

Supplemental Letter of Findings: 04-20150407R; 04-20150408R; 04-20150409
Gross Retail and Use Tax
For the Years 2010, 2011, and 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 Supplemental Letter of Findings.

HOLDING

The Department found that plastic Manufacturer was entitled to a sales tax exemption on the purchase of ventilation hoods and the rental of flame retardant clothing because the hoods and uniforms were necessary for Manufacturer's employees to safely work within its production facility; Manufacturer was not entitled to an exemption on equipment and nitrogen employed to purge charcoal filters because the equipment and nitrogen were employed outside Manufacturer's direct production of its plastic products.

ISSUES

I. Gross Retail and Use Tax - Equipment Directly Used in Direct Production.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b); IC § 6-2.5-5-2(a); IC § 6-2.5-5-3; IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(c); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Conklin v. Town of Cambridge City, 58 Ind. 130 (1877); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-8\(g\)](#); [45 IAC 2.2-5-8\(h\)](#); [45 IAC 2.2-5-8\(k\)](#); [45 IAC 2.2-5-10\(g\)](#).

Taxpayers argue that their purchases of ventilation hoods, fire resistant uniforms, and equipment used to heat and transport hot nitrogen are exempt from tax because these items are directly used in the production of Taxpayers' plastics.

II. Gross Retail and Use Tax - Consumed in Direct Production.

Authority: IC § 6-2.5-5-5.1(b); Alloy Custom Products, Inc. v. Indiana Dept. of State Revenue, 26 N.E.3d 1078 (Ind. Tax Ct. 2015); [45 IAC 2.2-5-8\(g\)](#); [45 IAC 2.2-5-12](#).

Taxpayers maintain that their purchase of nitrogen is exempt because the nitrogen is consumed in the production of Taxpayers' plastics.

STATEMENT OF FACTS

Three related Indiana companies ("Taxpayers") are in the business of manufacturing plastic and film products. The companies filed claims for refund of sales or use tax. The Indiana Department of Revenue ("Department") reviewed the Taxpayers' refund claims denying the claims in part and granting the claims in part. In addition, the Department issued an assessment of additional sales/use tax. The tax was assessed on items considered during the refund review for which the Department determined the Taxpayers should have paid sales tax at the time the purchases were made or should have subsequently self-assessed use tax.

For simplicity's sake, the three companies are hereinafter referred to as "Taxpayer."

Taxpayer manufactures plastic products including "[Trade Names] resins and films for use in the plastics manufacturing industry." Taxpayer sells its plastic and film products to companies in the automobile, electronic, information technology, consumer, industrial, and health care businesses.

Taxpayer disagreed with that portion of the Department's decision denying it any amount of the requested refund; Taxpayer also disagreed with the assessment of additional tax. Taxpayer submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. A Letter of Findings ("LOF") was issued February 18, 2016. The LOF sustained Taxpayer's protests in part and denied them in part. Taxpayer disagreed and requested a rehearing. The rehearing request was granted but was limited to four discrete issues.

I. Gross Retail and Use Tax - Equipment Directly Used in Direct Production.

DISCUSSION

Taxpayer argues that its purchases of ventilation hoods, fire resistant employee uniforms, and equipment used to heat and transfer hot nitrogen are exempt. Taxpayer maintains that these items are directly used and essential to the production of Taxpayer's plastic products.

As a threshold issue, it is the Taxpayer's responsibility to establish that any 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). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. 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, fn. 9 (Ind. Tax Ct. 2012). Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. 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 investigation, are entitled to deference.

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). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoades v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Id.* at 1048; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 469 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-5-2(a). A taxable retail transaction occurs when: (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b); IC § 6-2.5-3-2(a).

Taxpayer is in the business of manufacturing plastics and films. The general rule is that all purchases of tangible personal property directly used by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property - such as Taxpayer's plastics and film - are taxable. [45 IAC 2.2-5-8\(a\)](#).

However, as authority for its conclusion that certain of its equipment is exempt, Taxpayer cites to the Indiana statute, IC § 6-2.5-5-3, which states in part:

(b) Except as provided in subsection (c), transactions 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.

(c) The exemption provided in subsection (b) does not apply to transactions involving distribution equipment or transmission equipment acquired by a public utility engaged in generating electricity.

