

**Letter of Findings: 04-20120461**  
**Sales and Use Tax**  
**For the Years 2009, 2010, 2011**

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**ISSUE**

**I. Sales and Use Tax – Industrial Production Exemption.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-5-3; IC § 6-2.5-5-4; Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Rhoades v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); 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 (Ind. Tax Ct. 1999); [45 IAC 2.2-5-8](#).

Taxpayer protests the assessment of use tax on industrial magnets it claims are used in its industrial production process.

**STATEMENT OF FACTS**

Taxpayer is an Indiana company that produces dry milled corn products. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for the years 2009 through 2011. As a result of the audit, Taxpayer was assessed additional use tax on several items it had purchased without paying sales tax and on which it had not self-assessed and remitted use tax. Taxpayer was also assessed interest. Initially Taxpayer protested the assessment of tax on three items; a portable metal detector, a heater, and four industrial magnets, all of which Taxpayer claimed qualified for the industrial production exemptions and were therefore not subject to sales or use tax. An administrative hearing was held on its protest. Subsequent to the hearing, Taxpayer withdrew its protest relating to the portable metal detector and the heater. Therefore, this final determination addresses the use of the industrial magnets. Additional facts will be provided as needed.

**I. Sales and Use Tax – Industrial Production Exemption.**

**DISCUSSION**

The Department assessed use tax on what Taxpayer describes as four magnets it claims are used in its corn milling production process. The magnets are referenced as two invoices totaling \$34,428 on page 5 of the Department's audit report. Subsequent to the hearing, Taxpayer provided additional documentation which included photographs and narrative explanation of the use of the magnets in Taxpayer's corn milling process. Taxpayer states that three of the magnets (invoice number 140338) are used to remove any remaining metal pieces from the milled corn prior to bulk storage of the milled corn. The fourth magnet (invoice number 140339) is used to detect any remaining metal pieces in the milled corn as the stored milled corn is loaded in bulk form into transport vehicles.

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 exemption to which Taxpayer aspires, IC § 6-2.5-5-4, 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).

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).

In effect and practice, 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).

However, the general rule is that 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\(a\)](#). The exemption only applies to machinery, tools, and equipment directly used by the purchaser in direct production. Id. 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 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. [45 IAC 2.2-5-8\(c\)](#). 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\(c\)](#), example (1).

To summarize, machinery, tools, and equipment purchased for direct use in the production of manufactured goods are subject to use tax unless the property used has an immediate effect on the goods produced and is essential to the integrated process used to produce the marketable goods.

Proper application of the exemption requires determining at what point does "production" begin and at what point does "production" end. [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.

Under IC § 6-2.5-5-3(b):

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. In addition, [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.

Finally, [45 IAC 2.2-5-8\(k\)](#) states:

"Direct production, manufacture, fabrication, assembly, or finishing of tangible personal property" is performance of a 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.

The issue is whether the specific items of equipment are exempt because these items of equipment are "directly used in the production process because they have an immediate effect on the article being produced." IC § 6-2.5-5-3(b). The determining factor is when Taxpayer's production process is deemed to be end; i.e., when is the Taxpayer's milled corn in its final, marketable form?

As stated previously, Taxpayer sent in additional documentation and explanation of its production process which demonstrate that three of the magnets at issue are used during the production process where the corn has been milled but not yet placed in storage. These three magnets check the milled corn for metal pieces before the milled corn is placed in storage. These magnets are components of tubes through which different milled corn products flow on the way to conveyors that transport the product to storage. If metal pieces are found in the milled corn, that batch is returned for further processing.

The fourth magnet is used when the stored milled corn is removed from storage for loading into transport trucks. Taxpayer refers to [45 IAC 2.2-5-8\(d\)](#) which states that the "integrated production process ends at the point that the production has altered the item to its completed form, including packaging, if required." Taxpayer argues that the trucks are the "packaging." Taxpayer states that its customers pay for this packaging just as they would 50 pound bags which also can be used for packaging. Beyond this contention, Taxpayer did not present evidence that demonstrates that the trucks act as packaging. The trucks are a means of transporting Taxpayer's bulk product, as evidenced by the fact that the trucks do not remain with Taxpayer's customers. The fourth magnet is used in post-production and is therefore not exempt from sales or use tax.

Taxpayer has met its burden to show that three of the four magnets are directly used in Taxpayer's direct production process and therefore exempt from sales tax and use tax. In its supplemental audit, the Department will remove the items on invoice number 140338 from the assessment of tax. The fourth magnet (invoice number 140339) remains subject to tax.

#### FINDING

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

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