

Letter of Findings: 04-20100698
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 Revenue 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\(d\)](#); [45 IAC 2.2-5-8\(g\)](#).

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

II. Truck Purchase – Gross Retail Tax.

Authority: U.S. Const. amend. XIV § 1; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-2(a); IC § 6-2.5-4-10; IC § 6-2.5-5-8(a); IC § 6-2.5-5-8(b); IC § 9-13-2-111; *Monarch Beverage v. Dept. of State Revenue*, 589 N.E. 1209 (Ind. Tax Ct. 1992); [45 IAC 2.2-4-27](#).

Taxpayer maintains that it was not required to pay sales tax when it purchased four trucks and two trailers because – after selling the trucks and trailers to an unrelated company – it paid sales tax on the price it paid to lease those same trucks and trailers from the unrelated company.

III. Packaging Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2(a); IC § 6-2.5-3-4; IC § 6-2.5-5-3(b); IC § 6-2.5-5-1(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 is exempt from sales/use tax because the equipment was used in the direct production of Taxpayer's food products.

IV. 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 argues 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.

V. Production Equipment Repair Parts – Gross Retail Tax.

Authority: [45 IAC 2.2-5-8\(f\)\(1\)](#); [45 IAC 2.2-5-8\(f\)\(3\)](#); [45 IAC 2.2-5-8\(h\)\(2\)](#).

Taxpayer maintains that its purchase of repair parts for a "cage dumper" and motor are exempt from sales/use tax because these items are directly used in the direct production of Taxpayer's food products.

VI. Sanitizer Pump – Gross Retail Tax.

Authority: IC § 6-2.5-5-2(b)(1); IC § 6-2.5-5-2(a); *Indiana Dept. of State Revenue, Gross Income Tax Division v. American Dairy of Evansville, Inc.* 338 N.E.2d 698 (Ind. Ct. App. 1975).

Taxpayer states that it was not required to pay sales or use tax on the purchase of a "sanitizer pump" because the pump is used in conjunction with the application of sanitizing chemicals to Taxpayer's food products.

VII. Agricultural Equipment – Gross Retail Tax.

Authority: [45 IAC 2.2-5-6\(a\)](#); [45 IAC 2.2-5-6\(d\)\(1\)](#); [45 IAC 2.2-5-6\(g\)](#); [45 IAC 2.2-5-6\(d\)\(5\)](#); [45 IAC 2.2-5-6\(d\)\(7\)](#); [45 IAC 2.2-5-8\(f\)\(1\)](#).

Taxpayer argues that it was not required to pay sales or use tax on the purchase of certain equipment because the equipment was used for "agricultural" purposes.

VIII. Chemical Coolant – Gross Retail Tax.

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

Taxpayer maintains that it was not required to pay sales or use tax on the purchase of propylene glycol because this coolant is directly used in the direct production of Taxpayer's food products.

IX. Computer Equipment – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); [45 IAC 2.2-5-8\(c\)\(5\)](#); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-12\(c\)](#).

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.

X. 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.

STATEMENT OF FACTS

Taxpayer is a business which produces various food products. Taxpayer operates meat processing plants in Indiana and outside Indiana. In addition, Taxpayer breeds and raises animals which it uses to produce its food products. These animals are raised on farms which Taxpayer does not own although Taxpayer retains title to the animals throughout the entire process. Taxpayer also owns an Indiana feed mill.

The Indiana Department of Revenue (Department) conducted an audit review of Taxpayer's business records. Taxpayer and the Department agreed to a "statistical sampling methodology to estimate the additional purchases subject to use tax...." The Department found that Taxpayer had accrued use tax but had not paid those amounts to the state.

After completing the audit review, the Department concluded that Taxpayer owed 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.

DISCUSSION

Taxpayer argues that its purchase of a "blast freezer" and a "finished goods freezer" is exempt from sales and use tax. Taxpayer explains that, "These sections of freezers have an immediate and direct effect upon the article being produced by lowering the temperature of the article to the point of being frozen completely through."

