

DEPARTMENT OF STATE REVENUE

04-20130412.LOF

Letter of Findings Number: 04-20130412
Sales/Use Tax
For Tax Years 2008 & 2009

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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. Sales/Use Tax—Manufacturing Exemptions.**

Authority: IC § 6-8.1-5-1; IC § 6-2.5-5-30; IC § 6-8.1-9-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-3-8](#); [45 IAC 15-9-2](#); Wendt LLP v. Indiana Dept. of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012).

Taxpayer protests the Department's assessment of use tax; Taxpayer also protests purported overpayments of sales tax.

STATEMENT OF FACTS

For the years at issue, Taxpayer had business locations in two Indiana cities. Taxpayer manufactured railroad-related ties (e.g., crossties). Taxpayer was audited for sales and use tax by the Indiana Department of Revenue ("Department"), for the years 2008 and 2009. As a result of the audit, the Department issued Taxpayer a proposed assessment for use tax. Taxpayer filed a protest; an administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales/Use Tax –Manufacturing Exemptions.**DISCUSSION**

At the outset, 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).

In a protest letter to the Department, Taxpayer's representative states that the protest consists of three parts: (1) capital purchases; (2) sampled expense purchases; and (3) "[o]verpayments that [Taxpayer] made on purchases exempt from sales & use tax"

Capital Purchases:

The first protested issue is capital purchases. Taxpayer states regarding its process:

The wood is unloaded from the vendor's truck via a fork truck and placed into a temporary storage part of the plant (dead stack) until they can be moved to the tie sorter building for grading and inspection. Their customers require specific specifications that differ from customer to customer. Therefore, they must also grade and trim the ends of the incoming wood so that the wood will become a specific size and grade of crosstie and/or switchtie that meets various customer specifications. Along with this grading process, the tie is run through an incisor that imbeds razor teeth holes into the ties to relieve pressure and keep the wood from breaking apart. **After the ties have been graded and incised, they proceed down the conveyor roller system, which is a staging process. A crane hoist picks up 5 to 6 ties at a time to stack into trams.** These ties are strapped together with steel banding, which keeps the ties from floating out of control while inside of the treating cylinder, and placed upon trams.

These trammed ties are then pushed down a track system to a Drip Management System (DMS) building. At the DMS building, the ties are transferred from "dirty" trams and put onto trams that are specifically for treating. This eliminates bringing dirt into the DMS building, as well as contamination of the ground outside after treating. The DMS building is a federal government agency mandated building that keeps any spillage of creosote contained within the confines of the building. It also contains a specialized floor that keeps any spillage from contaminating the ground soil. In addition, this building is mandated by the

EPA or they could not open or continue business.

When the ties reach the DMS building and are transferred onto "treating trams," they are banded onto these trams to keep the bundles from floating out of control while inside the cylinders. A motorized pulley system pulls the ties in and out of the cylinders. While the ties are in the cylinders, hot oils are pumped into the cylinders. This causes the pores of the wood to open. A vacuum is drawn back out of the cylinders pulling out the hot oils and any moisture that was in the ties after the pores opened up. **Then hot creosote is forced into the cylinders under pressure which forces creosote to penetrate into the ties and act as a preservative.** After a release of the pressure and drainage of the excess creosote back into working tanks, the ties are pulled from the cylinders. They must remain in the DMS building for a cooling period before they can be taken back out of the DMS building and placed into a storage area for outbound shipping.

The [Indiana city] facility also has a portion of the plant that manufactures creosote, to be used in the manufacturing process. Coal comes in on a leased rail care [sic] and is vacuum pumped into a holding tank on a tank farm. It is then pumped into a still, and is heated with natural gas. A boiler is used to heat the creosote tank and keep it warm. In the heating process, the coal separates and the different layers are then pumped into different tanks. The end-products are shipped out on tanker trucks. [**Bold in the original; footnotes omitted**].

Taxpayer protests the various capital purchases. The first item is the wood block conveyor and grapppler head; Taxpayer states that "these conveyors transport the product throughout the production process" and that the grapppler head is used for "tie stacking occurs during the process after ties have been graded, trimmed, and incised." The audit report states that Taxpayer "purchased wood conveyors and a grapppler head for loading/unloading stacking ties," and that it is taxable under [45 IAC 2.2-5-8\(c\)\(4\)\(G\)](#) ("Equipment used to remove raw materials from storage prior to introduction into the production process or to move finished products from the last step of production."). Given Taxpayer's description, in the extended quotation above, the Department finds that the conveyor and grapppler head are part of the integrated production process. The conveyor belt and the grapppler head, to the extent that they are conveying "work-in-process" during the production process, are exempt. For example [45 IAC 2.2-5-8\(f\)\(3\)](#), although talking about transportation equipment, notes that "[t]ransportation 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." The Department's Audit Division will conduct a supplemental audit to verify the percentage of exempt use of the conveyor and grapppler head within the production process.

Next, Taxpayer protests the imposition of use tax upon items that were found to be taxable under [45 IAC 2.2-3-8](#). That regulation states:

- (a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.
- (b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt (see 6-2.5-5 [[45 IAC 2.2-5](#)]).

The items at issue are fans and vents, and also a "bar granting [sic] for exhaust on treatment [building]." Taxpayer believes these items are exempt as "exhaust vents for pollution control." Taxpayer cites to IC § 6-2.5-5-30, which states in part:

- (a) Sales of tangible personal property are exempt from the state gross retail tax if:
 - (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and
 - (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, recycling (as defined in section 45.8 of this chapter), or agriculture.
- (Emphasis added).

