

Supplemental Letter of Findings: 04-20150513
Gross Retail Tax
For the Years 2012 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Indiana Company established that it was entitled to a sales tax exemption on the purchase of equipment used to palletize and shrink-wrap its products; Indiana Company's customers required that these products be delivered on pallets and be shrink-wrapped.

I. Gross Retail Tax - Shrink-Wrap and Palletizer Equipment.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-5-3; IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Brandenburg Industrial Services Company v. Indiana Department of Revenue, No. 49T10-1206-TA-00037, 2016 WL 4239921 (Ind. Tax Ct. 2016); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 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\(d\)](#).

Taxpayer argues that the Department erred when it concluded that equipment used to shrink-wrap and palletize Taxpayer's products was not exempt from Indiana's sales and use tax.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of producing and distributing "premium" soils and various landscape materials. Taxpayer produces and sells top soil, peat moss, mushroom compost, composted manure, potting soil, garden soil, peat moss, playground sand, limestone paver base, mulch, and various rock products.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and tax returns. The audit found that Taxpayer was entitled to a limited "manufacturing" sales tax exemption.

However, the audit found that Taxpayer had purchased equipment, parts, and supplies without paying sales tax or subsequently self-assessing use tax and that these items were not exempt because they did not fall within the manufacturing process. As a result, the Department assessed Taxpayer additional sales and use tax.

Taxpayer disagreed with the results of the audit and 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 April 7, 2016. The LOF sustained Taxpayer's protest in part and denied it in part.

Taxpayer asked for and was granted a rehearing. The rehearing was conducted during which Taxpayer's representative explained the basis for the renewed protest. This Supplemental Letter of Findings results.

I. Gross Retail Tax - Shrink-Wrap and Palletizer Equipment.

DISCUSSION

In addressing Taxpayer's original protest, the April 7, 2016, LOF found that Taxpayer failed to establish it was entitled to a sales tax exemption on the purchase of equipment used to package Taxpayer's products.

Taxpayer has failed to explain what equipment is at issue, how this equipment has a direct effect on Taxpayer's product, or how the equipment causes a substantial change in that product. One of the

touchstones of the manufacturing exemption is that the equipment at issue must have "an immediate effect on the article being produced." [45 IAC 2.2-5-8\(c\)](#). Another basic prerequisite is that the equipment leads to a "substantial change" in the article being produced. [45 IAC 2.2-5-8\(k\)](#). In this case, the Department is unable to agree that Taxpayer has established that equipment used for "bagging and palletizing" is exempt from tax.

As explained in Taxpayer's written request for rehearing, Taxpayer asks that the Department "find that the equipment used to palletize and shrink-wrap sealed bags of [Taxpayer's] products is part of the integrated process . . . and qualifie[s] for the industrial exemptions."

As in the original protest, it is the Taxpayer's responsibility here 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).

In applying any exemption such as that sought by Taxpayer, 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)). (But See *Brandenburg Industrial Services Company v. Indiana Department of Revenue*, No. 49T10-1206-TA-00037, 2016 WL 4239921 (Ind. Tax Ct. 2016), in which the court held that cutting and moving scrap steel constituted a "substantial change or transformation" to the scrap entitling a demolition company to the IC § 6-2.5-5-3 "manufacturing" exemption.)

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). However, Indiana law permits specific exemptions from the tax. IC § 6-2.5-5-3, 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 paying the gross retail tax when the equipment is 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."

Taxpayer argues that equipment used to shrink-wrap and palletize Taxpayer's products is exempt because the equipment falls within the "direct production" of these products. Taxpayer relies on [45 IAC 2.2-5-8\(d\)](#) which 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.

(Emphasis added).

Taxpayer explains that it does not sell its products to individual retail customers, but that it exclusively sells these products to major home-and-garden chain stores. Taxpayer explains that these customers require that its products be delivered both shrink-wrapped and palletized. To that end, Taxpayer provided copies of its major customers' "vendor manual" and "vendor compliance program letter." These two customers require that Taxpayer's products be delivered on pallets and that the products be "wrapped in UV protectant shrink wrap." One of the customers specifically demands that Taxpayer "not ship on Chep pallets or other rental pallets." This

particular customer imposes a "financial penalty" if the product is not shipped on "good quality 48" by 40" 4 way pallets." The other customers requires that Taxpayer's goods be delivered on "good quality, solid hardwood pallet[s]" and that "all pallets . . . be shrink wrapped tightly and securely to prevent shifting during transportation."

The "completed form" of Taxpayer's product is a palletized, shrink-wrapped delivery of Taxpayer's soil or landscape materials. [45 IAC 2.2-5-8\(d\)](#). Under [45 IAC 2.2-5-8\(d\)](#), Taxpayer's integrated production process is not complete until Taxpayer performs the required packaging.

It is important to note here that palletizing and shrink-wrapping equipment is not exempt because of the packaging function that equipment performs. In this particular circumstance, the equipment is exempt because it acts within a continuous, integrated process of producing the particular "article being produced," acts within - and not outside - Taxpayer's integrated production process, and because the "article being produced" is a palletized, wrapped, and completed product produced and delivered to Taxpayer's specific and immediate customers.

Taxpayer has met its burden of establishing that its customers require that Taxpayer's products be delivered palletized and shrink-wrapped. As such, Taxpayer's production process encompasses the equipment used to place the goods on pallets and the equipment used to shrink-wrap the products. Therefore, the equipment falls within its "production process" and qualifies for the exemption.

FINDING

Taxpayer's protest is sustained.

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