DEPARTMENT OF STATE REVENUE

Letter of Findings Number: 04-20150642
Use Tax
For Tax Years 2012-14

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Business providing agricultural lime sales and spreading services was not eligible for the agricultural exemption. Brick crushing operations qualified for the manufacturing exemption.

ISSUES

I. Use Tax–Agricultural Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-2; IC § 6-8.1-5-1; Ind. Dep't of State Rev. v. United Parcel Service, Inc., 969 N.E.2d 595 (Ind. 2012); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Sales Tax Information Bulletin 9 (July 2012); 45 IAC 2.2-3-4; 45 IAC 2.2-5-4.

Taxpayer claims eligibility for the agricultural exemption.

II. Use Tax–Manufacturing Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-3; IC § 6-8.1-5-1; Ind. Dept' of Rev. v. Cave Stone, Inc. 457 N.E.2d 520 (Ind. 1983); Rotation Products Corp. v. Dept' of State Rev., 690 N.E.2d 795 (Ind. Tax 1998); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 2.2-3-4; 45 IAC 2.2-5-8.

Taxpayer claims eligibility for the manufacturing exemption.

STATEMENT OF FACTS

Taxpayer sells and spreads agricultural lime ("lime") on farmers' fields. Taxpayer also operates a landscaping materials business, including selling crushed brick which it crushes itself. As the result of an audit for the tax years 2012, 2013, and 2014, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on certain taxable purchases. The Department therefore issued proposed assessments for use tax and interest. Taxpayer protested the proposed assessments, claiming that it qualified for two exemptions from sales and use taxes. An administrative hearing was held this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Agricultural Exemption.

DISCUSSION

Taxpayer protests that it was eligible for the agricultural exemption on certain purchases it made during the tax years 2012, 2013, and 2014. The Department issued proposed assessments for use tax based on its determination that Taxpayer is a service provider that sells and spreads agricultural lime on fields owned by other parties. Taxpayer states that it purchased equipment such as repair parts and fuel for loaders and buggy spreaders which it believes qualify for the agricultural exemption. Specifically, Taxpayer believes that the equipment should qualify for the agricultural exemption because it is involved in the agricultural industry and to not allow it the same exemptions as farmers is discriminatory and unfair.

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). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. 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, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

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 sales tax is not paid at the time TPP is purchased, use tax will be imposed unless there is an applicable exemption.

In the instant case, Taxpayer purchased repair parts for loaders, spreaders, and fuel to operate them. Taxpayer believes that its purchases of the parts for the loaders and spreaders, plus the fuel, were exempt under the agricultural exemption provided by IC § 6-2.5-5-2, which states:

> (a) Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.
> (b) Transactions involving agricultural machinery or equipment are exempt from the state gross retail tax if:
> (1) the person acquiring the property acquires it for use in conjunction with the production of food and food ingredients or commodities for sale;
> (2) the person acquiring the property is occupationally engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food and food ingredients or commodity production; and
> (3) the machinery or equipment is designed for use in gathering, moving, or spreading animal waste.
>
> (Emphasis added).

Also of relevance is 45 IAC 2.2-5-4(e), which states in relevant part:

> The fact that an item is purchased for use on the farm does not necessarily make it exempt from sale [sic.] tax. It must be directly used by the farmer in the direct production of agricultural products. The property in question must 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 agricultural products. The fact that a piece of equipment is convenient, necessary, or essential to farming is insufficient in itself to determine if it is used directly in direct production as required to be exempt.

(Emphasis added).

Therefore, in order for a person to acquire agricultural machinery, tools, or equipment exempt from sales and use taxes, the person must acquire the agricultural machinery, tools, or equipment for his direct use in the direct production of food and food ingredients or commodities which he sells, as provided by IC § 6-2.5-5-2(b). Also, the person who acquires agricultural machinery must be the farmer who is raising the agricultural products, as provided by 45 IAC 2.2-5-4(e).

