

**Letter of Findings: 04-20100681**  
**Gross Retail Tax**  
**For the Years 2006, 2007, and 2008**

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**ISSUES**

**I. Refrigeration Equipment – Gross Retail Tax.**

**Authority:** IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b)(c); IC § 6-8.1-5-1(c); Rhoades v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); 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); USAir, Inc. v. Ind. Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); [45 IAC 2.2-5-8\(b\)](#); [45 IAC 2.2-5-8\(g\)](#); [45 IAC 2.2-5-8\(k\)](#).

Taxpayer argues that its purchase of refrigeration equipment was entirely exempt from sales/use tax because the equipment is directly used in the direct production of its food products.

**II. Evaporation Equipment – Gross Retail Tax.**

**Authority:** Indiana Dep't of Revenue v. Kimball Int'l, Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(j\)](#); Letter of Findings 04-20050063 (May 22, 2006); Letter of Findings 04-20020168 (May 29, 2003).

Taxpayer maintains that its purchase of evaporation equipment was exempt from sales/use tax because the evaporation equipment is directly used in the direct production of its food product.

**III. Packaging Equipment – Gross Retail Tax.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3(b); IC § 6-2.5-5-5.1(b); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-8\(k\)](#); [45 IAC 2.2-5-11\(c\)](#); Audit-Gram 4-060 (March 26, 2001).

Taxpayer states that its purchase of equipment used to package its food products was exempt from sales/use tax because the equipment was used in the direct production of those products.

**IV. Tax Rate – Gross Retail Tax.**

**Authority:** IC § 6-2.5-2-1(b).

Taxpayer argues that it is not responsible for an error in which one of Taxpayer's suppliers charged six percent sales tax instead of seven percent.

**V. Production Equipment Repair Parts – Gross Retail Tax.**

**Authority:** IC § 6-8.1-5-1(c); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-8\(g\)](#).

Taxpayer states that it was not required to pay sales tax on the purchase of repair parts for an auger because the auger is directly involved in the direct production of Taxpayer's food products.

**VI. Production Equipment – Gross Retail Tax.**

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

Taxpayer argues that its purchase of a "hopper" is exempt from sales tax because the hopper is essential to the production of Taxpayer's food products.

**VII. Plastic Electronic Enclosure – Gross Retail Tax.**

**Authority:** [45 IAC 2.2-5-8\(h\)\(1\)](#); [45 IAC 2.2-5-8\(h\)\(2\)](#).

Taxpayer states that its purchase of a plastic enclosure is exempt from sales/use tax because the plastic enclosure protects electronic components and that the enclosure is directly used in the direct production of Taxpayer's food products.

**VIII. Computer Equipment – Gross Retail Tax.**

**Authority:** [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(c\)\(2\)\(G\)](#); [45 IAC 2.2-5-8\(c\)\(5\)](#); [45 IAC 2.2-5-8\(d\)\(1\)](#).

Taxpayer states that it was not required to pay sales or use tax on the purchase of computer components and software because the computer and the software are directly used in the direct production of animal feed.

**STATEMENT OF FACTS**

Taxpayer operates food manufacturing plants both in Indiana and outside Indiana. The Department of Revenue conducted an audit review of Taxpayer's business records. Taxpayer and the Department "agreed to use statistical sampling methodology to estimate the additional purchases subject to use tax...." The Department found that Taxpayer had self-assessed use tax on certain items but failed to pay that tax to the state. The audit review resulted in the assessment of additional sales/use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for its protest. This Letter of Findings results.

**I. Refrigeration Equipment – Gross Retail Tax.**

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**DISCUSSION**

Taxpayer purchased a "work-in-process" cooler and a "finished goods cooler." Taxpayer argues that it was not required to pay sales tax at the time it purchased this refrigeration equipment and was not required to self-assess use tax on the ground that the equipment "has an immediate and direct effect upon the articles being produced...." Taxpayer explains that the equipment acts by "lowering the temperature of the [food product] as close to the point of freezing without freezing the product." Taxpayer concluded that the "coolers are the final steps of an integrated process...."