The Department's regulation, [45 IAC 2.2-5-8](#), explains that a taxpayer is entitled to purchase machinery, tools, and equipment without payment of the gross retail tax when the equipment is directly used in the direct production of tangible personal property. [45 IAC 2.2-5-8\(a\)](#) emphasizes that the exemption is limited to that equipment "directly used by the purchaser in direct production." [45 IAC 2.2-5-8\(c\)](#) specifies that "directly used" means that the equipment has "an immediate effect on the article being produced." Refining the definition further, the regulation states that "[p]roperty 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." *Id.* See IC § 6-2.5-5-3(b). However, it should also be noted that "[t]he fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required . . . by practical necessity does not itself mean that the property 'has an immediate effect upon the article being produced.'" [45 IAC 2.2-5-8\(g\)](#).

Finally, [45 IAC 2.2-5-8\(k\)](#) specifies that, in order to qualify for the exemption, the articles being produced have undergone a "substantial change."

"Direct production, manufacture, fabrication, assembly, or finishing of tangible personal property" is performance as a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change, and it must result in a transformation of property into a different product having a distinctive name, character, and use. Operations such as compounding, fabricating, or assembling are illustrative of the types of operations which may qualify under this definition.

Proper application of this particular exemption requires determining at what point "production" begins and at what point "production" ends. In part [45 IAC 2.2-5-8\(d\)](#) states:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the 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 completed form, including packaging, if required.

To summarize, machinery, tools, and equipment purchased for use in the production of goods are subject to use tax unless the item has a direct and immediate effect on the goods produced, falls within the actual production process, and is essential to an integrated process used to produce those marketable goods.

In addition, Taxpayer has the burden of establishing that it is entitled to the sought after exemption. In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Rev. v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). 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 (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

A. Extruder Line Extraction Hoods.

Among its other products, Taxpayer produces "pelletized resin." Taxpayer explains this production process:

Within the manufacturing process, plastic strands, run through a water bath, and move on through the process to be cut into pellets. The extruder line extraction hood is positioned about the die head where the plastic strands are extracted. This highly integrated equipment removes vapors which include steam and trace elements of related plastic and chemicals.

During the audit period the extruder line equipment was replaced at both the [redacted] and the [redacted] locations. Because this equipment is so highly integrated in this water bath process, it is essential and integral to Taxpayer's manufacturing process and is exempt under [45 IAC 2.2-5-8\(c\)](#) and [45 IAC 2.2-5-8\(h\)](#).

The regulation on which Taxpayer relied in its protest provides in part as follows:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. 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.

...

(h) Maintenance and replacement equipment.

- (1) Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.
- (2) Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax. [45 IAC 2.2-5-8\(h\)](#).

The Department's audit review found that the ventilation hood were not exempt. As described in that report:

[Taxpayer] purchased and installed exhaust hoods above extruders and in the compounding area to extract vapor, smoke, and fumes from the plant. The hoods capture particles before moving up to roof vents where it is released into the outside air.

The February 2015 Letter of Findings did not agree that the hoods were exempt because "[i]n the case of Taxpayer's ventilation equipment, the hoods do not directly affect Taxpayer's plastics and films" but were 'post-production' equipment outside the purview of the exemption."

In its request for rehearing, Taxpayer has based its argument on a different regulation. Taxpayer cites to [45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#). The regulation provides:

The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

Taxpayer concludes that the hoods are necessary for the safety of its employees. Taxpayer explains the production of the "pelletized resin" results in hazardous byproducts. To that end, Taxpayer has provided third-party documentation outlining dangers associated with these byproducts along with the Occupational Safety and Health Administration ("OSHA") standards for dealing with these byproducts. The third-party documentation specifies - in the case of one of the byproducts - that the substance "can cause severe thermal burns," cautions that overexposure may cause "eye, skin, and respiratory tract irritation," and that "over-exposure may result in nausea, headache, chills, and fever."

Taxpayer has provided documentation sufficient to meet its burden of establishing that the hoods fall within the cited exemption, [45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#).

B. Flame Resistant Uniforms.

Taxpayer leases "flame retardant and ordinary work clothing." Taxpayer explains, "Personnel in certain areas of the plant are required to wear the flame retardant uniforms to perform their production jobs."

