

Letter of Findings 04-20160085
Use Tax
For the Years 2012-2014

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Brick manufacturer established that its loader and diesel fuel for the loader is exempt as directly used in the direct production of its production. Thus, use tax was not due on the transactions at issue.

ISSUE

I. Use Tax - Imposition.

Authority: IC § 6-2.5-5-3; IC § 6-2.5-3-2; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); [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); North Cent. Industries, Inc. v. Indiana Dep't of State Revenue, 790 N.E.2d 198 (Ind. Tax Ct. 2003); Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

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

STATEMENT OF FACTS

Taxpayer is a manufacturer doing business in Indiana. Taxpayer manufactures silicon based carbide briquettes ("bricks") and concrete blocks. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of the company for the tax years 2012-2014. The Department imposed use tax on several purchases, including the rental of and fuel for two front end loaders.

Taxpayer protests one loader rental and diesel fuel used by the loader. Taxpayer argues that the loader used only for bricks and its fuel is 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.

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 exempted 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 Taxpayer's machines are 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).

[45 IAC 2.2-5-8\(b\)](#) notes:

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.

Property 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 an integrated process which produces tangible personal property." [45 IAC 2.2-5-8\(c\)](#).

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

"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).

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).

In *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520 (Ind. 1983), the taxpayer engaged in mining and claimed that it was entitled to the sales tax exemption under the manufacturing exemption for trucks that haul crude stone. *Id.* The Indiana Supreme Court determined that the trucks themselves do not have to transform the crude stone in order to be exempt; it is enough that the item plays "an integral part of the ongoing process of transformation." *Id.* at 524.

In this case the audit report stated that Taxpayer's process ends when the bricks come out of the kiln and thus the loader is moving a finished product to storage. Taxpayer argues that its process does not end when the bricks are removed from the kiln, because once the bricks are made they need to cure for up to two weeks. Once removed from the kiln, the bricks are moved to an open air storage room to cure 24-48 hours; then the bricks are moved to an outdoor storage bin where they cure for 1-2 weeks. After the bricks have been cured they are put in the "shaker." This "shaker" removes broken pieces and excess debris. Customers only allow up to seven percent excess debris in their orders. Furthermore, Taxpayer provided a study from Penn State University stating that these specific type of bricks need to cure for 2 weeks because of the chemical compounds.

Based on the language in IC § 6-2.5-5-3 and *Cave Stone*, production begins when there is a first step towards installation of a substantial change in the property state of the tangible personal property and ends with a finished product. Taxpayer substantiated that the bricks are not a finished product until they are properly cured and put through the shaker.

Taxpayer demonstrated that its loader is used in the manufacturing process and is thus exempt under IC § 6-2.5-5-3. Since the loader is exempt the diesel fuel is also exempt. Taxpayer has met its burden under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

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