The Department's audit addressed Taxpayer's multi-stage coolant process as follows:

[Taxpayer's] refrigeration system consists of four... separate sections: a work in process cooler, a spiral freezer used during the process, a blast freezer used after packaging, and a 20 below finished goods freezer used in storage areas to maintain temperature of completed products until shipped. According to plant engineers, the blast freezer and the 20 below finished goods freezer comprised 50[percent] of the refrigeration system and the remaining 50[percent] was work in process refrigeration. There [Taxpayer's] refrigeration system was considered to be used 50 percent of the time in taxable operations within the facility.

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. *Id.* 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. *Rhoades*, 774 N.E.2d at 1047. 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 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\(d\)](#) as authority for its position that the refrigeration equipment – the "blast freezer" and a "finished goods freezer" – are entirely exempt. The cited regulation states as follows:

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.

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 2.2-5-8](#)(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 that frozen food constitutes the Taxpayer's product and that this product is not complete until the frozen food leaves its facility. The audit took the position that the "blast freezer" and the "20 below finished goods freezer" acted directly upon Taxpayer's food product and that blast freezer and finished goods freezer were exempt. Insofar as the remaining cooling equipment, no doubt it is necessary to preserve the food product in its frozen state until the product leaves Taxpayer's door. However, it should be noted that the regulation also explains in part as follows:

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 "blast freezer" and the "20 below finished goods freezer" are exempt because they have a direct effect on Taxpayer's food product. The remaining equipment may be "essential" but – except to the extent that the audit agreed that the "blast freezer" and the "20 below finished goods freezer" were exempt – Taxpayer's remaining refrigeration equipment simply maintains the food product in its frozen states and does not have "an immediate effect upon the article being produced." *Id.* The audit's determination was correct.

FINDING

Taxpayer's protest is respectfully denied.

II. Truck Purchase – Gross Retail Tax.

DISCUSSION

Based on the description set out in the audit report and in Taxpayer's description of the subject issue, Taxpayer purchased four trucks and two tractor-trailers. Taxpayer sold the four trucks and two tractor-trailers to an unrelated "leasing company." The leasing company then rented the four trucks and two tractor-trailers to Taxpayer. According to Taxpayer, the leasing company charged sales tax on the lease payments and Taxpayer paid that tax.

The audit found that taxpayer should have paid sales tax when it first bought the trucks and the tractor-trailers; having failed to do so, the audit assessed use tax on the purchase price.

Taxpayer objects on constitutional grounds citing to U.S. Const. amend. XIV § 1 which states in part, "[N]or shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the law."

On the question of whether the leasing company was required to collect sales tax, IC § 6-2.5-4-10 provides as follows:

(a) A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person other than for subrent or sublease.

(b) A person is a retail merchant making a retail transaction when the person sells any tangible personal property which has been rented or leased in the regular course of the person's rental or leasing business. (Emphasis added).

The Department's regulation repeats the rule in [45 IAC 2.2-4-27](#):

In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation... only exempts from tax those transactions which would have been exempt in an equivalent sales transactions. (Emphasis added).

Based on IC § 6-2.5-4-10 and [45 IAC 2.2-4-27](#), the leasing company was required to collect sales tax on the money it earned from renting the four trucks and two tractor-trailers to Taxpayer.

The next question is whether the Taxpayer should have paid sales tax when it originally purchased the four trucks and two tractor-trailers. Based on Taxpayer's description, Taxpayer seems to suggest that it bought the four trucks and the two tractor-trailers for the purpose of reselling them to the leasing company. IC § 6-2.5-5-8(b) states:

Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary

course of the person's business without changing the form of the property. (Emphasis added).

IC § 6-2.5-5-8(a) explains that "new motor vehicle" is defined at IC § 9-13-2-111 which states "'New motor vehicle' means a motor vehicle: (1) that has not been previously titled under [IC 9-17](#) and carries a manufacturer's certificate of origin; or (2) that has never been transferred by a manufacturer, distributor, or dealer to an ultimate purchaser."