Taxpayer originally argued that forty percent of the clothing it rented during the audit period consisted of "required flame retardant for specific personnel." In its rehearing request, Taxpayer restated the percentage of which it believes is exempt; Taxpayer states that 55 percent of the uniforms it leases are necessary in order for its employees to safely work a particular area of Taxpayer's production facilities. Taxpayer states the lease of these uniforms was exempt pursuant to [45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#). The regulation provides:

The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

The February 2015 LOF did not agree that the fire-retardant uniforms were exempt. As explained in the Letter of Findings, "Taxpayer has not provided information sufficient to allow for a conclusion that it is entitled to the exemption on the purchase of this clothing."

In its rehearing, Taxpayer provided an OSHA "interpretation" addressing the question of "How does OSHA enforce the use of flame-resistant clothing in a setting such as a petrochemical plant?" Taxpayer explains that employees "in certain areas of [its] plant are required to wear the flame retardant uniforms to perform their production jobs." Taxpayer further explains:

Based on Site policy, flame resistant . . . clothing is required to be worn by personnel in areas [of] operations where the personal protective . . . evaluation indicates personnel could be exposed to an electrical arc or flash fire burn hazard The 55[percent] estimate is based on a review of monthly invoicing, and represents the [percent] of total clothing pieces being invoiced that are coded as [fire retardant] and not used by the Maintenance Departments.

In addition, Taxpayer provided a spreadsheet which details its inventory of all its rented uniforms "identifying those areas and individuals required to wear the Flame Retardant [] uniforms."

Taxpayer has provided documentation sufficient to meet its burden of establishing that the fire resistant uniforms fall within the cited exemption, [45 IAC 2.2-5-8\(c\)\(2\)\(F\)](#).

C. Hot Nitrogen Production Equipment.

Taxpayer purchased equipment which it used to produce and transport hot nitrogen. Taxpayer argues that the equipment purchases are exempt because the distribution of the hot nitrogen is essential and integral to the production of its plastic products.

Taxpayer manufactures an "industry specific chemical [Chemical] that is further used within the manufacture of its final product." Hot nitrogen is used in the manufacturing of the Chemical. The hot nitrogen is used to "remov[e] sulfur dioxide by regenerating the activated carbon [filters] within the [Chemical] production process" As described by Taxpayer, the inert hot nitrogen is used to "flush" waste sulfur dioxide from Taxpayer's activated charcoal filters. Taxpayer asserts that the flushing of the waste sulfur dioxide regenerates the filters.

Taxpayer explains:

The above described process explains how [Taxpayer's] [Chemical] production process requires the use of hot nitrogen. The process equipment consists of a series of "beds." These beds contain activated carbon. The stream of carbon monoxide flows through the beds of activated carbon, until the process requires the introduction of hot nitrogen to regenerate the activated carbon. [Taxpayer] refers to this process [as] online and offline. This reference does not mean that the machinery is shut down during the introduction of the hot nitrogen. Rather, the process is a cyclical process and the equipment is continually functioning, simply with a different chemical stream running through the beds. [45 IAC 2.2-5-10\(g\)](#).

The regulation which Taxpayer cites provides in part as follows:

Machinery, tools, and equipment used during processing or refining which have an immediate effect upon the tangible personal property being processed or refined are exempt from tax. Component parts of an exempt unit of machinery and equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of the manufacturing unit. [45 IAC 2.2-5-10\(g\)](#).

Taxpayer further explains:

The use of hot nitrogen to regenerate the activated carbon in this process is essential and integral to the [integrated] production of not only [Chemical], but [Taxpayer's] final products. Not only is the hot nitrogen

essential and integral to the integrated process, it actually has an immediate effect on the exempt production equipment as exempted in [\[45 IAC 2.2-5-12\(e\)\]](#).

The cited regulation provides:

Purchases of materials to be consumed during the production or mining process are exempt from tax, if the consumption of such materials has an immediate effect upon the article being produced and mined, or upon machinery, tools, or equipment which are both used in the direct production or mining process and are exempt from tax under these regulations [\[45 IAC 2.2\]](#).

Taxpayer concludes that "equipment that heats and moves the hot nitrogen throughout the above described process is exempt under [45 IAC 2.2-5-8\(c\)](#)" because the equipment is "an essential and integral part of an integrated process which produces tangible personal property."