Plainly, Taxpayer does not qualify for the exemption provided by IC § 6-2.5-5-2 and defined by 45 IAC 2.2-5-4(e). Taxpayer did not own the fields upon which the agricultural lime was spread. The loader, spreaders, and the fuel to operate them were not directly used by a farmer in the direct production of agricultural products. Taxpayer did not sell the agricultural products which were grown on those fields. None of the requirements of IC § 6-2.5-5-2 were met.

In the course of the audit, the Department referred to IC § 6-2.5-5 in explaining that there are several exemptions from sales and use tax. In the audit report, the Department also refers to Sales Tax Information Bulletin 9 (July 2012) 20120725 Ind. Reg. 045120427NRA, Sales Tax Information Bulletin 9 "Example 5" found on page five of that bulletin. That example provided:

> Corporation C is engaged in the business of selling agricultural chemicals and fertilizers to farmers. Corporation C purchases an applicator that will be used to spread the chemicals and fertilizer on its customers' fields. The purchase of the applicator is exempt from tax because the application of fertilizers and agricultural chemicals is necessary and plays a key role in the raising of crops.

The Department allowed any equipment and fuel directly used in the application of lime to the fields as exempt and determined that any other use of the loaders, spreader, or fuel for those pieces of equipment were not eligible for the exemption provided by IC § 6-2.5-5-2(b).

The Department takes this opportunity to state that Example 5 found on page five of Sales Tax Information Bulletin 9 (2012) 20120725 Ind. Reg. 045120427NRA was incorrect and the Department's reliance on it in this audit was incorrect. "Corporation C" in Example 5 would not be eligible for the exemption provided by IC § 6-2.5-5-2 because "Corporation C" was not the person selling the agricultural commodities, as required by IC § 6-2.5-5-2(b)(2). Therefore, Example 5 found on page five of Sales Tax Information Bulletin 9 (2012) 20120725 Ind. Reg. 045120427NRA is not and will not be considered a valid source of information from the Indiana Department of Revenue.

The Department also takes this opportunity to state that Sales Tax Information Bulletin 9 has been revised to remove the incorrect example. However, since the Department did not impose use tax on those items in the course of the audit, the Department will not impose use tax on these items as a result of the protest process. The fact that the Example 5 in Sales Tax Information Bulletin 9 (2012) 20120725 Ind. Reg. 045120427NRA was incorrect will not result in the imposition of any additional use tax for the tax years at issue for Taxpayer. For tax years occurring after the audit years, the statutory standards of IC § 6-2.5-5-2(b)(2) will be applied as written.

Regarding Taxpayer's position that not allowing it to use the agricultural exemption even though it clearly does not qualify for it constitutes discrimination, in Ind. Dep't of State Rev. v. United Parcel Service, Inc., 969 N.E.2d 595 (Ind. 2012) the Indiana Supreme Court has explained:

> As with other statutes, we interpret tax statutes to give effect to their language and the intent of the legislature. See Ind. Wholesale Wine & Liquor Co. v. State ex rel. Ind. Alcoholic Beverage Comm'n, 695 N.E.2d 99, 103, 104-05 (Ind.1998); DeKalb Cnty. E. Cmty. Sch. Dist. v. Dep't of Local Gov't Fin., 930 N.E.2d 1257, 1260 (Ind.Tax Ct. 2010). **Further, "[i]t has long been held that exemption statutes are to be strictly construed against the taxpayer and, therefore, the burden is on the taxpayer to establish its right to an exemption."** Tipton Cnty. Health Care Found, Inc. v. Tipton Cnty. Assessor, 961 N.E.2d 1048, 1051 (Ind.Tax Ct. 2012).
> Id. at 600-601.
> (**Emphasis added**).

In this case, IC § 6-2.5-5-2(b) is clear when it states that in order to qualify for the exemption, ". . .the person acquiring the property is occupationally engaged in the production of food or commodities which he sells." Since Taxpayer was not occupationally engaged in the production of food or commodities which it sold, Taxpayer unambiguously does not qualify for the agricultural exemption. Taxpayer has not established that it has a right to

the exemption, therefore it does not qualify for the exemption, as provided by the Court in United Parcel Service. This is not a case of discrimination. This is a case of a taxpayer misunderstanding the exemption statute.

