

Letter of Findings: 04-20130006
Gross Retail and Consumer Use Tax
For the Years 2009, 2010, and 2011

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Reference Book – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-2(a); IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-10\(g\)](#).

Taxpayer argues that it was not required to pay sales tax on the purchase of a reference book because the book is necessary for the production of its pharmaceutical products.

II. Exempt Sales Transactions – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); IC § 6-2.5-8-8(a).

Taxpayer states that it was not required to collect sales tax on transactions in which the purchaser provided an exemption certificate.

III. Laboratory Equipment and Supplies – Gross Retail Tax.

Authority: IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(c); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-10\(g\)](#); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer maintains it is not required to pay sales tax on the purchase of laboratory equipment and supplies because these items are used during the production and manufacture of Taxpayer's pharmaceutical products.

IV. Forklift Battery – Gross Retail Tax.

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

Taxpayer argues that it was entitled to purchase a forklift battery without paying the full amount of sales tax otherwise due because the forklift was used in an exempt manner.

V. Imposition – Consumer Use Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4.

Taxpayer argues that it should not be required to pay use tax on items of certain tangible personal property because it has provided documentation which establishes it paid sales tax at the time it purchased the property.

STATEMENT OF FACTS

Taxpayer is an Indiana business which produces pharmaceutical products. The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records. The audit resulted in the assessment of 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 the protest. This Letter of Findings results.

I. Reference Book – Gross Retail Tax.

DISCUSSION

Taxpayer purchased a standard pharmaceutical reference guide called the "United States Pharmacopeia" (USP). The Department's audit found that Taxpayer was required to pay use tax because sales tax was not paid at the time of the original transaction.

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-3-2(a). A complementary 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. IC § 6-2.5-3-2.

Taxpayer disagrees with the audit's decision maintaining that the book contains information necessary during the production of its pharmaceutical products.

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 Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Taxpayer suggests that the USP is necessary in the production of Taxpayer's pharmaceutical products. Taxpayer is correct to the extent that the state's gross retail tax does not apply to sales of manufacturing

machinery, tools, and equipment directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property. ([45 IAC 2.2-5-8](#)). However, there is no evidence that the USP directly acts upon or affects Taxpayer's products. The USP may be "necessary" but [45 IAC 2.2-5-10\(g\)](#) explains as follows:

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, of itself, mean that the property "acts upon and has an immediate effect on the tangible personal property being processed or refined."

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.

There is no evidence that the USP acts directly upon or affects Taxpayer's pharmaceutical products.

FINDING

Taxpayer's protest is respectfully denied.

II. Exempt Sales Transactions – Gross Retail Tax.

DISCUSSION

During the course of the administrative hearing, Taxpayer's representatives provided exemption certificates from two customers. Taxpayer asks that the Department adjust the audit assessment to reflect the fact that it was not required to collect sales tax from the customers represented by the exemption certificates.

Taxpayer is correct that under certain circumstances, a retail merchant is not required to collect sales tax. Under IC § 6-2.5-8-8(a), "A person... who makes a purchase in a transaction which is exempt from the state gross retail tax and use taxes, may issue an exemption certificate to the seller instead of paying the tax." Once the purchaser provides the exemption certificate, the retail merchant is under no obligation to collect sales tax on the transaction. IC § 6-2.5-8-8(a) states that, "A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase."

Because Taxpayer has belatedly provided exemption certificates relevant to certain of the challenged assessments, Taxpayer has met its burden under IC § 6-8.1-5-1(c) of demonstrating that certain of the original sales tax assessments may be incorrect. Therefore, the Audit Division is respectfully requested to review the newly submitted exemption certificates and to make whatever adjustments as may be found appropriate.

FINDING

Subject to audit review, Taxpayer's protest is sustained.

III. Laboratory Equipment and Supplies – Gross Retail Tax.

DISCUSSION

Taxpayer purchased various items of laboratory equipment and supplies. Taxpayer maintains that it is not required to pay sales tax or self-assess use tax on the purchases. Taxpayer explains, "Our opinion is that all lab tests for ingredients and to produce a product are in-process tests and therefore, exempt from sales/use tax."