Taxpayer suggests that it did not purchase the vehicle but that its parent company purchased the trucks and trailers in transactions completed outside Indiana and that the parent company "holds an automobile dealer's license for the purposes [of] buying and selling trucks and trailers in large quantities." However Taxpayer's description of the transactions is plainly at odds with the description set out in the audit report and it is not possible to entirely reconcile the Taxpayer's description of the transactions with the report.

As stated above, the state's "gross retail tax" is imposed on retail transactions made in Indiana under IC § 6-2.5-2-1(a). Taxpayer – as the entity which acquired the four trucks and two tractor-trailers – was liable for the sales tax on the purchase. IC § 6-2.5-2-1(b). Because Taxpayer did not pay the sales tax, the Department's audit was correct in imposing the "complementary" use tax. IC § 6-2.5-3-2(a).

As noted at the outset, Taxpayer objects on constitutional grounds implying that the Department is attempting to tax twice the same four trucks and two tractor-trailers. However, it should be noted that the tax in question is a transactional tax meaning that the tax is not imposed on the trucks and tractor-trailers, it is imposed on the sale and rental of that equipment. As noted in *Monarch Beverage v. Dept. of State Revenue*, 589 N.E. 1209, 1214. (Ind. Tax Ct. 1992), "[S]ales or use tax can be collected more than once on the same item if the item is the subject of more than one non-exempt retail transaction." In Taxpayer's case, there were two transactions. The first transaction occurred when Taxpayer acquired the four trucks and two tractor-trailers. Since there was no relevant exemption at the time the transaction occurred, sales tax was due on the first transaction. The second transaction – or series of transactions – occurred when Taxpayer rented the four trucks and two tractor-trailers from the new owner. Again, there was no apparent exemption in effect at the time of the rental transactions.

FINDING

Taxpayer's protest is respectfully denied.

III. Packaging Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer purchased packaging equipment. In particular, Taxpayer bought "case sealing equipment" which, Taxpayer explains, "is used to seal boxes of product." Taxpayer also purchased "strapping equipment" which Taxpayer uses "to attach metal bands around the box of product to further help contain the product." Taxpayer also purchased "box forming equipment" which Taxpayer uses "to form the box which the product is placed in."

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(a) 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," and "box forming equipment" 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 § 6-2.5-5-5.1(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," and "box forming equipment" facilitate the 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...."

FINDING

Taxpayer's protest is respectfully denied.

IV. Evaporation Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer purchased evaporation equipment which Taxpayer describes as "used to evaporate moisture from the air and product." Taxpayer believes the equipment is exempt because it is "used directly in [its] manufacturing process by removing moisture from the [food] product 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 ft³ 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 the 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.

V. Production Equipment Repair Parts – Gross Retail Tax.

DISCUSSION

Taxpayer bought parts to repair equipment. The repair parts were for a "cage dumper" and a motor for moving a chain used to transport live poultry through the production process. Taxpayer explains that the cage dumper "releases the birds from their original state of confinement and allows them to be placed on the production line for further processing." Taxpayer argues that this constitutes "the first step in materially affecting the product in the production process."

Taxpayer maintains that the "chain" is an "integral part of the production process." Taxpayer explains that the "chain carries the poultry from the first production step of the cage dumper through the slaughter process, where the bird is then transferred over to the next process (evisceration)."

Taxpayer cites to [45 IAC 2.2-5-8\(f\)\(3\)](#) as authority for its position.

(f) 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. (Emphasis added).

Based on Taxpayer's description, the cage dumper is best categorized as moving the raw materials "prior to their entrance into the production process...." under [45 IAC 2.2-5-8\(f\)\(1\)](#). However, the Department is prepared to agree that – based on its description – the replacement motor is exempt pursuant to [45 IAC 2.2-5-8\(h\)\(2\)](#) and [45 IAC 2.2-5-8\(f\)\(3\)](#); [45 IAC 2.2-5-8\(h\)\(2\)](#) provides an exemption for repair parts installed on exempt transport equipment.

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

[45 IAC 2.2-5-8\(h\)\(2\)](#) exempts the chain used to transport Taxpayer's poultry into and within the production process.

FINDING

Taxpayer's protest is sustained in part and denied in part.

