

**Supplemental Letter of Findings: 04-20160010**  
**Sales and/or Use Tax**  
**For the Years 2012, 2013, and 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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Medical device manufacturer's purchases of shipping labels and printer ribbons were not exempt from use tax because it did not provide adequate documentation to prove that certain customer required product labels were a material or integral part of the processed medical device.

### ISSUE

#### I. Sales/Use Tax - Imposition.

**Authority:** IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-6; IC § 6-8.1-5-1; 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. 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, 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); Indiana Dep't of State Rev. v. Caterpillar, Inc., 15 N.E.3d 579, 583 (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); [45 IAC 2.2-2-1](#); [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-14](#).

Taxpayer protests the Department's assessments on additional taxable purchases, claiming that its purchases of labels and printer ribbons were exempt from use tax.

### STATEMENT OF FACTS

Taxpayer develops and manufactures minimally invasive surgical products and catheter devices for medical companies. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer's business records for tax years 2012, 2013, and 2014. The Department determined that Taxpayer purchased some tangible personal property to be used during the course of its business without paying sales tax or self-assessing and remitting the use tax. As a result, the Department assessed additional use tax on these purchases.

Taxpayer protested the use tax assessed on its purchases of labels and printer ribbons. An administrative hearing was held. The Department issued Letter of Findings 04-20160010 (June 23, 2016), 20160831 Ind. Reg. 045160375 NRA ("LOF") which determined that Taxpayer's purchases of shipping labels and printer ribbons were not exempt from tax as the labels were not a material part of the processed medical devices.

Taxpayer disagreed and requested a rehearing. A rehearing was granted and this Supplemental Letter of Findings ensues. Additional facts will be provided as necessary.

#### I. Sales/Use Tax - Imposition.

### DISCUSSION

The LOF determined that the printer ribbons and labels in question were placed outside shipping containers and were used for shipping and inventory control. The items were not physically incorporated as material or integral parts of Taxpayer's products and did not become a component part of Taxpayer's finished products. As a result, the LOF concluded that Taxpayer must pay use tax on the items because the printer ribbons and labels did not have an immediate effect on the device being produced and did not become a part of the final product.

In its rehearing request, Taxpayer argued that the facts reflected in the LOF are incorrect. Taxpayer claims that the LOF failed to "properly identif[y], describe[] or differentiate[]" shipping labels from "customer required product labels." Taxpayer agrees that shipping labels are taxable but argues that customer required product labels are exempt under IC § 6-2.5-5-6 and [45 IAC 2.2-5-14\(a\)](#).

As discussed in the LOF, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment 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); see also Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." Indiana Dep't of State Rev. v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014).

Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a); [45 IAC 2.2-2-1](#). A retail transaction is a transaction made by a retail merchant that constitutes "selling at retail." IC § 6-2.5-1-2(a). Selling at retail occurs when a person "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration." IC § 6-2.5-4-1(b). A person who acquires tangible personal 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). Tangible personal property purchased in a retail transaction is subject to use tax when the tangible personal property is "stored, used or otherwise consumed in Indiana . . . unless the Indiana state gross retail tax has been collected at the point of purchase." [45 IAC 2.2-3-4](#). When sales tax is not paid as a part of a retail transaction, use tax will be imposed unless the purchase is eligible for an exemption.

Use of tangible personal property in Indiana could be exempt from Indiana use tax if the sales tax is paid or collected at the time of the purchase pursuant to IC § 6-2.5-3-4 and [45 IAC 2.2-3-4](#). There are also various tax exemptions available outlined in [IC 6-2.5-5](#). 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 (internal citations omitted) (**emphasis added**). 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) (**Emphasis added**).

Taxpayer claims that under IC § 6-2.5-5-6 its purchases of labels and the printer ribbons used to print customer required product labels were exempt from sales/use tax. IC § 6-2.5-5-6, in relevant part, states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for **incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business.** (**Emphasis added**).

[45 IAC 2.2-5-14](#) further explains:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property which is to be incorporated by the purchaser as a material or an integral part into tangible personal property produced for sale by such purchaser in the business of manufacturing, assembling, refining or processing.
- (b) The exemption provided by this regulation [\[45 IAC 2.2\]](#) applies only to tangible personal property to be incorporated as a material or an integral part into tangible personal property produced for sale by a purchaser engaged in the business of manufacturing, assembling, refining or processing. This regulation [\[45 IAC 2.2\]](#) does not apply to persons engaged in producing tangible personal property for their own use.
- (c) This regulation [\[45 IAC 2.2\]](#) does not exempt from tax tangible personal property to be used in production, such as supplies, parts, fuel, machinery, etc., refer to Regs. 6-2.5-5-5(010) and 6-2.5-5-5(020) (dealing with

material consumed in direct production) for the application of those regulations to taxpayers engaged in the production of tangible personal property.

