

Letter of Findings 04-20150063
Use Tax
For the Years 2011-2013

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Sawmill could not establish that its loader and diesel fuel for the loader are exempt as directly used in the direct production of wood products. Thus, use tax was properly imposed.

ISSUE

I. Use Tax - Imposition.

Authority: IC § 6-2.5-5-3; IC § 6-2.5-3-2; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-12](#); [45 IAC 2.2-3-14](#); 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); Indiana Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Mynsberge v. Indiana Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Indiana Dep't of State Revenue v. Horizon Bancorp, 644 N.E.2d 870 (Ind. 1994); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d (Ind. Tax Ct. 2012); General Motors Corp. v. Indiana Dep't of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); North Cent. Industries, Inc. v. Indiana Dep't of State Revenue, 790 N.E.2d 198 (Ind. Tax Ct. 2003); IN ST TAX CT Rule 17.

Taxpayer protests the assessment of use tax on loader and diesel fuel for the loader.

STATEMENT OF FACTS

Taxpayer is a sawmill doing business in Indiana. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of the company for the tax years 2011-2013. The Department imposed sales and use tax.

Taxpayer only protests that the loader and diesel fuel used by the loader are exempt from use tax as part of the manufacturing process. An administrative hearing was held in which Power of Attorney represented Taxpayer. This Letter of Finding ensues. Additional facts will be provided as necessary.

I. Use Tax - Imposition.

DISCUSSION

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). Further, when an agency is charged with enforcing a statute, the courts defer to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." Indiana Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

Audit Determination.

The Department examined Taxpayer's 2011-2013 purchase invoices and determined that some purchases were made in which sales or use tax was not paid. In addition, the purchase invoices showed that Taxpayer had purchased diesel fuel for a loader used at the sawmill with no sales or use tax paid. The Department determined that Taxpayer used the loader in the course of moving raw materials and the finished product. The Department went on to cite [45 IAC 2.2-5-8\(f\)](#) stating, that tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable, tangible personal property used for moving finished goods from the plant after the manufacturing process is subject to tax. The Department determined that since the loader was used to move raw materials into the mill and finished products out of the mill the loader and the fuel it uses are subject to use tax.

Taxpayer's Response.

Taxpayer argues that the loader and its fuel are exempt because the loader was acquired by Taxpayer for the direct use in the direct production, manufacture, and fabrication of finished wood products in the sawmill operation. Taxpayer described its process and the percentage of use of the loader for each step of production. Taxpayer estimates that twenty percent of the loader's usage is pre-production, consisting of unloading log trucks and placing logs into storage. Fifty percent of the loader's usage is loading logs onto the "live deck." Ten percent of the loader's usage is to remove bad logs that have been scanned by the scanner, unjamming the log line, and put logs that had foreign objects removed from it back onto the line. Finally, twenty percent is post production. Taxpayer argues that the loading of the "live deck" and removing bad logs, unjamming the log line, and putting logs back onto the line are exempt activities.

Taxpayer argues that the point of first operation of the manufacturing process at the sawmill is when the loader retrieves a selected log from Taxpayer's log storage and places the log on the "live deck." The "live deck" is the initial starting point of the entire machining process that the logs undergo to arrive at the finished wood products. Thus, the loader moves the logs within the initial part of the production process. The loader loading the logs "sets into motion the entire manufacturing process by which Taxpayer produces finished wood products at the sawmill." Taxpayer stated that the manufacturing process cannot start until the loader loads the log onto the "live deck."

Taxpayer further supports its argument by stating that the Indiana General Assembly recently passed legislation that exempts "material-handling equipment purchased for the purpose of transporting materials into such [manufacturing] activities from an onsite location." Senate Enrolled Act No. 441 (2015); IC § 6-2.5-5-3 (effective January 1, 2016). Taxpayer believes that, based on the plain language of IC § 6-2.5-5-3 (effective January 1, 2016), the Legislature intended the scope of the manufacturing exemption always meant to include, "material-handling equipment purchased for the purpose of transporting materials into such [manufacturing] activities from an onsite location."

Finally, Taxpayer stated in its protest that:

Taxpayer [would] also direct the Department's attention to the following case law:

1. Colonial Brick Corp. v. Department of State Revenue, 1998 Ind. Tax LEXIS 70 (Ind. Tax Ct. Jan. 14, 1998). Please note that this is an unpublished decision.
2. Energy Supple, Inc. v. Indiana Department of State Revenue, 549 N.E. 2d 1110 (Ind. Tax Ct. 1990).
3. Indiana Department of State Revenue v. Cave Stone, Inc., 457 N.E. 2d 520 (Ind. 1983).
(Citation taken directly from Taxpayer's protest letter).

Analysis.

Indiana imposes a 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). IC § 6-2.5-5-3(b) provides an exemption from sales tax for "manufacturing machinery, tools, and equipment . . . if the person acquiring the property acquires it for direct use in the direct production [or] manufacture . . . of other tangible personal property." Under [45 IAC 2.2-3-14\(2\)](#) exemptions that also apply to IC § 6-2.5-5 also apply to use tax.

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, unless specifically exempt by a statute. [45 IAC 2.2-5-8\(a\)](#). 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 (quoting *Conklin v. Town of Cambridge City* (1877), 58 Ind. 130, 133). Thus, in applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). The exemptions to which Taxpayer aspires, 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. Indiana Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999).

The Department turns to IC § 6-2.5-5-3(b) to determine whether the loader and its fuel exempt under the manufacturing exemption, which in relevant part, provides:

[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).

