including production line workers, and squeegees used to remove hazardous accumulations of water from the factory floor are exempt from sales and use tax. Note, however, that the rain suits used by workers while cleaning the production facility are not exempt from sales and use tax as the rain suits are not required to allow a worker to participate in the production process. Though cleaning activities may be considered essential to the conduct of the business of manufacturing, their required use by practical necessity does not itself mean that the items have an immediate effect upon the article being produced. Cleaning activities are used to sanitize the processing and

production facility and production machinery and therefore are not directly used in direct production or processing.

**FINDING**

Taxpayer's protest for the assessment of sales and use tax is denied in part and sustained in part.

**VI. Sales and Use Tax - Manufacturing and Environmental Exemptions.**

**DISCUSSION**

Taxpayer protests the assessment of use tax on the purchase of a refrigerator that it uses to store water samples that are to be tested by the EPA. In addition, because Taxpayer partially paid sales tax on the purchase at the time of purchase Taxpayer requests refund on the sales tax paid.

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

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 [sic.] statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

Taxpayer utilizes its own water treatment plant for support of the water distributed to the production facilities. The water received by the treatment plant is used in the direct production of the food products. Taxpayer tests the water for quality assurance purposes and uses the refrigerator to store the test samples at required temperatures in accordance with 40 CFR 136, guidelines establishing test procedures for the analysis of pollutants. Based on its use, the refrigerator "constitutes . . . a device . . . predominately used and acquired for the purpose of complying with any state, local or federal environmental quality statutes, regulations or standards," and since taxpayer is engaged in the business of manufacturing/ processing, the purchase is exempt.

**FINDING**

Taxpayer's protest is sustained and request for refund granted for the amount of sales tax paid on the purchase which will be credited against Taxpayer's liability.

**VII. Sales and Use Tax – Resale.**

**DISCUSSION**

Taxpayer protests the assessment of use tax on its purchase of bins and hoppers used to collect "seeds and peels" which are by-products and waste from its production process. Taxpayer claims that because the seeds and peels are sold to farmers, the bins and hoppers are tax exempt under Indiana's resale exemption regulation [45 IAC 2.2-5-15](#).

[45 IAC 2.2-5-15](#) states:

(a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.

(b) General rule. Sales of tangible personal property for resale, rental or leasing are exempt from tax if all of the following conditions are satisfied:

(1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;

(2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and

(3) The property is resold, rented or leased in the same form in which it was purchased.

(c) Application of general rule.

(1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.

(2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

(Emphasis added).

[45 IAC 2.2-5-15](#) states that the "exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property." While Taxpayer does purchase crop products from farmers, Taxpayer purchases these products with the intent to add value to the property by further processing and adding to the crop to make food products. Therefore any "resale" of the product back to farmers would not qualify for the resale exemption and Taxpayer's purchase of bins and hoppers is not exempt under [45 IAC 2.2-5-15](#). Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c).

**FINDING**

Taxpayer's protest is denied.

**VIII. Sales and Use Tax—Gross Invoice Amount vs. Net Invoice Amount.****DISCUSSION**

Taxpayer protests the amount of tax assessed, claiming that the audit assessment relied on the gross invoice amounts as opposed to the net invoice amounts for determining the amount of use tax due. Taxpayer brought this to the Department's attention after the completion of the audit and prior to the protest hearing. Taxpayer claims it supplied the Department with a list of general ledger accounts and associated invoices applied to those accounts. Taxpayer uses multiple accounts for the gross invoice amounts and another for any earned discount amounts such as early payment. Taxpayer claims that the audit samples were pulled based on the gross invoice amount and any discounts received were not taken into consideration.

IC § 6-2.5-3-2(a) 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.

IC § 6-2.5-2-2(a) states:

The state gross retail tax is measured by the gross retail income received by a retail merchant in a retail unitary transaction and is imposed at seven percent (7[percent]) of that gross retail income. (Emphasis added).

