

**Letters of Findings: 04-20120577; 04-20120578; 04-20120579;
04-20120580; 04-20120581
Sales and Use Tax
For The Tax Years 2008-2010**

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ISSUE

I. Sales and Use Tax—Research and Development Equipment Exemption.

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; IC § 6-2.5-5-5.1; IC § 6-2.5-5-6; IC § 6-2.5-5-40; IC § 6-8.1-5-1; Sales Tax Information Bulletin 75 (October 2008); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); S.B. 649, 1999 Gen. Assem., Reg. Sess. (Ind. 1999); H.B. 1369, 2012 Gen. Assem., Reg. Sess. (Ind. 2012); H.B. 1171, 2013 Gen. Assem., Reg. Sess. (Ind. 2013).

Taxpayer protests the imposition of sales/use tax on its purchase of prototypes on the ground that the purchases qualify for the "research and development equipment exemption."

STATEMENT OF FACTS

Taxpayer is an international corporation headquartered in Indiana. Taxpayer is engaged in the business of manufacturing and distributing medical implants and instruments utilized in medical industries. Taxpayer has manufacturing facilities in Indiana. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional use tax and made assessments of tax and interest for the 2008, 2009, and 2010 tax years. The Department found that Taxpayer had made purchases of tangible personal property without paying sales tax at the time of purchase or remitting use tax to the Department. Taxpayer protests the assessment of tax on its purchases of prototypes. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as required.

I. Sales and Use Tax—Research and Development Equipment Exemption.

DISCUSSION

All tax assessments are prima facie evidence that the Department's claim for the tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. 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 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). In general, all purchases of tangible personal property are subject to sales and/or use tax. An exemption from use tax is granted for transactions where sales tax was paid at the time of the purchase pursuant to IC § 6-2.5-3-4. In certain circumstances, additional enumerated exemptions from sales and/or use tax are available.

The Department found that Taxpayer had purchased certain items without paying sales tax at the time of purchases, and assessed use tax on the purchases. Taxpayer asserts that the Department erred in determining that its purchases of prototypes are subject to sales and use tax. Taxpayer believes that its purchases of completed prototypes from outside vendors are eligible for the "research and development equipment exemption."

The "research and development equipment exemption" is found at IC § 6-2.5-5-40, which provides:

- (a) As used in this chapter, "research and development activities" does not include any of the following:
- (1) Efficiency surveys.
 - (2) Management studies.
 - (3) Consumer surveys.
 - (4) Economic surveys.
 - (5) Advertising or promotions.
 - (6) Research in connection with literary, historical, or similar projects.

(7) Testing for purposes of quality control.

(b) As used in this section, "research and development equipment" means tangible personal property that:

(1) consists of or is a combination of:

- (A) laboratory equipment;**
- (B) computers;**
- (C) computer software;**
- (D) telecommunications equipment; or**
- (E) testing equipment;**

(2) has not previously been used in Indiana for any purpose; and

(3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:

- (A) new products;
- (B) new uses of existing products; or
- (C) improving or testing existing products.

(c) A retail transaction:

(1) involving research and development equipment; and

(2) **occurring after June 30, 2007;**

is exempt from the state gross retail tax.

(Emphasis added).

The Department refers to Sales Tax Information Bulletin 75 (October 2008), 20081029 Ind. Reg. 045080815NRA, which explains, on page two, as follows:

Research and development equipment means tangible personal property that consists of laboratory equipment, computers, computer software, telecommunications equipment, or testing equipment that has not previously been used in Indiana for any purpose and is acquired by the purchaser and devoted directly to experimental or laboratory research and development for new products, new uses of existing products, or improving or testing existing products.

Research and development equipment does not include hand powered tools or property with a useful life of less than one year.

Taxpayer asserts that the prototypes qualify for the "research and development equipment exemption."

Taxpayer maintains that even though it accounts for its prototypes by expensing them, the prototypes qualify as equipment because they have a useful life of much longer than one year.

The Department notes that 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). "Exemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of government." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) *aff'd* 599 N.E.2d 588 (Ind. 1992) (Internal citations omitted). Thus, "[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." *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 100-101 (Ind. Ct. App. 1974). Accordingly, the taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d at 404.

Notwithstanding that the research and development exemption is to be applied narrowly, it remains that IC § 6-2.5-5-40 provides an exemption for "research and development equipment" in certain circumstances. The Department notes that IC § 6-2.5-5-40(b) provides a specific definition of what constitutes "equipment" for purposes of the Indiana research and development equipment exemption. Specifically, the exemption applies when the "research and development equipment:" (1) consists of or is a combination of "laboratory equipment, computers, computer software, telecommunications equipment, or testing equipment;" (2) has not previously been used in Indiana for any purpose; and (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for new products, new uses of existing products, or improving or testing existing products. The legislature specifically used the term "research and development equipment" and included only equipment that fits into the five specifically listed categories.

Therefore, regardless of whether or not the prototypes meet the generic definition of equipment, the prototypes must fit into one of the five specifically listed categories of equipment that are used to perform the research and development activities—i.e., "laboratory equipment, computers, computer software, telecommunications equipment, or testing equipment." However, the prototypes—i.e., the products that are being tested themselves—do not fit into any of the listed categories. If the legislature wanted these types of items to be included in the exemption, the legislature would have not only enacted the provisions in the statute that exempted the categories of equipment that are used to perform the research and development testing, but would have also included a category for the items that make up the tested product themselves like the legislature did when

enacting the manufacturing exemptions. See IC § 6-2.5-5-6 (enacting a manufacturing exemption that includes the tangible personal property that is incorporated as a material part of the manufactured product). See IC § 6-2.5-5-3 (enacting a manufacturing exemption that includes manufacturing machinery, tools, and equipment that are used to manufacture the product). See also IC § 6-2.5-5-5.1 (enacting a manufacturing exemption that includes the tangible personal property that is consumed during the manufacture of a product).

Taxpayer invites the Department to expand the statutory definition of "research and development equipment" to include its purchases of prototypes as purchases of one of the five categories of exempt equipment. Taxpayer, therefore, invites the Department to exceed the statutory authority granted in IC § 6-2.5-5-40. Taxpayer has not referenced any statute or regulation which clearly requires the Department to grant, or which allows the Taxpayer to claim such an exemption for its prototypes. In fact, the originally proposed statutory language attempted to exempt a broader category of purchases by referring in general to all purchases of "tangible personal property," including items such as utilities in the definition. S.B. 649, 1999 Gen. Assem., Reg. Sess. (Ind. 1999). However, this broad exemption was not enacted by the legislature. The legislature, after considering this broad exemption, enacted a narrow exemption that included only "equipment" that is defined in five specific categories. If the "research and development equipment exemption" is to be broadened to include the prototypes—i.e., the products that are being tested themselves, such action must come from the Indiana General Assembly. See also H.B. 1369, 2012 Gen. Assem., Reg. Sess. (Ind. 2012) (attempting to amend IC § 6-2.5-5-40 to include tangible personal property in general in which the bill did not leave committee.) See also H.B. 1171, 2013 Gen. Assem., Reg. Sess. (Ind. 2013) (attempting to amend IC § 6-2.5-5-40 to include tangible personal property in general in which the bill did not leave committee.)

FINDING

Taxpayer's protest is respectfully denied.

Posted: 05/29/2013 by Legislative Services Agency
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