In its rehearing request, Taxpayer provides additional explanation:

The absorber system continuously functions to remove sulfur impurities from a process feed stream which is always being fed forward to serve as a raw material for the resin production process. The process feed stream is not interrupted during absorber bed regeneration, but rather routed through an available bed that is ready to remove sulfur compounds. The removal of sulfur is necessary to prevent contamination in the downstream process and to prevent sulfur from "plating out" upon reaction with other chemical streams used in the integrated process.

The Department does not agree that the heating and transport equipment is exempt. The various filtration beds are cycled in and out of the production of the plastic products. While production of the plastics is continuous, the function and utility of each individual bed is not continuous. In order to conduct the regeneration of the filtration bed, each bed is - by necessity - removed from the production process thereby intermittently interrupting that bed's function with the manufacturing process. The February 2015 Letter of Findings concluded as follows:

Taxpayer's position is this stop-and-start purging of the filters occurs frequently. ("[T]he process is a cyclical process and the equipment is continually functioning, simply with a different chemical stream running through the beds . . .") Bearing in mind that "exemptions are strictly construed in favor of taxation and against the exemption," The Department concludes that the nitrogen purging equipment is one-step removed from the actual production of Taxpayer's manufacturing process.

After considering Taxpayer's supplementary information and written explanation, the Department concludes that the decision in the February LOF was correct.

FINDING

Taxpayer's protest is sustained in part and denied in part.

II. Gross Retail and Use Tax - Consumed in Direct Production.

DISCUSSION

Taxpayer maintains that it was not required to pay sales tax or self-assess use tax on the purchase of nitrogen which Taxpayer argues is consumed in the production of its plastics and films. As explained in the February 2015 LOF:

Taxpayer heats the nitrogen and introduces it into the production process intermittently to "regenerate" or "flush" activated charcoal filters. The heated nitrogen scrubs accumulates sulfur dioxide from the filters. The sulfur dioxide is removed from the Chemical production stream and "flared off into the environment."

Taxpayer relies on the exemption set out in IC § 6-2.5-5-5.1(b) which provides as follow:

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. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

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.

...

- (f) Other taxable transactions. Purchases of materials consumed in manufacturing, processing, refining, or mining activities beyond the scope of those described in subsection B above [subsection (e) of this section] are taxable. Such activities include postproduction activities; storage step) [sic.]; maintenance, testing and inspection (except where in direct production); (except where essential and integral to the process system); management and administration; sales; research and development; exhibition of products; safety or fire prevention; space heating; ventilation and cooling equipment for general temperature control; illumination; shipping and loading.

As noted above in Part I above, Taxpayer has the burden of establishing that it is entitled to an exemption from sales or use tax. "[Taxpayer's] burden of demonstrating that it is entitled to the exemption precedes the Department's burden of demonstrating that [Taxpayer] is not entitled to the exemption." *Alloy Custom Products, Inc. v. Indiana Dept. of State Revenue*, 26 N.E.3d 1078, 1082 n.4 (Ind. Tax Ct. 2015).

Taxpayer's use of the nitrogen to purge the activated charcoal beds and the use of those beds was described in Part I.C above. In its rehearing request, Taxpayer argues that:

The use of hot nitrogen to regenerate the activated carbon in this process is essential and integral to the integrated production of not only [chemical substance] but [Taxpayer's] final products. Not only is the hot nitrogen essential and integral to the integrated process, it actually has an immediate effect on the exempt production equipment as exempted in [\[45 IAC 2.2-5-12\(c\)\]](#).

The Department is unable to agree; Taxpayer claims the hot nitrogen is "essential" but that is the exemption threshold. As explained in [45 IAC 2.2-5-8\(g\)](#), "The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required . . . by practical necessity does not mean that the property 'has an immediate effect upon the article being produced.'" In Taxpayer's circumstances, the hot nitrogen does not directly affect Taxpayer's plastic products; it has a direct effect on the charcoal filtration beds but only during those periods of time when a particular beds is "offline."

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Taxpayer's protest is sustained in part and denied in part. Taxpayer's purchase of the ventilation hoods and rental of the flame resistant clothing are exempt from sales and use tax. However the equipment used to heat and transfer hot nitrogen is not exempt because both the equipment - and the nitrogen itself - are used in a process which does not have an immediate effect on Taxpayer's plastic and film products.

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