In addition, IC § 6-2.5-5-5.1(b), in relevant part, provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it **for direct consumption as a material to be consumed in the direct production of other tangible personal property** in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. (Emphasis added).

An exemption applies to "manufacturing machinery, tools, and equipment directly used by the purchaser in direct production." [45 IAC 2.2-5-8\(b\)](#). Manufacturing machinery, tools, and equipment are directly used in the direct production process "if they have an immediate effect on the article being produced." [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. *Id.* An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#), Example (1). "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" is not exempt because the use of the equipment lacks "an essential and integral relationship with the integrated production system." [45 IAC 2.2-5-8\(c\)](#), Example (4)(G).

[45 IAC 2.2-5-8\(k\)](#) describes direct production as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired. The change must be substantial resulting in a transformation of the property into a different and distinct product. *Id.* The Indiana Tax Court in *General Motors Corp. v. Indiana Dep't of State Revenue*, recognized the essential and integral test to determine whether the double direct standard is met. 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991) (citing *Indiana Department of State Revenue v. Cave Stone, Inc.* 457 N.E.2d 520, 524 (Ind. 1983)). The court held the "transportation equipment at issue was both essential to transforming crude stone into a marketable product and integral to 'the ongoing process of transformation.'" *Id.*

Additionally, the Indiana Tax Court explained in *North Cent. Industries, Inc. v. Indiana Dep't of State Revenue*, 790 N.E.2d 198, 200 (Ind. Tax Ct. 2003):

To qualify for the equipment exemption, North Central must show, in part, that it is engaged in the direct production or manufacture of other tangible personal property. **If it satisfies this element, North Central must then show that the equipment for which it seeks an exemption is directly used in the production of the tangible personal property.**

Although "[t]here are innumerable ways to produce other tangible personal property, [Indiana Code Section 6-2.5-5-3] cannot be expected to give a precise answer to each factual situation that arises." **Nevertheless, the Department's rules make clear that production must entail a "substantial" change or transformation that "places tangible personal property in a form, composition, or character different from that in which it was acquired."** Moreover, production must increase the number of "scarce economic goods," i.e., it must create a new, marketable product. (Emphasis added) (Internal citations omitted).

The exemption for direct consumption in production is further explained at [45 IAC 2.2-5-12](#), in part, as follows:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.
- (b) The exemption provided by this regulation [\[45 IAC 2.2\]](#) applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.
- (c) The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; **i.e., they have an immediate effect on the article being produced. The 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.**

(Emphasis added).

[45 IAC 2.2-5-8\(g\)](#) further explains:

"Have an immediate effect upon the article being produced": 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. (Emphasis added).**

Taxpayer argued that the production process begins when the logs are loaded onto the "live deck." However, based on the language in [45 IAC 2.2-5-8\(k\)](#) and North Cent. Industries, Inc. production begins when there is a first step towards installation of a substantial change in the property state of the tangible personal property. The loader, itself, does not alter the state of the log nor change the composition of the log. Furthermore, while it may be true that the sawmill cannot run without the loader loading logs onto the sawmill line, the loader is not directly involved in the direct production of finished wood products. Taxpayer claims once the log is placed into storage at Taxpayer's facility, it becomes work-in-progress. However, work does not begin until the wood is transformed in some way. Thus, the moving of the log from storage to the "live deck" is the moving of raw material, which is taxable. Just because the loader is essential to the manufacturing of wood products does not "mean that the property has an immediate effect upon the article being produced." [45 IAC 2.2-5-8\(g\)](#).

Second, "A statute that is clear and unambiguous on its face needs no further interpretation beyond the plain and ordinary meaning of the words contained therein," and "must be applied and enforced as written." *Indiana Dep't of State Revenue v. Horizon Bancorp*, 644 N.E.2d 870, 872 (Ind. 1994). Thus, it is clear that the statute in effect in this case meant to exclude "material-handling equipment" from the definition of direct effect on the direct production of tangible personal property. In addition, Taxpayer has not provided any documentation or substantial argument to justify the position the Legislature always intended to include "material-handling equipment" as exempt under the manufacturing exemption. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Thus, Taxpayer's loader always intended to be considered taxable under IC § 6-2.5-5-3. Taxpayer cannot avail itself of a statute not in effect during the periods at issue.

Taxpayer does not explain how the cases it referred to in its protest are related to Taxpayer's in this instance. As stated above in *Scopelite* and *Wendt LLP* poorly developed and non-cogent arguments are subject to waiver. Furthermore, "Memorandum Decisions are not published in the official reporter and shall not be regarded as precedent . . ." IN ST TAX CT Rule 17. In addition, in *General Motors Corp.*, the Indiana Supreme Court held the transportation equipment at issue was both essential to transforming crude stone into a marketable product and integral to "the ongoing process of transformation." *Id.* at 401. It is clear from Taxpayer's description of the loader that placing a log onto the "live deck" is moving raw material.

Taxpayer cannot demonstrate that its loader alters the form of the wood to create a new product and thus exempt under IC § 6-2.5-5-3, because the loader is not exempt the diesel fuel is also not exempt. In addition, Taxpayer

has not demonstrated that the loader is directly involved in the direct production of tangible personal property and thus exempt under IC § 6-2.5-5-3. Finally, Taxpayer cannot support the notion that the Legislature always intended to exempt "material-handling equipment" under IC § 6-2.5-5-3. Thus, the use tax on the loader and diesel fuel is properly assessed.

FINDING

Taxpayer's protest is denied.

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