Therefore, since Taxpayer was able to produce documentation establishing that it actually paid less than the amount originally listed in the audit report, the amount of use tax due will be recalculated using the new, lower amounts.

**FINDING**

Taxpayer's protest is sustained subject to the findings of a supplemental audit.

**IX. Sales and Use Tax—Loading Dock.****DISCUSSION**

Taxpayer protests the imposition of use tax on the purchase of a loading dock claiming that it qualifies for the manufacturing exemption. The loading dock is unique to Taxpayer's operations as the loading dock consists of an angled concrete slab that facilitates the unloading of crop products from the delivery trucks into a catcher. Taxpayer contests that the loading docks are part of the integrated production process and therefore should be exempt.

[45 IAC 2.2-5-8\(f\)](#) states:

Transportation equipment.

- (1) Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable.
- (2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.
- (3) Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.
- (4) Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

Though the loading dock may be considered essential to the conduct of the business of manufacturing, their required use by practical necessity does not itself mean that the items have an immediate effect upon the article being produced. The loading dock is used to move raw materials into the production facility and does not have an immediate effect upon the article being produced. Furthermore, [45 IAC 2.2-5-8\(f\)\(1\)](#) states, "Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable." Therefore, because the loading dock is utilized to move the raw materials (crop products) into the production process, the loading dock is not exempt from sales and use tax. Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c).

**FINDING**

Taxpayer's protest is denied.

**X. Sales and Use Tax—Quality Control Equipment.**

Taxpayer protests the imposition of use tax on the purchase of an Examolite which is a light system designed for grading of food products. Taxpayer claims that the purchase and use of the light system is exempt under [45 IAC 2.2-5-8\(i\)](#).

[45 IAC 2.2-5-8\(i\)](#) states:

Testing and inspection. Machinery, tools, and equipment used to test and inspect the product as part of the production process are exempt.

—EXAMPLE—

Selected parts are removed from production according to a schedule dictated by statistical sampling methods. Quality control equipment is used to test the parts in a room in the plant separate from the production line. Because of the functional interrelationship between the testing equipment and the machinery on the production line and because of the product flow, the testing equipment is an integral part of the



integrated production process and is exempt.

Taxpayer uses the lighting system as part of its quality control system to monitor the coloration of food products. The specialized light system is used in Taxpayer's designated quality control testing area and is distinct from other light sources as it contains multiple bulbs designed to include the full spectrum of visible light to be comparable to natural sunlight. Because the lighting system is used to test and inspect the product as part of the production process, the lighting system qualifies for sales and use tax exemption under [45 IAC 2.2-5-8\(i\)](#).

#### FINDING

Taxpayer's protest is sustained.

#### XI. Tax Administration - Negligence Penalty.

Taxpayer protests the imposition of a ten percent negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a tax return;
- (2) fails to pay the full amount of tax shown on the tax return;
- (3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
- (4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

[45 IAC 15-11-2\(b\)](#) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2\(c\)](#), in part, as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

In the course of the protest process, Taxpayer has provided substantial documentation and analysis in support of its position regarding the taxable or non-taxable status of the items of tangible personal property in question. Taxpayer has met its burden of proof to show that the deficiencies they incurred are due to reasonable cause and are therefore not subject to penalty under IC § 6-8.1-10-2.1.

#### FINDING

Taxpayer's protest is sustained.

#### CONCLUSION

In Issues I and II Taxpayer's assessments will be adjusted to reflect the items to which the auditor agreed. Issues III and V are denied in part and sustained in part subject to the findings of a supplemental audit. Issues IV Subsections (A),(B),(E), and (F), as well as issues VII and IX are denied. Issues IV Subsection (C), X, and XI are sustained. Issues IV Subsection (D) and VIII are sustained subject to supplemental audit. Issue VI is sustained and Taxpayer's request for refund is granted and will be credited against the remaining liabilities.

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