The audit report addressed Taxpayer's refrigeration equipment as follows:

[Taxpayer's] refrigeration consists of a work in process cooler, which comprises 30[percent] of the system, and a finished goods cooler, which comprises 70[percent] of the system. The finished goods cooler is located in the storage areas, in which completed product must be held for 24 hours before being shipped to customers. Therefore, the [Taxpayer's] refrigeration system was considered to be used 70[percent] of the time in taxable operation within the facility.

The Department's audit found that the Taxpayer's refrigeration system – consisting of the "work-in-process" cooler and the "finished goods cooler" – was used in an exempt manner and a non-exempt manner. The audit found that the "work-in-process" cooler was exempt and the "finished goods cooler" was not exempt.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" 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 § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Rhoades*, 774 N.E.2d at 1047; *USAir, Inc. v. Ind. Dep't of State Revenue*, 623 N.E.2d 466, 468–69 (Ind. Tax. Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. Id. A taxable retail transaction occurs when; (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

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. Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

However, Taxpayer presumably believes its cooling equipment is exempt from both sales and use tax pursuant to [45 IAC 2.2-5-8](#)(b) which states as follows:

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. (Emphasis added).

In particular Taxpayer cites to [45 IAC 2.2-5-8](#)(k) as authority for its position that the refrigeration equipment – "work-in-process cooler" and a "finished goods cooler" – are entirely exempt. The cited regulation states as follows:

"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.

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 Rev. v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

[45 IAC 2.2-5-8](#)(b) 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).

In effect, Taxpayer argues the chilled food products constitute Taxpayer's finished goods and that production is not complete until after the food products are removed from its refrigerated storage facility. Taxpayer maintains that without the "holding period" – the time in which the food product remains in storage – the food product is "unsellable and is worthless." Taxpayer explains that the food product undergoes a "substantial change" during the time the food product is held in the storage facility in which the "finished goods cooler" maintains the food product at the desired temperature.

The Department is unable to agree that Taxpayer has established that the audit's conclusion was wrong. The designation of the equipment at issue, the "finished goods cooler," is particularly appropriate because by the time Taxpayer's food product reaches its storage area, the food product is essentially "finished." The "finished goods cooler" does not act upon the Taxpayer's food product to cause a further "transformation" of that food product. The Department does not disagree with Taxpayer's contention that the "finished goods cooler" is both necessary and required by its customer, however the exemption is not based upon those standards.

The fact that particular property may be considered essential to the conduct of manufacturing because its use is required either by law or by practical necessity does not mean itself 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. [45 IAC 2.2-5-8\(g\)](#). (Emphasis added).

The Department is in agreement with the audit report's analysis concluding that the "work-in-process cooler" is exempt and the "finished goods cooler" is not exempt and that the 70/30 percent apportionment between exempt and non-exempt use was appropriate. However, it should be noted that the "work-in-process" cooler is not exempt simply because it is a "work-in-process" cooler. This device is exempt because the audit found that it has a direct effect – leading to a "substantial change" – on Taxpayer's food products.

#### FINDING

Taxpayer's protest is respectfully denied.

## II. Evaporation Equipment – Gross Retail Tax.

#### DISCUSSION

Taxpayer purchased equipment which it explains is "used to evaporate moisture from the air and product." Taxpayer believes that the equipment "is directly in the manufacturing process by removing moisture from the various [food products] to reduce the incidence of harmful pathogens on the product."

Taxpayer further explains that the evaporation equipment "allows the product to stay fresh by lowering the temperature of the product, thus helping to preserve the product until such time it can be fully frozen."

Taxpayer cites to [45 IAC 2.2-5-8\(c\)](#) as authority for its position that the evaporation equipment is exempt. The regulation states as follows:

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.

Taxpayer believes the regulation is applicable because "the evaporators are acting directly upon the product to preserve it during the production process...."