The Department's audit report states that "testing must be on done on [Taxpayer's] water and chemicals to ensure it will meet the required quality standard associated with the [pharmaceutical] products they sell." However, the audit determined that only a portion of the equipment was used in Taxpayer's production process citing to [45 IAC 2.2-5-8\(d\)](#) as authority. That portion of the regulation 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.

The audit concluded that a certain percentage of the testing equipment and supplies are used either before or after Taxpayer's production process and granted a partial sales/use tax exemption to that effect. Taxpayer maintains that the audit erred in determining that a portion of the equipment and supplies were used outside the production of Taxpayer's pharmaceuticals.

IC § 6-2.5-5-3(b) 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, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property."

[45 IAC 2.2-5-8\(c\)](#) makes clear that, in order to qualify for the exemption, the equipment must "have an immediate effect on the article being produced." The rule inherently recognizes that some equipment and supplies will not qualify because the items are utilized before production begins. [45 IAC 2.2-5-8\(d\)](#) deals with "preproduction" and "post production" and states in relevant part:

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 argues that its pharmaceutical production begins at the point raw materials are first introduced into the production facility and presumably ends only when the product is shipped from that facility.

In applying any tax exemption such as that sought by Taxpayer, 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). 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.

Taxpayer's pharmaceutical production necessarily has a beginning point and an end-point. Taxpayer disagrees with the audit's interpretation of when and where production begins and when it ends. Although, the laboratory equipment and supplies are certainly not frivolous and very likely "necessary," seriousness of purpose and "necessity are not the exemption's benchmark." See [45 IAC 2.2-5-10\(g\)](#). The Department is unable to agree that Taxpayer has met its burden under IC § 6-8.1-5-1(c) of demonstrating that the laboratory equipment and supplies are exempt and that the original assessment was "wrong."

FINDING

Taxpayer's protest is respectfully denied.

IV. Forklift Battery – Gross Retail Tax.

DISCUSSION

Taxpayer purchased a battery for its forklift. The audit determined that the forklift – and by necessity the battery – were used in an exempt manner five percent of the time and the remainder of the time was used in a non-exempt manner. Taxpayer disagrees stating that the forklift battery is used in an exempt manner ten percent of the time.

[45 IAC 2.2-5-8\(f\)](#) sets out the rule for determining when equipment such as forklift is used in an exempt manner and when it is used in a non-exempt manner.

(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.

Taxpayer simply makes a bare statement that the exempt percentage is incorrect but provides nothing to substantiate that assertion. The Department is unable to agree that Taxpayer has not met its burden under IC § 6-8.1-5-1(c) of demonstrating that the forklift is used in an exempt manner ten-percent of the time and not five percent of the time.

FINDING

Taxpayer's protest is respectfully denied.

V. Imposition – Consumer Use Tax.

DISCUSSION

The audit assessed Taxpayer use tax. Taxpayer now argues that the assessments are unwarranted because it can – belatedly – supply documentation which establishes that it paid sales tax at the time Taxpayer acquired the property.

As noted above, IC § 6-2.5-2-1 imposes a sales tax, known as the state gross retail tax, on retail transactions made in Indiana unless a valid exemption is applicable. A complementary 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. IC § 6-2.5-3-2.

However, an exemption is provided if "the property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property...." IC § 6-2.5-3-4.

Taxpayer provided documentation purporting to establish that the audit's assessment of tax should be adjusted to reflect its position that the supplementary documentation establishes that it paid sales tax when it acquired the property.

The audit division is requested to review the documentation and to make whatever adjustment is deems appropriate.

FINDING

Taxpayer's protest is sustained subject to audit review.

SUMMARY

The Audit Division is requested to review the exemption certificates and invoices mentioned in Parts II and V; in all other respects, Taxpayer's protest is denied.

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