

Letter of Findings: 04-20130289
Gross Retail 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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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. Direct Production – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-2(a); IC § 6-2.5-5-3; IC § 6-8.1-5-1(c); *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); *Indiana Dept. of State Revenue 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); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-10](#).

Taxpayer argues that certain items of tangible personal property it purchased are exempt from sales/use tax because the items were directly used in its manufacturing process.

II. Services – Gross Retail Tax.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-4-1(a); IC § 6-2.5-4-1(b).

Taxpayer maintains that the amounts it paid to certain vendors were exempt from sales/use tax because the vendors provided only services and not tangible personal property.

III. Construction Contracts – Gross Retail Tax.

Authority: [45 IAC 2.2-3-9\(e\)](#).

Taxpayer claims that it was not required to pay sales/use tax on lump-sum construction contracts.

IV. Maintenance Contracts – Gross Retail Tax.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-4-1; IC § 6-2.5-4-1(b); IC § 6-8.1-5-1(c); [45 IAC 2.2-4-2\(a\)](#).

Taxpayer argues that the prices it paid for various maintenance agreements were not subject to sales or use tax because the agreements do not include the provision of tangible personal property.

V. Packaging Materials – Gross Retail Tax.

Authority: IC § 6-2.5-5-9(d); [45 IAC 2.2-5-16\(a\)](#); [45 IAC 2.2-5-16\(d\)\(1\)](#).

Taxpayer states that it purchased various packaging materials which are exempt from sales/use tax.

VI. Out-of-State Delivery – Gross Retail Tax.

Authority: IC § 6-2.5-2-1(b); IC § 6-2.5-3-2(e); IC § 6-8.1-5-1(c).

Taxpayer argues that it was not required to pay sales/use tax on transactions in which the tangible personal property was shipped to out-of-state locations.

VII. Executive Reimbursements – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c).

Taxpayer argues that it was not required to pay sales tax or self assess use tax when it reimbursed one of its executive staff members for expenses.

VIII. Subscriptions – Gross Retail Tax.

Authority: [45 IAC 2.2-4-2\(a\)](#).

Taxpayer states that it was not required to pay sales tax or self-assess use tax on the amount it paid for membership/magazine subscriptions.

IX. Installation Charges – Gross Retail Tax.

Authority: IC § 6-2.5-1-5(b).

Taxpayer maintains that separately stated installation charges are exempt from sales tax.

STATEMENT OF FACTS

Taxpayer operates an Indiana manufacturing facility. Taxpayer manufactures mechanical equipment and also services that equipment. In addition, Taxpayer is a registered retail merchant selling its products to various private and government customers.

The Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's records. The audit resulted in the assessment of additional tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted and this Letter of Findings results.

I. Direct Production – Gross Retail Tax.

DISCUSSION

Taxpayer states that it purchased items of tangible personal property exempt from sales/use tax because the items are used in the production of the tangible personal property it manufactures.

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 makes no specific legal argument but apparently relies on two regulations which state as follows:

(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. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

(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. (45 IAC 2.2-5-8).

Taxpayer also apparently relies on 45 IAC 2.2-5-10 which states:

(a) In general, all purchases of tangible personal property by persons engaged in the processing or refining of tangible personal property are taxable. The exemption provided in this regulation [45 IAC 2.2] extends only to manufacturing machinery, tools, and equipment used in direct production. It does not apply to materials consumed in production or to materials incorporated into the tangible personal property produced.

Additionally, the exemption provided in this regulation [45 IAC 2.2] extends to industrial processors. An industrial processor, as defined in IC 6-2.5-4-2, is one who:

- (1) acquires tangible personal property owned by another person;
- (2) provides industrial processing or servicing, including enameling or plating, on the property; and
- (3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.

(b) The state gross retail tax will not apply to sales of manufacturing machinery, tools, and equipment which are to be directly used by the purchaser in processing or refining tangible personal property.

(c) Purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in processing or refining are exempt from tax; provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the tangible personal property being processed or refined. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which processes or refines tangible personal property. (Emphasis added).

The statutory authority for the above-cited regulations is found at IC § 6-2.5-5-3 which states in part:

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. IC § 6-2.5-5-3(b) (Emphasis added).

As a threshold issue – as with all the items and transactions addressed within this Letter of Findings – it is the Taxpayer's responsibility to establish that the existing tax assessment is wrong. 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."

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). A statute which provides a tax exemption, 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.

The "manufacturing exemption" as set out in IC § 6-2.5-5-3, 45 IAC 2.2-5-8, and 45 IAC 2.2-5-10, 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).

In order to qualify for the exemption, both the regulation and the statute require that the equipment at issue

be "directly used" in "direct production." That means that the equipment or device must have an "immediate effect" on the manufactured items being produced by Taxpayer.

