

Letter of Findings: 04-20120315
Sales and Use Tax
For Tax Years 2008, 2009, and 2010

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ISSUE

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-11](#); [45 IAC 2.2-5-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoads v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Mumma Bros. Drilling Co. v. Department of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

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

STATEMENT OF FACTS

Taxpayer is an Indiana company, which manufactures and sells ready-mix concrete to retail customers. Taxpayer delivers concrete in ready-mix trucks. Taxpayer also sells concrete related items, which include "sprayers, sealers, form release, drain tile, rebar, wire mesh, steel/wood stakes."

The Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer's business records for 2008, 2009, and 2010 tax years ("Years at Issue"). Pursuant to the audit, the Department determined that Taxpayer sold certain tangible personal property to its customers without collecting and remitting the sales tax. The Department's audit also determined that Taxpayer purchased and used certain tangible personal property in the course of its business activities without paying sales tax or remitting use tax. In addition to imposing sales tax, the Department assessed Taxpayer use tax on several items which Taxpayer purchased and used in the course of its business activities.

Taxpayer only protests the imposition of use tax. Specifically, Taxpayer stated that its use of (1) certain repair parts, (2) off-road diesel fuel, as well as (3) certain office computers, supplies, and equipment (collectively, "Items at Issue") was exempt from sales/use tax. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales and Use Tax – Imposition.

DISCUSSION

The Department's audit assessed Taxpayer use tax on its purchases of the Items at Issue which Taxpayer used for its business without paying sales tax. The Department's audit noted that "these items were determined to be used outside the production process." Taxpayer, to the contrary, claimed that it was entitled to the manufacturing exemption on those items pursuant to Indiana case law.

As a threshold issue, all tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

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 Rhoads v. Indiana 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.*; USAir, Inc. v. Indiana 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).

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 sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101.

IC § 6-2.5-5-3, in relevant part, states:

(b) Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for **direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.**

(c) The exemption provided in subsection (b) **does not apply to transactions involving distribution equipment or transmission equipment acquired by a public utility engaged in generating electricity. (Emphasis added).**

IC § 6-2.5-5-1(b) provides:

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. **(Emphasis added).**

Thus, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture... of other tangible personal property." In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. "Fairly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Department of Revenue*, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. *General Motors Corp. v. Indiana Dep't. of State Revenue*, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991). The application of Indiana's double-direct manufacturing exemptions often varies based on a determination of when a taxpayer's manufacturing process is considered to have begun and ended.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment are directly used in the direct 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\(c\)](#), example 1.

[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](#), in part, as follows:

(a) The state gross retail tax shall not apply to sales of tangible personal property to be directly used by the purchaser in the direct production or manufacture of any manufacturing or agricultural machinery, tools, and equipment described in [IC 6-2.5-5-2](#) or 6-2.5-5-3 [[IC 6-2.5-5-3](#)].

(b) The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to tangible personal property directly used in the direct production of manufacturing or agricultural machinery, tools, and equipment to be used by such manufacturer or producer.

(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.

(d) For the application of the rules [subsections] above, refer to Regs. 6-2.5-5-3 [[45 IAC 2.2-5-8](#) through [45 IAC 2.2-5-10](#)] with respect to tangible personal property used directly in the following activities: pre-production and post-production activities; storage; transportation; tangible personal property which has an immediate effect upon the article produced; maintenance and replacement; testing and inspection; and managerial, sales, and other nonoperational activities.

The exemption for direct consumption in production is further explained at [45 IAC 2.2-5-12](#), in part, as follows:

(a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.

(b) The exemption provided by this regulation [[45 IAC 2.2](#)] applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.

(c) 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.

[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.

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

(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.

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

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit.

The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property. (Emphasis added).