Taxpayer asserts that the "DMS building is a federal government agency mandated building" Taxpayer does not cite to any applicable federal, state, or local environmental laws to that effect, and instead simply asserts that the items are fans and vents are exempt. Taxpayer has failed to meet its burden of proof on these items, thus Taxpayer's protest is denied.

The Audit Report also found items relating to a storage tank as taxable, with the report stating: "Taxpayer had

purchased raw material storage tanks, and material for the storage tanks." Taxpayer states that the tanks are not for storage but "are used in the production process to transfer creosote into the rail ties." Regarding a pump at issue, Taxpayer asserts "pumping creosote [sic] is exempt as an integral and necessary part of the process." In the quote from Taxpayer's protest above, Taxpayer states that this portion relates to the storage tank:

Then hot creosote is forced into the cylinders under pressure which forces creosote to penetrate into the ties and act as a preservative.

The tanks are taxable, per [45 IAC 2.2-5-8\(e\)](#) as storage equipment. The tanks, as described by Taxpayer, are pre-production storage tanks. The pump is also taxable as pre-production equipment.

Sampled Expense Purchases:

Taxpayer argues that a rented loader is exempt. Taxpayer argues that the loader is used for destacking ties, which Taxpayer states "occurs after the ties have been trimmed and before they are treated." Taxpayer describes its process as follows:

The wood is unloaded from the vendor's truck via a fork truck and placed into a temporary storage part of the plant (dead stock) until they can be moved to the tie sorter building for grading and inspection. Their customers require specific specifications that differ from customer to customer. Therefore, they must also grade and trim the ends of the incoming wood so that the wood will become a specific size and grade of crosstie and/or switchtie that meets various customer specifications. Along with this grading process, the tie is run through an incisor that imbeds razor teeth holes into the ties to relieve pressure and keep the wood from breaking apart. After the ties have been graded and incised, they proceed down the conveyor roller system, which is a staging process. **A crane hoist picks up 5 to 6 ties at a time to stack into trams.** These ties are strapped together with steel banding, which keeps the ties from floating out of control while inside the treating cylinder and placed upon trams. **[Bold in the original].**

According to Taxpayer, the portion of the above description that relates to the loader is the part that states that a "crane hoist picks up 5 to 6 ties" [45 IAC 2.2-5-8\(f\)\(3\)](#) states:

(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.

To the extent that the loader is used during the production process to move work-in-process, Taxpayer's protest is sustained. The Department's Audit Division will conduct a supplemental audit to verify the percentage of exempt use of the loader within the production process. At the hearing, Taxpayer stated that a forklift was leased and used in Ohio and was thus wrongly in the sample. Taxpayer failed to develop that argument, thus that argument is denied.

Credits/Overpayments:

Regarding issue three, the Department notes that it will only address in this Letter of Findings items that were examined by the audit as part of the sample period. For purported overpayments Taxpayer would need to file a timely claim for refund with the Department. [45 IAC 15-9-2\(b\)](#) states, "The department has no legal method of generating a claim for refund. A claim for refund can only be initiated pursuant to [IC 6-8.1-9-1](#)." And IC § 6-8.1-9-1(a) states:

If a person has paid more tax than the person determines is legally due for a particular taxable period, the person may file a claim for a refund with the department. Except as provided in subsections (f) and (g), in order to obtain the refund, the person must file the claim with the department within three (3) years after the latter of the following:

- (1) The due date of the return.
- (2) The date of payment.

For purposes of this section, the due date for a return filed for the state gross retail or use tax, the gasoline tax, the special fuel tax, the motor carrier fuel tax, the oil inspection fee, or the petroleum severance tax is the end of the calendar year which contains the taxable period for which the return is filed. The claim must set forth the amount of the refund to which the person is entitled and the reasons that the person is entitled to the refund.

Taxpayer claims that it "paid sales tax to vendors on items that are exempt from sales & use tax." Within this

portion of the protest, Taxpayer specifically mentions "forklift taxability listing" and "utilities." Taxpayer provides a "Detail Listing" and "Reason Codes" as well. The "Detail Listing," for example is a spreadsheet that states information such as vendor name, invoice number and date, location, account name and number, invoice amount, tax paid, a brief description, and a reason code. The reason code, in turn, corresponds to the "Reason Codes" sheet that Taxpayer provided. That sheet states things such as the following, which deals with "Manufacturing Machinery"—

Indiana Regulation [45 IAC 2.2-5-8](#)(c) states that manufacturing machinery, tools, and equipment used directly by the purchaser in the production process are exempt from sales and use tax. Tangible personal property is considered to be directly used if it has an immediate effect on the article being produced or if it is an essential and integral part of the process.

The "Reason Codes" is two pages long; it has entries for repair parts, pollution control, utilities, safety supplies, and lubricants. Those entries simply cite either a statute or a regulation.

Regarding any items that were covered by the sample period, Taxpayer does not sufficiently develop and explain its arguments. The "Detail Listing" does not show how and when the items are specifically used by Taxpayer, and the corresponding reason code does not explain how the cited statute or regulation is applicable to the items at issue. The Department notes the Indiana Tax Court case of *Wendt LLP*, where the Court stated in a footnote "that poorly developed and non-cogent arguments are subject to waiver" by the Indiana Tax Court. *Wendt LLP v. Indiana Dept. of State Revenue*, 977 N.E.2d 480, 485 n.9, (Ind. Tax Ct. 2012) (quoting *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010)).

Taxpayer's protest of these items is thus denied.

FINDING

Taxpayer's protest regarding the conveyor belt, grapppler head, and loader, is sustained—subject to audit verification of the percentage of exempt use of the equipment. Taxpayer's protest of all other items and issues is denied.

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