Taxpayer has provided sufficient information to establish that the following transaction represents the acquisition of materials or equipment directly involved in Taxpayer's production process and which has an immediate effect on the Taxpayer's products;

Invoice F59663; \$30.00

Taxpayer has also provided documents such as invoices related to the acquisition of various items such as "Pallets, "machining/coolant system," "Elliott Equipment," "Propane," "modular plug-in lighting," and the like on the ground that these items or supplies are directly involved in Taxpayer's production process and which presumably have an immediate effect on Taxpayer's products. Perhaps so, but there is no independent documentation, explanation, or confirmation for Taxpayer's position. There is simply Taxpayer's assertion that the items are used in direct production of Taxpayer's mechanical products and that items have an "immediate" effect on those items. Bearing in mind that the exemption is "strictly construed against exemption," the Department must conclude that Taxpayer has not met its burden of demonstrating that the exemption applies to these additional items.

FINDING

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

II. Services – Gross Retail Tax.

DISCUSSION

IC § 6-2.5-2-1(a) imposes sales tax on retail transactions made in Indiana. IC § 6-2.5-1-2 defines a retail transaction as "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4-1 . . . or that is described in any other section of IC § 6-2.5-4." IC § 6-2.5-4-1(a) provides that "[a] person is a retail merchant making a retail transaction when he engages in selling at retail." IC § 6-2.5-4-1(b) further explains that a person sells at retail when he "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration."

A transaction subject to the state's sales tax necessarily involves the transfer of "tangible personal property."

A review of the invoices provided by Taxpayer establishes that the following invoices represent costs paid for services.

Invoice 1266; Inc. \$1,950.00

Invoice 12032; \$2,385.00

Invoice 12192; \$405.00

Invoice 12457; \$500.00

Invoice 13942; \$2,300.00

Invoice 022655; \$670.00

Invoice 26503; \$405.00

Invoice D0304; \$153.34

Invoice 211712; \$3,355.00

The Audit Division is requested to review the result of the original audit and remove the transactions noted above.

FINDING

To the extent that Taxpayer provided invoices demonstrating that the underlying transactions represent services only, Taxpayer's protest is sustained.

III. Construction Contracts – Gross Retail Tax.

DISCUSSION

Taxpayer protests the assessment of sales/use tax on lump-sum contracts it argues were for improvements to real property. Taxpayer cites to no legal authority but apparently relies in general on [45 IAC 2.2-3-9\(e\)](#) which states in part:

With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner . . . (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

Taxpayer has met its burden of demonstrating that the following represent lump sum contracts for which no use tax is due by Taxpayer.

Purchase Order X5602; LLC \$6,480.55

Purchase Order X5601; LLC \$2,383.00

Purchase Order X5381; LLC \$2,850.00

Purchase Order X5600; LLC \$4,758.00

Purchase Order 4504633922; LLC \$6,299.00

Purchase Order 4504308279; LLC \$1,695.00

Purchase Order 4504608279; LLC \$1,090.00

Purchase Order X-5638; LLC \$5,874.00

Purchase Order X-CAPX; \$2,313.00
Purchase Order X-6478; \$4,888.00

FINDING

To the extent that Taxpayer provided invoices demonstrating that the underlying transactions represent "lump-sum contracts," Taxpayer's protest is sustained.

IV. Maintenance Contracts – Gross Retail Tax.

DISCUSSION

Taxpayer argues that it was not required to pay sales tax or self-assess use tax on payments for "maintenance contracts" because the documents provided specify that the vendor will only supply services and will not provide tangible personal property.

Taxpayer maintains that payments it made on maintenance contracts are exempt. IC § 6-2.5-2-1(a) imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-4-1 provides that a retail transaction occurs when a seller "acquires tangible personal property for the purpose of resale; and . . . transfers that property to another for consideration." IC § 6-2.5-4-1(b).

Nonetheless [45 IAC 2.2-4-2](#)(a) in part states that, "Professional services, personal services, and services in respect to property not owned by the person rendering such services are not 'transactions of a retail merchant constituting selling at retail', and are not subject to gross retail tax."

The issue is whether the maintenance agreements into which taxpayer entered were subject to sales tax or whether the agreements merely constitute exempt contracts for the provision of professional services.

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."

Taxpayer has provided sufficient information to establish that the following transactions are exempt from sales or use tax.

Invoice F11303; \$1,210.00
Invoice F11518; \$1,210.00
Invoice F10903; \$1,210.00
Invoice F11082; \$1,210.00

FINDING

With regard to the transactions noted above, Taxpayer's protest is sustained.

V. Packaging Materials – Gross Retail Tax.

DISCUSSION

Taxpayer maintains it was not required to pay sales tax or self-assess use tax on the purchase of various packaging supplies.

IC § 6-2.5-5-9(d) provides that "[s]ales of wrapping materials and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as non-returnable packages for selling the contents that he adds." The applicable companion regulation is found at [45 IAC 2.2-5-16](#)(a) which states that "[t]he state gross retail tax shall not apply to sales of non-returnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added." The regulation goes on to state that, in order to qualify for the exemption, "non-returnable wrapping materials and empty containers must be used by the purchaser in the following way: (A) The purchaser must add contents to the containers purchased; and (B) The purchaser must sell the contents added." [45 IAC 2.2-5-16](#)(d)(1).