Additionally, [45 IAC 2.2-5-8\(j\)](#) provides:

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).**

As mentioned above, only when the use of the tangible personal property has met the "double direct" test, is a taxpayer entitled to the manufacturing exemption. In this instance, Taxpayer manufactures, sells, and delivers the concrete to its customers in ready-mix trucks. Thus, Taxpayer's manufacturing process begins when the ingredients of ready-mix concrete (raw materials) are blended after the raw materials were weighted (or measured); Taxpayer's manufacturing process ends when the ready-mix trucks deliver the concrete to its customers at the places designated.

Claiming the manufacturing exemption, Taxpayer offered the basis of its protest of the assessment on the Items at Issue in three (3) categories. This Letter of Findings addresses each of categories as follows:

A. Repair parts.

Taxpayer claimed that the repair parts, which included "PVC," "Analog Cards," "Surge Protectors," "Loadcell Simulator," "Butterfly Valve, Actuator," were exempt for two reasons. First, Taxpayer asserted that "the items were

billed to the entity that is actually responsible for the operation of the concrete plants and production process" and the entity was exempt. Second, Taxpayer maintained that these "repairs to the plant... are cost[s] incurred in the direct production of concrete." To support its protest, Taxpayer provided an exemption certificate of the entity, its purchase invoices, its billing invoices to the entity, and three video clips showing the equipment at its plant. Taxpayer, however, did not provide documentation to demonstrate its use of "PVC," "Analog Cards," "Surge Protectors," "Loadcell Simulator," "Butterfly Valve, Actuator."

Upon reviewing Taxpayer's documentation, the Department is not able to agree with Taxpayer's assertion that the repair parts were exempt on the ground that Taxpayer billed an entity which claimed exemption. First, Taxpayer here is a concrete manufacturer. Taxpayer purchased the items and used the items. Taxpayer did not resell those items at retail transactions. Thus, whether the entity was exempt is beyond the scope of this protest.

Even if, assuming that Taxpayer purchased and resold the items to the entity which claimed exemption, its documentation failed to substantiate that the sales were exempt. Specifically, Taxpayer's purchase invoices contained itemized charges for each of the items purchased. For example, Taxpayer's purchase invoices showed that it purchased "Elbow" for "\$20.50," "PVC" for \$26.30," and "Surge Protectors" for \$776.44"; no sales tax was paid. But, Taxpayer's two billing invoices (numbers 2093 and 2269) demonstrated that it billed the exempt entity, in the total amount of "\$22,429.03" (Invoice 2093) and "\$10,718.47" (Invoice 2269) each for a line item of "7690 plant repair, misc. supplies for plant repairs." Both billing invoices did not have itemized details as to the items used for repairs. Thus, in the absence of other supporting documentation, the Department is not able to agree with Taxpayer's assertion that the repair parts were exempt because Taxpayer billed an entity which claimed exemption.

The Department is also unable to agree with Taxpayer that the "repairs to the plant... are cost[s] incurred in the direct production of concrete." As discussed above, only when the use of the tangible personal property has met the "double direct" test, is Taxpayer entitled to the manufacturing exemption. Taxpayer's documentation showed that it purchased the repair parts, including "Elbow" for "\$20.50," "PVC" for \$26.30," and "Surge Protectors" for \$776.44"; however, its documentation did not explain how the items were used in its plant. Given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that the repair parts were directly used in Taxpayer's direct production.

In short, Taxpayer's documentation failed to substantiate its assertion that the repair parts were exempt. Since no sales tax was paid at the time of the purchases, use tax is properly imposed.

B. Off-road Diesel Fuel.

Taxpayer claimed that its purchases of the diesel fuel were exempt from sales/use tax because it used the diesel fuel to "run loaders which perform production operations of fine and coarse aggregates to be used in the production of concrete." Taxpayer further explained, in relevant part, that:

The loaders are used to take crude stone and further separate the crude stone to the conveyer processing plant which separates and washes the aggregate into various grades of product. The washed product is then taken by conveyer to a loader to separated stock piles. The stockpiling is part of the production process as it preserves the gradation and keeps the moisture levels to the acceptable standards for the eventual end use – for the production of concrete. This is consistent with the applications already tested and tried in the Calcar Quarries and Meshberger Bros Stone case.

