

Letter of Findings: 04-20160407
Sales and 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Fertilizer Manufacturer was liable for use tax on a loader which it used to transfer raw materials to a hopper to be weighed before the production process began.

ISSUE

I. Sales and 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 § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; 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 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Rhoads 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); 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); Mumma Bros. Drilling Co. v. Indiana Dep't of State Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); [45 IAC 2.2-5-8](#).

Taxpayer protests the assessment of use tax on its purchase of a loader.

STATEMENT OF FACTS

Taxpayer is an Indiana company that manufactures and sells dry and liquid fertilizers. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for tax years 2012, 2013, and 2014. Pursuant to the audit, the Department determined that Taxpayer did not pay sales tax or self-assess use tax on certain purchases of tangible personal property, including a loader ("Loader"), used in the course of its business. As a result, the Department's audit assessed additional use tax, negligence penalty, and interest.

Taxpayer only protests the assessment on its purchase of the Loader. A phone hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax - Imposition.

DISCUSSION

The Department's audit found that Taxpayer "manufactures dry [and] liquid fertilizers." Nonetheless, the audit assessed use tax on the Loader because Taxpayer did not pay sales tax or self-assess use tax on its purchase. The audit determined that Taxpayer's use of the loader did not qualify for any exemptions.

Taxpayer, to the contrary, claimed that it was entitled to the manufacturing exemption on the Loader. Taxpayer stated, in relevant part, that:

The manufacturing process involves the use of liquid fertilizer solution (such as acid, nitrogen, and water) and dry materials (such as potash fertilizer). Prior to the beginning of the manufacturing process these dry and liquid raw materials are purchased, delivered, and stored in tanks and storage bins. The manufacturing

process begins with the transfer of these raw materials into large . . . mixing tanks. The liquid fertilizer solutions are added and mixed first and then dry materials are added for the final mixture. . . .

Taxpayer further explains that it uses the loader "to transfer potash fertilizer from its storage bin into an adjacent large weigh hopper where the potash fertilizer flows through to an attached conveyor belt that carries it into the mixing tank to be combined with the liquid fertilizer solutions"

Accordingly, the issue in this case is whether, as a manufacturer of fertilizers, Taxpayer's use of the loader qualifies for the manufacturing exemption.

As a threshold issue, 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); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

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. Rhoades, 774 N.E.2d at 1048; USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466, 468 - 69 (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. Rhoades, 774 N.E.2d at 1050. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a); USAir, Inc., 623 N.E.2d at 468 - 69. 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) and (c); IC § 6-2.5-3-2(a).

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 exempt 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).

IC § 6-2.5-5-3(b), 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).

Thus, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture . . . of other tangible personal property." In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer

purchases for use within its manufacturing facility. [45 IAC 2.2-5-8\(a\)](#). "[F]airly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Indiana Dep't of State Revenue*, 411 N.E.2d 676, 677 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "[T]he test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* (citing *Department of Revenue v. U. S. Steel Corp.*, 425 N.E.2d 659 (Ind. App. Ct. 1981)).

An exemption applies to "manufacturing machinery, tools, and equipment directly used by the purchaser in direct production." [45 IAC 2.2-5-8\(b\)](#). Manufacturing machinery, tools, and equipment are directly used in the direct production process "if they have an immediate effect on the article being produced." [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. *Id.* An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#), Example (1). "Equipment used to **remove raw materials from storage prior to introduction into the production process** or to move finished products from the last step of production" are not exempt because the use of the equipment lacks "an essential and integral relationship with the integrated production system." [45 IAC 2.2-5-8\(c\)](#), Example (4)(G) (**emphasis added**). Thus, proper application of this particular exemption requires determining at what point "production" begins and at what point "production" ends.

[45 IAC 2.2-5-8\(d\)](#) further 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. . . .

Thus, 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.

[45 IAC 2.2-5-8\(k\)](#) describes direct production as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired. The change must be substantial resulting in a transformation of the property into a different and distinct product. *Id.*

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

"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).**

In this instance, Taxpayer asserted that it was entitled to the manufacturing exemption on the purchase and use of the Loader pursuant to the Indiana statutes, regulations, and case law. Taxpayer argued that it "uses the loader in [its] integrated manufacturing process. Specifically, the loader is used to transfer potash fertilizer from its storage bin into an adjacent large weigh hopper where the potash fertilizer flows through to an attached conveyor belt that carries it into the mixing tank to be combined with the liquid fertilizer solutions." Taxpayer referenced *Cave Stone* to support its assertion that its use of the Loader similar to the front-end loader which was "used by Cave in its hauling crude stone and stock out steps" Taxpayer further claimed that its manufacturing process, similar to the process of the taxpayer in *Kimball Int'l Inc.*, would be impossible from an operational standpoint without the Loader. Taxpayer maintained that it used the Loader exclusively for the purpose of transferring the raw materials and is therefore a direct and necessary component of the manufacturing process because without it no manufacturing could take place.

Upon review, however, Taxpayer's reliance of *Cave Stone* and *Kimball Int'l Inc.* is misplaced. Specifically,

Taxpayer used the Loader to transfer the raw materials to a weigh hopper before the raw materials were introduced into the production process (i.e., mixing or blending); therefore, its use of Loader is different from the front-end loader used in Cave Stone. The taxpayers in Cave Stone were "engaged in the business of selling sized aggregate stone removed from their respective quarries." Cave Stone, 457 N.E.2d at 521. Their production "procedure involves stripping, drilling, blasting, and loading the crude stone into a truck." Id. The taxpayers then hauled the crude stone to their primary crusher to be "crushed, separated, washed, and screened into various grades of aggregate." Id. "The graded stone is next taken by conveyor to a front-end loader which loads it onto a truck which carries it to separated stockpiles (stock out) from which it is eventually sold." Id. The court concluded that the front-end loader used in Cave Stone was exempt because the production had begun, the "production process is continuous and indivisible" and "the transportation [was] an integral part of the production or processing of the stone." Id. at 524. Therefore, the front-end loader used to transport semi-finished products, namely, the various grades of aggregate was exempt because its use was an integral part of the production or processing of the stone. Taxpayer's production process is different from the petitioner's production in Kimball Int'l Inc. The petitioner, Kimball, was "in the business of manufacturing finished wood products and components, including pianos, speaker cabinets and furniture" and its "manufacturing process extends from milling the uncut logs to shipping the ultimate product." Kimball Int'l, Inc., 520 N.E.2d at 455. The court concluded that Kimball was entitled to manufacturing exemption on its purchase and use of "spray booths and air make up units" because without them, Kimball could not transform the raw wood into finished marketable products. Id. at 457.

Taxpayer here demonstrated that its manufacturing process begins after all ingredients are placed into the mixing tank to be combined with the liquid fertilizer solution. Taxpayer used the Loader exclusively to "remove raw materials from storage prior to introduction into the production process." The Loader did not "have an immediate effect upon the article being produced." As mentioned earlier, the Loader "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' Taxpayer's use of the Loader is pre-production and not exempt pursuant to Indiana law.

In short, given the totality of the circumstances, Taxpayer's documentation demonstrates that the Loader was not exempt.

FINDING

Taxpayer's protest is respectfully denied.

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