Taxpayer purchased pallets which it argues are not subject to tax. If Taxpayer uses the pallets to ship its products to its customers, the pallets are not exempt because pallets are "returnable" and do not fall within [45 IAC 2.2-5-16](#)(a). Alternatively, If Taxpayer's argument is that the pallets are used to transport its products within the production process, the argument fails because Taxpayer has not provided information to establish the premise.

Taxpayer also paid for staples, tape, "hot melt," "gray iron," all of which purportedly are used as wrapping or shipping materials. As with the pallets noted above in Part I, Taxpayer has not provided sufficient information to establish that it is entitled to this exemption.

FINDING

Taxpayer's protest is respectfully denied.

VI. Out-of-State Delivery – Gross Retail Tax.

DISCUSSION

Taxpayer purchased certain items from an Indiana vendor. Taxpayer argues it should have been provided a "credit" for taxes paid on the purchase of the items because the property was destined to be shipped to and used at out-of-state locations.

Indiana imposes an excise tax, "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).

As noted previously, it is 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."

Taxpayer has not provided any legal authority in support of its protest. Taxpayer presumably relies on IC § 6-2.5-3-2(e) which states:

Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:

- (1) the property is delivered into Indiana by or for the purchaser of the property;
- (2) the property is delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and
- (3) the property is subsequently transported out of state for use solely outside Indiana.

In this case, Taxpayer bought materials from an Indiana vendor. Taxpayer states that it never took delivery of the materials but that the materials were shipped directly to an out-of-state location. Taxpayer's documentation establishes nothing of the sort; Indiana purchaser was purchasing materials from an Indiana vendor and the authority upon which Taxpayer apparently relies is inapplicable.

FINDING

Taxpayer's protest is respectfully denied.

VII. Executive Reimbursements – Gross Retail Tax.

DISCUSSION

Taxpayer reimbursed one of its executive staff members for certain expenses. Taxpayer argues that it was not required to pay sales tax or self-assess use tax on the reimbursements.

As first stated in Part I above, it is the Taxpayer's responsibility to establish that the existing tax assessment is wrong. IC § 6-8.1-5-1(c). In this particular instance, Taxpayer has not set out the arguments which either explain the circumstances underlying the reimbursements or the legal basis for its argument. In one particular instance, Taxpayer reimbursed its executive \$7,410.55. Were the expenses exempt on their face or does Taxpayer maintain that the reimbursements were inherently exempt because Taxpayer did not acquire the underlying tangible personal property?

Taxpayer has not provided sufficient information to conclude that the underlying transactions were not subject to tax.

FINDING

Taxpayer's protest is respectfully denied.

VIII. Subscriptions – Gross Retail Tax.

DISCUSSION

Taxpayer paid for 16 membership/magazine subscriptions. Taxpayer maintains that the subscriptions were exempt from sales/use tax.

Taxpayer cites to no legal authority for its argument. Presumably Taxpayer relies [45 IAC 2.2-4-2\(a\)](#) which states as follows:

Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless . . . (3) the price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge

The subscriptions cost approximately \$20 each. There is no indication that the \$20 represents primarily exempt services and not simply the price it pays to subscribe to a magazine.

The information is insufficient to sustain Taxpayer's argument that the magazine/membership subscriptions are exempt.

FINDING

Taxpayer's protest is respectfully denied.

IX. Installation Charges – Gross Retail Tax.

DISCUSSION

Taxpayer argues that it is not required to pay sales tax or self-assess use tax on that portion of certain invoices which represent separately stated installation or labor charges. Taxpayer offers no legal argument but presumably relies on IC § 6-2.5-1-5(b) which states:

"Gross retail income" does not include that part of the gross receipts attributable to:

- (1) the value of any tangible personal property received in a like kind exchange in the retail transaction, if the value of the property given in exchange is separately stated on the invoice, bill of sale, or similar document given to the purchaser;
- (2) the receipts received in a retail transaction which constitute interest, finance charges, or insurance premiums on either a promissory note or an installment sales contract;
- (3) discounts, including cash, terms, or coupons that are not reimbursed by a third party that are allowed by

a seller and taken by a purchaser on a sale;

(4) interest, financing, and carrying charges from credit extended on the sale of personal property if the amount is separately stated on the invoice, bill of sale, or similar document given to the purchaser;

(5) any taxes legally imposed directly on the consumer that are separately stated on the invoice, bill of sale, or similar document given to the purchaser; or

(6) installation charges that are separately stated on the invoice, bill of sale, or similar document given to the purchaser. (Emphasis added).

Taxpayer has provided invoices that fall within the statutory exclusion of installation charges from the definition of "gross retail income."

Invoice 50731; \$415.00

Invoice 525668; \$2,300.00

Invoice 788543; \$330.00

Invoice 030853; \$5,625.00

Invoice 10-2208-02; \$11,550.00

Invoice 10-2208-04; \$2,720.00

Invoice 9005; LLC \$245.70; \$303.60

FINDING

To the extent that Taxpayer provided information establishing that certain transactions represent installation charges, Taxpayer's protest is sustained.

SUMMARY

The Audit Division is requested to review the original 2013 audit report and – based on the above specific findings – make whatever adjustments to the original proposed assessment it deems appropriate.

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