

**Letter of Findings: 04-20110359**  
**Gross Retail Tax**  
**For the Years 2008, 2009, and 2010**

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**ISSUE**

**I. Front-End Loader – Gross Retail Tax.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-2-1(a); IC § 6-2.5-3-1; IC § 6-2.5-3-4; IC § 6-2.5-3-5; IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(c); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(f\)\(1\)](#); [45 IAC 2.2-5-8\(g\)](#); 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); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct.1991).

Taxpayer argues that the Indiana Department of Revenue's audit incorrectly determined that a John Deere front-end loader was subject to sales/use tax.

**STATEMENT OF FACTS**

Taxpayer is an Indiana business which manufactures lumber used for flooring, paneling, cabinets, and furniture. Taxpayer primarily sells the lumber to wholesalers. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit. The audit determined that Taxpayer owed additional sales/use tax. Taxpayer disagreed with that decision and submitted a protest to that effect. An administrative hearing was conducted by phone during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

**I. Front-End Loader – Gross Retail Tax.**

**DISCUSSION**

Taxpayer purchased a John Deere 544 front-end loader in 2010. While the Department's audit determined that much of Taxpayer's equipment and supplies was used – at least in part – in an exempt manner, the audit assessed use tax on the entire purchase price of the front-end loader because the audit concluded that the front-end loader was used in Taxpayer's pre-production activities.

In a letter dated June 15, 2011, Taxpayer explains how the front-end loader is used and why it should be exempt from sales/use tax:

This loader was acquired for the purpose of placing logs in the production process. It is an essential and integral part of production. A recent definition of exempt purpose is: Machinery and equipment are considered used as an integral and essential part of an integrated production operation when used to receive transport, convey, handle raw materials in preparation of its placement on the production line, handling raw material in a process at any point from the beginning to the end.

In a subsequent letter dated September 14, 2011, Taxpayer further explained how the front-end loader is used and why it should be exempt from the tax:

This loader sometimes will unload a log truck. The time allocated to this process is approximately 5[percent] of it[is] use. It is also used to sort logs by specie and grade and placed on production ramps to fill product order. This process is approximately 15[percent] of its use. The remaining 80[percent] of use is dedicated to placement in debarker. All of these processes are required functions of the production process.

Taxpayer further cites to two earlier 1983 and 2001 audits when, according to Taxpayer, the Department found in one instance that 40 percent of its lifts were taxable and in another instance that 38.1 percent of Taxpayer's equipment and supplies were taxable.

In addition to the June and September letters, Taxpayer also supplied photographs of the John Deere 544 front-end loader being used at Taxpayer's facility along with copies of the 1983 and 2001 audit reports.

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."

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). In general, a person is liable for sales tax at the time of purchase, unless an exemption applies. IC § 6-2.5-2-1. A parallel tax, the use tax, is also due for any tangible personal property stored, used, or consumed in Indiana. IC § 6-2.5-3-1. If sales tax was paid to another state at the time of purchase, the amount paid is credited against the use tax. IC § 6-2.5-3-5. Further, if tangible personal property is purchased for an exempt purpose, the use of that property for the exempt purpose is also exempt from use tax. IC § 6-2.5-3-4.

Taxpayer maintains that the front-end loader is used in its lumber manufacturing process and that the front-end loader is entitled to an exemption. Taxpayer necessarily relies on IC § 6-2.5-5-3(b) which provides that

"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... of other tangible personal property. (Emphasis added). The applicable regulation, [45 IAC 2.2-5-8](#), provides in relevant part:

(a) In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production.

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

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

(d) 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. (Emphasis added). IC § 6-2.5-3(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). Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct.1991).

This issue is whether Taxpayer has established that the front-end loader is directly used in the direct production of Taxpayer's lumber. Taxpayer's description and the photographs establish that the front-end loader is used to position and place unprocessed logs onto a heavy, chain-driven conveyor which delivers the logs to the Taxpayer's debarker. Based on the information provided, the debarker is the first step in the Taxpayer's manufacturing process because debarking is the first time that Taxpayer's equipment has an "immediate effect on the article being produced." [45 IAC 2.2-5-8\(c\)](#).

[45 IAC 2.2-5-8\(f\)\(1\)](#) addresses Taxpayer's front-end loader stating that:

Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable.

Taxpayer's "production process" begins with debarking. The front-end loader is used prior to the entrance of the logs into that production process and is taxable.

Taxpayer notes that the front-end loader is "essential" but this argument misses the mark. The Department recognizes that the front-end loader may be "essential" to the production of the lumber but the test is whether or not the front-end loader is "directly used in the production process."

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).

Under IC § 6-8.1-5-1(c), Taxpayer has failed to meet its burden of establishing the proposed assessment is wrong.

#### FINDING

Taxpayer's protest is respectfully denied.

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