

Letter of Findings: 04-20130562
Gross Retail Tax
For the Years 2010 through 2012

NOTICE: [IC 6-8.1-3-3.5](#) and [IC 4-22-7-7](#) require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUES

I. Sales and Use Tax—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 6-2.5-5-8](#); [IC 6-8.1-5-1](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-12](#); [45 IAC 15-3-2](#); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); General Motors Corp. v. Indiana Dep't of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991).

Taxpayer protests the assessment of use tax on certain of its purchases.

II. Sales and Use Tax—Exempt Sales.

Authority: [IC 6-2.5-1-5](#); [IC 6-2.5-4-1](#); [IC 6-2.5-8-8](#); [IC 6-8.1-5-1](#); [45 IAC 2.2-8-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of sales tax on the sales it maintains were sold to exempt entities.

STATEMENT OF FACTS

Taxpayer manufactures and installs floating dock systems, boat lifts and the like. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for the 2010 through 2012 tax years. The Department's audit found that Taxpayer had made taxable sales and did not have a record of exemption certificates for any of those sales. The audit also found that Taxpayer did not pay sales tax on items purchased. Therefore, pursuant to the audit, the Department assessed Taxpayer additional sales and use tax. Taxpayer protested the assessment of additional sales and use tax. An administrative hearing was held, and this Letter of Findings ensues. Additional information will be provided as necessary.

I. Sales and Use Tax—Exemption.

DISCUSSION

The Department found that Taxpayer purchased machinery and equipment without paying sales tax at the time of purchase, and assessed use tax on the purchases. Taxpayer maintains that purchase of bungee cords is exempt because they were resold to customers, and that its purchase of the air powered mist coolant is exempt because it is used in the direct manufacturing of its customers' products.

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.

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). "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 Dep't 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." RCA, 310 N.E.2d at 101. 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.

Taxpayer asserts that an air powered mist coolant it purchased without paying sales tax is directly used in its manufacturing process. Taxpayer uses the air powered mist coolant to cool a horizontal drill Taxpayer uses to make posts for docks. 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\(a\)](#). However, [IC 6-2.5-5-3\(b\)](#) provides in relevant part:

[T]ransactions 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. (Emphasis added).**

Machinery, tools, and equipment acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-8\(c\)](#). [45 IAC 2.2-5-8\(d\)](#) excludes pre-production and post production activities by providing that "direct use in the production process" begins at the point of 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 complete form." Therefore, proper application of the exemption requires determining at what point "production" begins and at what point "production" ends.

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

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.

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.

Accordingly, tangible personal property purchased for use in the production of a manufactured good is subject to sales and use tax unless the property used has an immediate effect on and is essential to the production of the marketable good. Thus, it is only the property that has an immediate effect on and is essential to the direct production of a marketable good that is exempt. However, Taxpayer has not sufficiently explained how the "air powered mist coolant" has an immediate effect on the posts or crossbars of a dock.

Taxpayer purchased bungee cords, which it claims to have resold to its customers so that they could attach boat canopies cover to a frame. [IC 6-2.5-5-8\(b\)](#) provides in pertinent:

Transactions involving tangible personal property . . . are exempt from state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.

In the course of the protest process, Taxpayer provided documentation supporting its position that the bungee cords were purchased for resale. After a review of the documentation, Taxpayer has established that the sales in question were for resale and so were eligible for the exemption provided under [IC 6-2.5-5-8\(b\)](#). Taxpayer has met the burden of proving the imposition of use tax on its purchases of bungee cords incorrect, as required by [IC 6-8.1-5-1\(c\)](#).

FINDING

Taxpayer's protest is respectfully denied with regards to the air powered mist coolant. The protest is sustained with regards to the purchase of bungee cords.

II. Sales and Use Tax—Exempt Sales.

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).

During the course of the administrative hearing, Taxpayer's representative explained that Taxpayer could provide exemption certificates for some of its customers. Taxpayer asked 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 such as Taxpayer 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."

Taxpayer belatedly provided exemption certificates purportedly relevant to some of the challenged assessments. However, the certificates presented are not contemporaneous to the transactions at issue. For example, Taxpayer supplied a Form ST-105 dated March 24, 2013; however, the transactions at issue occurred prior to March 2013. Therefore, Taxpayer has not met its burden under [IC 6-8.1-5-1\(c\)](#) of demonstrating that the original sales tax assessments were incorrect.

The relevant regulation is [45 IAC 2.2-8-12\(b\)](#) which states, "Retail merchants are required to collect sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used for an exempt purpose." The regulation cautions that, "Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the necessity for such proof." [45 IAC 2.2-8-12\(d\)](#). Therefore, if the purchaser claims an exemption, the exemption certificate should be obtained at the time the transaction occurs; otherwise, the burden on the retail merchant of proving the transaction was exempt becomes measurably more difficult.

Taxpayer was informed that it would have to request that its purportedly exempt customers fill out an AD-70 form, which is the form used to allow exemption after the transaction has occurred. Taxpayer has been given the opportunity to provide AD-70 forms. The Department is prepared to accept the exemption certificates Taxpayer has presented, on condition that if the exemption certificate is dated after the particular transaction(s) occurred, that exemption certificate must be accompanied by a properly completed AD-70. Taxpayer provided several completed AD-70 forms. Taxpayer's file will be returned to the audit division for a supplemental audit of the documentation provided.

Additionally, Taxpayer provided two invoices for a customer for whom they could not obtain an AD-70. While Taxpayer acknowledges that without the exemption certificate or an AD-70 the majority of the invoice items are subject to sales tax, Taxpayer notes that the separately stated labor charges should not be subject to sales tax. However, the amount cited by the Taxpayer includes separate charges for "dock assembly" and "installation." The "installation" charge would not be subject to sales tax because "installation charges that are separately stated on [an] invoice" are not "gross retail income" subject to sales tax. [IC 6-2.5-1-5](#). The "assembly" charge would be subject to sales tax, because "bona fide charges which are made for preparation, fabrication . . . finishing, completion . . . or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records" are taxable. [IC 6-2.5-4-1\(e\)\(2\)](#).

Accordingly, Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest is denied to the extent that AD-70 forms are not presented to the Department for the transactions, or that the nonexempt customer mentioned above paid for anything but "installation" charges. However, Taxpayer's protest is sustained to the extent that a properly completed AD-70 form is presented to the Department, subject to the results of a supplemental audit consistent with the above, and to the extent that separately stated charges were made for "installation" for the otherwise nonexempt customer.

FINDING

Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest is denied to the extent that AD-70 forms are not presented to the Department for the transactions. However, Taxpayer's protest is sustained to extent that a completed AD-70 is presented to the Department, subject to the results of a supplemental audit, and to the extent that separately stated charges were made for "installation" for the otherwise nonexempt customer.

SUMMARY

Issue I. Taxpayer's protest is denied with regards to the air powered mist coolant. The protest is sustained with regards to the purchase of bungee cords. Issue II. Taxpayer's protest is denied to the extent that AD-70 forms are not presented to the Department for the transactions, or that the nonexempt customer mentioned above paid for anything but "installation" charges. However, Taxpayer's protest is sustained to the extent that a properly completed AD-70 form is presented to the Department, subject to the results of a supplemental audit consistent with the above, and to the extent that separately stated charges were made for "installation" for the otherwise nonexempt customer.

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