The audit report stated that the evaporators are "used as part of the cooling system at [Taxpayer's] plant [and] are used in all air conditioning systems to remove moisture." The audit noted that the evaporators do help to keep moisture out of the plant but disagreed as to the applicability of the exemption stating that "there was no positive causal effect on tangible personal property." The audit found the evaporation equipment was subject to tax pursuant to [45 IAC 2.2-5-8\(j\)](#) which states as follows:

Managerial, sales, and other non-operational activities. Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading. (Emphasis added).

Indiana case law on this issue is instructive. In *Indiana Dep't of Revenue v. Kimball Int'l, Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988), the taxpayer claimed it qualified for the manufacturing exemption for its paint spray booths, air "make up" units (including component parts) located in the taxpayer's finishing rooms (collectively "paint booths"), which were used to finish wood products such as pianos and furniture. The court recited the relevant law, stating that a taxpayer's equipment "will be held exempt if it is an essential and integral part of an integrated process that produces tangible personal property." *Id.* at 457. The paint booths came "into play during the final phase of the manufacturing process, when the finish is applied" and were "isolated from the rest of each plant." *Id.*

at 455. The spray booths created an airflow that promoted drying of newly applied finish. This process guarded against paint blistering and controlled paint flaws in newly applied finish. By recycling air at a rate of 120,000 ft<sup>3</sup> per minute, the paint booths also removed excess harmful chemicals that were byproducts of the process. Moreover, without the temperature and humidity controls the finish would become cloudy and the product unmarketable. The paint booths were therefore found to be integral and essential to the manufacturing process. The court granted Kimball the manufacturing exemption for the natural gas used in the paint booths. *Id.* at 457.

Manufacturing exemption cases are often decided under the totality of the circumstances, making each case unique. Nonetheless, Kimball and the Department's Letters of Findings which have addressed this particular issue suggest two elements for obtaining a sales tax refund under the manufacturing exemption. First, the ventilation or air conditioning must play an active and integral role in the manufacturing process. In other words, but for the use of Taxpayer's evaporators, the manufacturing process would be impossible and a final marketable product would not be produced. See Letter of Findings 04-20050063 (May 22, 2006); Letter of Findings 04-20020168 (May 29, 2003). While using the evaporators can be an element of the manufacturing process, merely managing or conditioning the air environment of an entire plant, by itself, is not manufacturing. Second, only clearly demarcated areas in which there is active manufacturing that depends on a controlled environment are entitled to the exemption. For example, paint booths or finishing stalls within a plant are such areas. The mere fact that the food processing occurs within an open area of a plant does not mean the evaporators are exempt, unless the size and volume of the manufactured product is so large as to dwarf the plant and render the whole interior an integral part of the processing facility. In Taxpayer's facility, the evaporators operate to "condition" the environment within that facility rather than a specific, demarcated area within that facility.

#### FINDING

Taxpayer's protest is respectfully denied.

### III. Packaging Equipment – Gross Retail Tax.

#### DISCUSSION

Taxpayer purchased "case sealing equipment" which it uses to seal products containing its food products. Taxpayer also purchased "strapping equipment" used to attach metal bands around the packaged food products. In addition, Taxpayer purchased "box forming equipment" used to form the cardboard boxes which contain Taxpayer's food products. Finally, Taxpayer purchased a knife which is "used for form packaging inserts for [food products]."

Taxpayer argues that these four items constitute equipment essential to the Taxpayer's manufacture of food products.

[Taxpayer] believes that the case sealing, strapping, box forming equipment, and insert forming knife are all essential and integrated in the production process of manufacturing a saleable product and this equipment is used to package the product.

The audit report found that the items were not exempt pursuant to [45 IAC 2.2-5-8\(d\)](#) which states as follows: "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.

IC § 6-2.5-2-1 provides, "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."

IC § 6-2.5-3-2 provides that, "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."

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). An exemption from use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional, particularized exemptions from sales tax and use tax.