In conclusion, the Department does not agree that the loaders, spreaders, and the fuel used to operate them qualified for the agricultural exemption. IC § 6-2.5-5-2(b)(2) directly requires that the person claiming the exemption be the person who is producing agricultural commodities which they will then sell. In this case, Taxpayer was not producing agricultural commodities which it sold. Taxpayer was only providing a service to those who were producing agricultural commodities which those producers will sell. The Department's reference to Example 5 on page five of Sales Tax Information Bulletin 9 was incorrect, but will not result in additional use tax for the instant audit period. Taxpayer has not met the burden of proving the proposed assessment wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

II. Use Tax–Manufacturing Exemption.

DISCUSSION

Taxpayer protests the imposition of use tax on its purchase of a crusher which it uses to transform whole bricks into crushed brick which it sells in its landscaping business. The Department determined that the crusher was not manufacturing equipment on the basis that the change in the character of the bricks was not substantial and therefore did not qualify for the manufacturing exemption. Taxpayer states that the crushing of the whole bricks into "crushed brick" does qualify for the manufacturing exemption.

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). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. 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, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

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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.

Also of relevance is IC § 6-2.5-5-3(b), which states:

> 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.

Also, 45 IAC 2.2-5-8(a) provides:

> In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [45 IAC 2.2] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

Also of relevance is the Indiana Tax Court's opinion in Rotation Products Corp. v. Dept' of State Rev., 690 N.E.2d 795 (Ind. Tax 1998), in which the court referenced the Indiana Supreme Court's opinion in Ind. Dept' of Rev. v. Cave Stone, Inc. 457 N.E.2d 520 (Ind. 1983) in which the court explained:

> Cave Stone presented a different question from the one at bar. **In Cave Stone, it was undisputed that the crushed stone was a product**. The critical question was whether the trucks were directly involved in making that product. See Mid-America Energy Resources, 681 N.E.2d at 262 (Ind. Tax Ct.1997) (describing Cave Stone double direct standard). The question here is different. The central dispute is whether a remanufactured bearing is a new product.
> Id at 799. (**Emphasis added**).

The court in Rotation Products therefore explained that in Cave Stone the crushed stone is a new product. The court also explained:

> Cave Stone's approach to the industrial exemptions has been applied to cases where the question was whether a product was created. For example, in Harlan Sprague Dawley, this Court drew from the teaching of Cave Stone in concluding that specially bred laboratory rats were products: "**In the context of the industrial exemptions, production is viewed expansively as all activity directed to increasing the number of scarce economic goods**." Harlan Sprague Dawley, 605 N.E.2d at 1228 (quoting Cave Stone, 457 N.E.2d at 524 (internal quotation marks omitted)). The laboratory rats were scarce economic goods. Laboratories used them for specialized research, and the rats were much more suitable for that research than their naturally occurring counterparts. Consequently, this Court found that they were products and held that the taxpayer was entitled to the industrial exemptions.
> Id. (**Emphasis added**).

In this case, Taxpayer takes whole bricks which it purchases as remainders from a local brick manufacturer and crushes them into "crushed brick" which it sells through its landscaping business. Taxpayer provided photographs of the whole bricks and the crushed brick. There is clearly a substantial change in the character of the bricks. Prior to crushing, the bricks are suitable for standard brick uses in construction of buildings. After crushing, the crushed brick cannot be used for traditional brick construction purposes. The crushed brick is suitable for new landscaping/mulching purposes. The crushing of the bricks in this case therefore increases a scarce economic good, which is a process eligible for the industrial exemptions, including the manufacturing exemption, as provided by the court in Rotation Products.

In conclusion, Taxpayer's brick crushing operation clearly increases a scarce economic good, which means that it is eligible for the manufacturing exemption as explained by the court in Rotation Products. Also, Taxpayer has established that the crusher is directly used in the direct production of the new product, as required by IC § 6-2-5-5-3(b). Therefore, Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) of proving the proposed assessment wrong.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's protest is denied in Issue I regarding its eligibility for the agricultural exemption in its lime spreading activities. Taxpayer's protest is sustained in Issue II above regarding its eligibility for the manufacturing exemption in its brick crushing activities.

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