**(d) The purchase of tangible personal property which is to be incorporated by the purchaser as a material or an integral part is exempt from tax. "Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:**

- (1) That the material must be physically incorporated into and become a component of the finished product;**
- (2) The material must constitute a material or an integral part of the finished product; and**
- (3) The tangible personal property must be produced for sale by the purchaser.**

**(e) Application of general rule.**

- (1) Incorporation into the finished product. The material must be physically incorporated into and become a component part of the finished product.**
- (2) Integral or material part. The material must constitute a material or integral part of the finished product.**
- (3) The finished product must be produced for sale by the purchaser.**

**(Emphasis added).**

Additionally, under [45 IAC 2.2-5-8](#):

(a) 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 produced 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 materials incorporated into tangible personal property produced.

(b) 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.

(c) The state gross retail tax does not apply to purchase 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.**

**(g) 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 . . . the property must also be an integral part of an integrated process which produces tangible personal property.**

**(Emphasis added).**

In its rehearing request, Taxpayer claims that the LOF did not distinguish between shipping labels and customer required product labels. Taxpayer asserts in part that, "Shipping Labels are labels placed on boxes and shipping containers to ship our products. . . ." Taxpayer agrees that "these labels are subject to tax . . . ." Taxpayer explains that both shipping labels and customer required product labels "start out as generic label from regular label stock of varying sizes and materials." However, Taxpayer states that "Customer Required Product Labels are applied to the actual medical devices (products) and/or customer required product packaging (not shipping containers) during various stages of production and inspection." Once production and inspection steps are completed, the products are placed in shipping containers to which a shipping label is affixed.

Taxpayer additionally explains that customer required product labels include "direction for use" labels or "DFUs," which are affixed to the medical devices themselves before being placed in shipping boxes. Taxpayer further explains that it does not perform sterilization on its products, but it "cannot sell its products to customers without the required [product] labels, thus, it does not consider a product a finished good until the label has been applied."

Taxpayer claims that its purchase and use of the labels and printer ribbons used to print customer required product labels were exempt from sales/use tax under IC § 6-2.5-5-6. In its original protest Taxpayer maintained that:

These labels are not only part of our manufacturing and automation processes, but are also required by our customers. Any products not labeled are rejected by our customer; therefore these labels are an integral and

material part of our products, meeting the definition of IC [§] 6-2.5-5-6.

At rehearing, Taxpayer reiterates:

The Customer Required Product Labels are deductible under IC [§] 6-2.5-5-6 as a material part of other tangible personal property, as this is required by our customer for it to be a complete saleable product; without this label the product is incomplete and is not saleable.

Taxpayer further explains:

The Customer Required Product Labels are also used in [Taxpayer's] manufacturing processes, and there can be multiple Customer Required Product Labels on a single product when the product is completed. They are used in our manufacturing process by checking for all customer required product label at various points in the production process before being further processes. If a label is missing, damaged, or inappropriate, the work-in-process is removed from further production until the label issue is corrected.

To support its protest, Taxpayer provided pictures of example shipping labels and customer required product labels; some affixed to boxes and others to packaging which secured a particular medical device. None of these pictures related to the purchases at issue in the audit. The Department requested additional information, specifically, proof that the labels purchased from the vendors in the protested purchases were labels that were eventually affixed to medical devices as customer required product labels.

Taxpayer responded with a signed affidavit and an offer to arrange a plant tour of Taxpayer's Indiana production facility. The audit is the Department's eyes and ears in the field and the Department relies on their findings to determine fact; a tour of Taxpayer's facility is not appropriate at this stage of the protest. In relation to labels, the audit report states that:

During the audit period, audit came across several invoices for labels . . . used for shipping and inventory control. These labels were placed on the outside of shipping containers and shipped to [T]axpayer's customers. Per [T]axpayer, these labels were required by their customers and pointed to the new [IC 6-2.5-5-50](#) . . . [which] does not apply for the years under audit.

In the audit report, no distinction is made between shipping labels and customer required product labels and there is no discussion of labels being affixed to medical devices or used during production or post production.

During the protest and rehearing process, Taxpayer bears the burden of proving that the Department's assessment is incorrect. In the signed affidavit, Taxpayer certified that the purchases they claimed to be exempt were purchases of customer required product labels, not shipping labels. Taxpayer further claimed that customer required product labels can be quality inspection labels, anti-tamper labels, or DFUs. Taxpayer mentions that DFUs can be "either traditional sticker type labels or booklets that are paper stock and not necessarily stickers." Either way, Taxpayer claims that DFUs are customer required and therefore a part of the product being sold, part of the production process and thus a component part of the products sold.

Upon review, the Department concludes that the self-serving affidavits and other documentation provided are not sufficient to establish that the protested labels were exempt from use tax. Without adequate documentation, the Department cannot agree that the customer required product labels were "an essential and integral part of" Taxpayer's production process as required by [45 IAC 2.2-5-8](#). Nor can the Department agree that the customer required product labels were physically incorporated as a material part of the medical devices produced as required under IC § 6-2.5-5-6. While Taxpayer's customers may not accept shipments without customer required product labels, this "does not itself mean that the property 'has an immediate effect upon the article being produced.'" [45 IAC 2.2-5-8](#).

In short, Taxpayer has not proven that its purchase and use of the labels and printer ribbons used to create customer required product labels were exempt under IC § 6-2.5-5-6 and [45 IAC 2.2-5-8](#).

## FINDING

Taxpayer's protest is respectfully denied.

*Posted: 12/28/2016 by Legislative Services Agency*