The Department's audit determined that the "case sealing equipment," "strapping equipment," "box forming equipment," and "insert forming knife" were subject to tax because none of the devices were directly used in the direct manufacturing process of Taxpayer's food products.

IC § 6-2.5-5-3(b), in pertinent part, states, "[T]ransactions 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."

IC § 6-2.5-5-1(b) provides, in part, "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing,

processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture."

The cited exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. Machinery, tools, and equipment are directly used in the production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. Id. An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#).

[45 IAC 2.2-5-8\(k\)](#) describes "direct production" as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired, and that the change must be substantial resulting in a transformation of the property into a different and distinct product. The exemption for direct use in production is further explained at [45 IAC 2.2-5-11\(c\)](#).

The state gross retail tax shall not apply to purchases of tangible personal property to be directly used by the purchaser in the production or manufacturing process of any manufacturing or agricultural machinery, tools, or equipment, provided that the machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect upon the article being produced or manufactured. 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).

Finally, [45 IAC 2.2-5-8\(d\)](#) states, "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."

Taxpayer manufactures food products within an integrated production process which produces tangible personal property in the form of food products. Taxpayer is in the business of producing those food products, and its customers are interested in obtaining those food products. Therefore, the object of a Taxpayer/customer transaction is the sale of the food products. The "case sealing equipment," "strapping equipment," "box forming equipment," and "insert forming knife" facilitate the intermediate transfer of the food products but is not the object of the transaction. The equipment is tangential to the production of the food products. As the Department has explained in the past, "Purchases of machinery, tools, equipment, and supplies used or consumed in producing or applying wrapping materials to a packaged completed product are subject to Sales Tax" Audit-Gram 4-060 (March 26, 2001) 24 Ind. Reg. 2604. The "case sealing equipment," "strapping equipment," and "box forming equipment" do not have "an immediate effect on the article being produced...." but instead assist in the intermediate packaging of the finished good.

#### FINDING

Taxpayer's protest is respectfully denied.

#### IV. Tax Rate – Gross Retail Tax.

#### DISCUSSION

One of Taxpayer's vendors charged Taxpayer six percent sales tax when it should have charged seven percent. The Department's audit found that Taxpayer was responsible for paying the one percent difference. Taxpayer objects on the ground that it is not responsible for the vendor's error.

As authority for its argument, Taxpayer cites to IC § 6-2.5-2-1(b) which states:

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.

Taxpayer points out the vendor acts as "an agent for the state" in retail transactions but fails to point out that Taxpayer is the entity which acquired the property and is "liable for the tax on the transaction...."

Taxpayer's reasoning is counter-intuitive; Taxpayer acquired property in a retail transaction and is responsible for paying the sales tax amount. The issue is not whether the vendor or the Taxpayer should be assigned "blame" for this error, but whether Taxpayer should be required to pay the remaining sales tax.

#### FINDING

Taxpayer's protest is respectfully denied.

#### V. Production Equipment Repair Parts – Gross Retail Tax.

#### DISCUSSION

Taxpayer purchased repair parts for an auger. Taxpayer explains that this auger moves "work-in-process" dough through the production process. The Taxpayer disagrees with the audit's determination that repair parts purchased for the auger are not exempt. The audit report states that it assessed tax on the auger and described the auger as "used to move raw materials from storage tanks to the production process." The audit cited to [45 IAC 2.2-5-8\(d\)](#) which states in relevant 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.

However, Taxpayer states that the auger is not merely moving raw materials – likely a "pre-production" step –

but is moving a mixture of water, flour, ground, or and additional ingredients." In other words, Taxpayer believes that the transport of these mixed ingredients occurs within the production process and there the auger and its repair parts are entitled to the exemption four at [45 IAC 2.2-5-8\(g\)](#) which states:

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.