VI. Sanitizer Pump – Gross Retail Tax.

DISCUSSION

Taxpayer purchased a repair part for a pump "used in sanitizing hatchery equipment." Taxpayer explains the

pump was intended for "use in conjunction with the production of food and food ingredients or commodities for sale." Taxpayer further explains that, "By applying the chemicals that sanitize equipment, the pump is being used in conjunction with the chemicals to help produce a commodity for sale (in this case a healthy chick which can be raised for meat for human consumption)." In particular, Taxpayer cites to IC § 6-2.5-5-2(b)(1) which states in full:

- (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[.]

The audit report concluded that the repair part was not exempt under Indiana Dept. of State Revenue, Gross Income Tax Division v. American Dairy of Evansville, Inc. 338 N.E.2d 698 (Ind. Ct. App. 1975). Based on that case, the audit report concluded that the "cleaning equipment was considered taxable since it was too far removed from the production process to satisfy the requirements of the exemption. The American Dairy court found that "insecticides, insect spray, bird repellent and cleaning compounds qualif[ied] for the exemption...." because the petitioner's used the chemicals "to retard growth of harmful bacteria...." Id. at 701. However, the court disagreed with the petitioner's argument that "sponges, scouring pads, towels, mops and wipers" were exempt because the items "though clearly essential to the cleaning process, their impact is arguably less direct than that of the cleaning compounds." Id.

Taxpayer cites to IC § 6-2.5-5-2(b)(1) as authority for its argument; however, IC § 6-2.5-5-2(a) also states:

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.

In this case, the American Dairy case is instructive. The article for which the exemption is sought must not only be "essential to the cleaning process," the article must be acquired for "direct use in the direct production" of Taxpayer's food product. The Department agrees with the audit report's conclusion that the pump is "too far removed from the production process...." As explained in American Dairy, "[T]he emphatic and repetitious language employed by the Legislature in expressing the requirement of directness reflects an intent that such technical distinctions be drawn." American Dairy, 338 N.E.2d at 701.

FINDING

Taxpayer's protest is respectfully denied.

VII. Agricultural Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer purchased items it believes are entitled to the "agricultural exemption." Those items include; (1) an auger used to move poultry feed through the product process; (2) lift trucks used to harvest poultry; and (3) cages used to house and transport poultry from the farm to the processing plant.

Taxpayer maintains that the auger is exempt pursuant to [45 IAC 2.2-5-6\(d\)\(1\)](#) which states:

Sales of agricultural machinery, tools, and equipment used by the purchaser directly in feeding exempt animals, poultry, etc., are exempt from tax. This exemption does not extend to machinery, equipment, and tools used for the handling, movement, transportation, or storage of feed prior to the actual feeding process. (Emphasis added).

Based on the description of the auger, the Department is prepared to agree that the auger is "directly" used to feed Taxpayer's poultry.

Insofar as the remaining two items – the lift trucks and cages – Taxpayer argues that the items are "used directly in the production process and are essential for harvesting the poultry from their living quarters." Taxpayer further explains:

To remove poultry from its confinement building, [poultry] must be placed into one of these specialized cages and then have the cage removed from the building so that it may be placed on transportation equipment to take it to a processing plant.

Taxpayer claims an exemption for the lift trucks and cages pursuant to [45 IAC 2.2-5-6\(d\)\(5\)](#) as follows:

Sales of other agricultural machinery, tools, and equipment to be directly used by the purchaser in the direct production, extraction, harvesting, or processing or [sic.] agricultural commodities are exempt from tax provided such machinery, tools, and equipment are directly used in the production process, i.e. they have an immediate effect upon the agricultural commodities 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 agricultural commodities.

Taxpayer buttresses its argument that the cages are exempt by citing to [45 IAC 2.2-5-6\(d\)\(7\)](#) as follows:

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 or completely produced for resale and are, in fact, resold. Storage facilities or containers for materials or items currently undergoing production during the production process are deemed temporary storage facilities and containers.

