

**Letter of Findings Number: 04-20140010**  
**Use Tax**  
**For Tax Years 2010-2012**

**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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

**ISSUE**

**I. Use Tax–Exemption.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-5-6; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#).

Taxpayer protests proposed use tax assessments.

**STATEMENT OF FACTS**

Taxpayer is an out-of-state corporation with Indiana activities. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid use tax on some items produced by Taxpayer as promotional samples. This resulted in proposed assessments for use tax and interest. Taxpayer protests the proposed assessments since the items were only temporarily stored in Indiana and were subsequently used outside Indiana. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Use Tax–Exemption.**

**DISCUSSION**

Taxpayer protests the imposition of use tax on items manufactured in Indiana and then used as promotional items in other states. Since Taxpayer had previously purchased the materials exempt from sales or use tax, the Department concluded that Taxpayer's manufacturing of samples that were given away as promotional materials constituted a first use of materials in Indiana, subjecting such materials to use tax. Taxpayer disagrees and states that the materials remain exempt. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

Sales tax is imposed by IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Use tax is imposed under IC § 6-2.5-3-2(a), which states:

An 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, regardless of the location of that transaction or of the retail merchant making that transaction.

[45 IAC 2.2-3-4](#) further explains:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction, or if there is an applicable exemption to sales and use taxes.

The Department refers to IC § 6-2.5-5-6, which states in relevant part:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing. (Emphasis added).

Therefore, purchases of raw materials used in the direct production of other tangible personal property in the Taxpayer's business of manufacturing will be exempt. As for items which are used as free samples and are not part of retail transactions, a three part test exists.

Of relevance is IC §6-2.5-3-2, which states in relevant parts:

- (d) The use tax is imposed on a person who:
  - (1) manufactures, fabricates, or assembles tangible personal property from materials either within or outside Indiana; and
  - (2) uses, stores, distributes, or consumes tangible personal property in Indiana.
- (e) 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.

...  
(Emphasis added).

The reason for exemption found here, focuses on three distinct elements, all of which must be met in order to avoid use tax. Here, Taxpayer provided samples in Indiana and other states for marketing purposes. Taxpayer manufactured such samples at an Indiana location prior to shipment. The auditor viewed Taxpayer's manufacturing of samples as an exercise of right or power of ownership over the materials so used, since the samples were manufactured in Indiana. This was because the samples were no longer for sale, thus disqualifying the items from the initial exemption which requires a retail sale.

However, the three part test found in IC §6-2.5-3-2 must be considered for the manufacture of samples subsequently shipped out of Indiana for use solely outside Indiana. Here, Taxpayer has met this test. The exercising of right or power over tangible personal property which is sent out of state to be used, does not give rise to a use tax if the property was delivered to the Taxpayer from out of state, and then manufactured into another tangible personal property item. Since this test includes the out of state use element, samples pulled out of inventory and used in Indiana will fail this test, resulting in use tax being owed.

Therefore, as a result of the protest process, Taxpayer is sustained on the issue of raw material used for the direct production of samples sent out of state.

### FINDING

Taxpayer's protest is sustained as provided above.

Posted: 09/24/2014 by Legislative Services Agency  
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