Taxpayer has provided a photograph of the auger, but it is not possible to tell from either the photograph or the Taxpayer's description whether the auger is used to transport "raw materials" or used to transport "work-in-process." Under IC § 6-8.1-5-1(c), it is the Taxpayer's responsibility to demonstrate that the audit's conclusion was wrong and that its own application and interpretation is correct.

**FINDING**

Taxpayer's protest is respectfully denied.

**VI. Production Equipment – Gross Retail Tax.**

**DISCUSSION**

Taxpayer purchased a "hopper" which Taxpayer explains is used to "direct[] the amount speed, and direction of work in process dough through the production process." Taxpayer describes the hopper as "essentially an industrial sized funnel." Taxpayer states that "work-in-process" dough is fed from an auger into the hopper which only permits a certain amount of dough to pass into the production line.

Taxpayer cites to [45 IAC 2.2-5-8\(g\)](#) which states:

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.

Based on Taxpayer's written description and the photograph of the hopper, it is not possible to determine whether or not the hopper is exempt. It is entirely possible that the Taxpayer's analysis is correct, but lacking any definite information to that effect, it is not possible to sustain Taxpayer on this issue.

**FINDING**

Taxpayer's protest is denied.

**VII. Plastic Electronic Enclosure – Gross Retail Tax.**

**DISCUSSION**

Taxpayer purchased a plastic enclosure "for electronics that controlled the weighing of product in the production process." Taxpayer explains that the "plastic enclosure is physically attached to the production equipment and is used to protect the sensitive electrical components from the harsh environmental heat and moisture which is persuasive in the production process and prolong the life of the production."

As authority for its position, Taxpayer cites to [45 IAC 2.2-5-8\(h\)\(2\)](#) which states:

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

The Department's audit found that the plastic enclosure was not exempt based on [45 IAC 2.2-5-8\(h\)\(1\)](#).

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.

The Department is unable to agree that the plastic enclosure is analogous to replacement parts installed on the electronic scales but is more closely similar to routine maintenance items not exempt from the tax. Under IC § 6-8.1-5-1(c), Taxpayer has failed to meet its burden of demonstrating that the audit's original determination was wrong.

**FINDING**

Taxpayer's protest is respectfully denied.

**VIII. Computer Equipment – Gross Retail Tax.**

**DISCUSSION**

Taxpayer purchased computer hardware and related software which it states "is used to control or is an integral and [is] essential part of the integrated production process...." Taxpayer explains that "[t]he computer equipment in question was purchased for controlling the quantity, type, and ratio of ingredients to be mixed together to make dough for further processing." Taxpayer concludes that "[t]his direct control over the mixing process demonstrates a direct and integral relationship with the product being produced and is entitled to [the exemption.]"

As authority for its position, Taxpayer cites to [45 IAC 2.2-5-8\(c\)\(5\)](#) which states as follows:

A computer is used to control and monitor various aspects of the plating and surface-treatment operations in Example (1). The computer is located in a separate room in a different part of the plant from the plating and surface-treatment operations but is connected to the equipment comprising those operations by means of electrical devices. The computer equipment, including related terminals, printer, and memory, data storage, and input/output devices, is exempt because its use in this manner is an integral and essential part of the integrated production process.

The audit report noted that tax was being assessed on "a computer and related software used in measuring raw materials prior to the mixture."

Based on Taxpayer's description, the Department is prepared to agree that the computer and related

software used to measure, sort, and combine raw materials used in producing Taxpayer's products. As state in [45 IAC 2.2-5-8\(c\)](#):

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.

An example cited immediately below appears analogous to Taxpayer's equipment when it exempts "[a]n automated scale process which measure quantities of raw aluminum for use the next production step of the casing process in the foundry." [45 IAC 2.2-5-8\(c\)\(2\)\(G\)](#). See also [45 IAC 2.2-5-8\(d\)\(1\)](#) which cites as an example of "direct use in the production process;"

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....

#### **FINDING**

Taxpayer's protest is sustained.

#### **SUMMARY**

Taxpayer's computer hardware and related software are exempt; in all other respects, Taxpayer's protest is denied.

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