[45 IAC 2.2-5-6\(a\)](#) points out that: "In general, all purchases of tangible personal property by persons engaged in the direct production, extraction, harvesting, or processing of agricultural commodities are taxable." (Emphasis

added). The exemptions which Taxpayer seek are governed by the "direct production" standard explained at [45 IAC 2.2-5-6\(g\)](#) which provides that:

"Direct production, extraction, harvesting or processing agricultural commodities" means action which has an immediate effect on the agricultural commodities being produced by "farming" as defined in Regs. 6-2.5-5-1(010) [[45 IAC 2.2-5-1](#)] for a human, animal, or poultry consumption. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces agricultural commodities.

Although the lift trucks and cages may be necessary for transporting Taxpayer's poultry, the equipment does not have an "immediate effect on the agricultural commodities being produced...." And are employed prior to Taxpayer's production of its food products pursuant to [45 IAC 2.2-5-8\(f\)\(1\)](#) which states that, "Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable." (Emphasis added).

FINDING

Taxpayer's protest is denied in part and sustained in part.

VIII. Chemical Coolant – Gross Retail Tax.

DISCUSSION

Taxpayer purchased a chemical called propylene glycol. When Taxpayer purchased this chemical, it paid use tax. The audit did not disagree that use tax was paid. However, Taxpayer now believes that it erred in paying the tax on the ground that the chemical "is used directly in the production process by cooling a marinade that becomes part of the final product." Taxpayer explains that the "chemical directly affects the marinade by chilling to near freezing without freezing the liquid marinade." Taxpayer further explains that the "propylene glycol allows [Taxpayer] to lower the temperature of the marinade that is coated/impregnated upon [Taxpayer's] processed chickens to almost freezing without creating ice." Taxpayer concludes that the chemical has "a direct affect to an ingredient of the production and is consumed in the manufacturing process."

As authority for its position, Taxpayer cites to [45 IAC 2.2-5-12\(c\)](#) as follows:

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.

Beyond Taxpayer's description, there is nothing which addresses the issue in the audit report. Taxpayer has not pointed to anything in the audit report which addresses the issue raised. The only thing which is known with any certainty is that propylene glycol has numerous uses. As noted in Part I above, 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 regards to the propylene glycol, Taxpayer has failed to establish that – insofar as this chemical – the audit report was incorrect or that the audit ever considered this issue. Taxpayer has failed to establish that it is entitled to claim a "credit" for the use tax it paid at the time Taxpayer acquired the chemical.

FINDING

Taxpayer's protest is respectfully denied.

IX. Computer Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer purchased computer equipment. Specifically, Taxpayer bought a "power supply for a micro feed additive system." Taxpayer also bought a "new micro feed additive hardware/software package."

Taxpayer explains that the devices "control[] the amount and type of poultry feed ingredients that go into making poultry feed. By controlling the amount and type of ingredients that are used, the hardware and software work directly to control the production process and are therefore exempt under [[45 IAC 2.2-5-8\(5\)](#)]." Taxpayer further explains that "the computer controls the introduction of the correct mix of micro ingredients based on the batch size and nutritional need."

The cited regulation, [45 IAC 2.2-5-8\(c\)\(5\)](#), 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 simply notes that items assessed in the "stat sample" included "a computer and related software used in measuring raw materials prior to the mixer." [45 IAC 2.2-5-8\(d\)](#) states as follows:

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.

The issue is whether the computer equipment and software function before the production of poultry feed occurs or whether the equipment and software control the actual production of the poultry feed. Do the computer equipment and software "have an immediate effect on the article being produced" and do the computer equipment and software constitute "an essential and integral part of an integrated process which produces tangible personal property"? [45 IAC 2.2-5-12\(c\)](#).

IC § 6-8.1-5-1(c) states the "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid" and that the "burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Without more specific information as to this particular equipment and software, it is not possible to conclude that the audit was incorrect and that Taxpayer is entitled to the exemption.

FINDING

Taxpayer's protest is respectfully denied.

X. 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.

SUMMARY

Taxpayer's transport chain is exempt as described in Part V as is the auger as described in Part VII; in all other respects, Taxpayer's protest is denied.

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