([Taxpayer] - sales tax appeal.doc, September 24, 2012 e-mail attachment).

Taxpayer, however, did not provide any legal analysis as to how the above two cases apply and support its protest in this instance.

Upon reviewing Taxpayer's documentation, the Department is not able to agree with Taxpayer that it directly used the loaders in its direct production of the ready-mix concrete. As discussed above, Taxpayer's manufacturing process begins when the ingredients of ready-mix concrete (raw materials) are blended after the raw materials were weighted (or measured); Taxpayer's manufacturing process ends when the ready-mix trucks deliver the concrete to its customers. "The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property 'has an immediate effect upon the article being produced.'" [45 IAC 2.2-5-8\(g\)](#). Taxpayer's use of the off-road diesel fuel to operate the loaders may be necessary to prepare its raw materials for its concrete production; however, its use of the loaders and the diesel fuel was, at best, pre-production and not directly used in its direct production. Therefore, Taxpayer's use of the off-road diesel fuel was not exempt under manufacturing exemption.

In short, the off-road diesel fuel Taxpayer purchased and used to operate the loaders was pre-production and, therefore, was subject to sales tax. Since sales tax was not paid, use tax is properly imposed.

C. Office Computers, Supplies, and Equipment.

Taxpayer claimed that it was entitled to 70 percent exemption on the office computers, supplies, and equipment because it purchased the "computer equipment... to be used at approximately 70 [percent] of the time to communicate directly in the production process of ready mix concrete." Specifically, Taxpayer asserted that its use of the office computers, supplies, and equipment "is to communicate with the various concrete plants the correct information to the computers to produce the correct type of concrete." Taxpayer thus maintained that

those office computers, supplies, and equipment were exempt at 70 percent because in order to properly produce the concrete to the customers' specification, it used 70 percent of them to transmit the production information electronically and "to monitor the production process" remotely.

Upon reviewing Taxpayer's documentation, however, the Department is not able to agree. First, Taxpayer stated that it was entitled to a 70 percent exemption on the purchases of the office computers, supplies, and equipment. But, Taxpayer did not offer any documentation to substantiate its 70 percent calculation.

Additionally, pursuant to [45 IAC 2.2-5-8\(g\)](#), the office computers, supplies, and equipment must have an immediate effect upon the concrete being produced to qualify for the manufacturing exemption under the "double direct" test. Taxpayer stated that it used the office computers, supplies, and equipment "to communicate with the various concrete plants the correct information to the computers to produce the correct type of concrete." Using the office computers, supplies, and equipment "to communicate with the various concrete plants" may be essential to Taxpayer's manufacturing operations; however, Taxpayer's use of those items merely conveys information, i.e., its customers' specification or purchase orders, prior to the commencement of its manufacturing production. Moreover, Taxpayer's documentation failed to demonstrate that it directly used the office computers, supplies, and equipment "to monitor the production process to make sure the production of [various] grades of concrete are being properly produced." "The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property 'has an immediate effect upon the article being produced.'" [45 IAC 2.2-5-8\(g\)](#). Thus, in the absence of other supporting documentation, the Department is not able to agree with Taxpayer's assertion that it was entitled to 70 percent exemption on its purchases of the office computers, supplies, and equipment.

In short, Taxpayer's documentation failed to substantiate that it directly used 70 percent of the office computers, supplies, and equipment in its direct production. Since sales tax was not paid, use tax is properly imposed.

FINDING

Taxpayer's protest of the use tax on (1) certain repair parts, (2) off-road diesel fuel, as well as (3) certain office computers, supplies, and equipment is respectfully denied.

Posted: 03/27/2013 by Legislative Services Agency
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