

Letter of Findings Number: 04-20160007
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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 was able to produce documentation and explanation showing that certain purchases were partially eligible for the manufacturing exemption. Therefore, those purchases are partially exempt.

ISSUE

I. Use Tax—Imposition.

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; 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); 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); [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-8](#).

Taxpayer protests the imposition of use tax on certain transactions.

STATEMENT OF FACTS

Taxpayer is an Indiana business in the landscaping industry. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on some taxable purchases during the tax years 2012, 2013, and 2014. The Department therefore issued proposed assessments for use tax, penalty, and interest for those years. Taxpayer protested the imposition of use tax on some of the transactions determined to be taxable by the Department. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Imposition.

DISCUSSION

Taxpayer protests the imposition of use tax on some purchases of tangible personal property ("TPP") it made during the tax years 2012-14. The Department imposed use tax because it determined that the TPP was purchased in a taxable transaction and that sales tax had not been paid at the time of purchase. Taxpayer protests that some of the transactions determined by the Department to be subject to sales and use taxes were actually exempt purchases and that no use tax is due on them.

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 Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. 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 by 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 the course of the protest process, Taxpayer established that the mulch it sold to its customers was a scarce economic good. The mulch was a distinct and separate good from the scrap wood and scrub trees which were the raw materials used in the mulch production process. Taxpayer purchased several items of TPP during the tax years and states that some were used in production of other TPP which it sold to its customers. Specifically, Taxpayer purchased repair parts for production equipment, including one skid steer and five tractor/loaders. Taxpayer also rented one tractor/loader during the tax years at issue.

Regarding the skid steer, Taxpayer explains that this piece of equipment was used to unload the scrap wood and scrub trees and also to move the raw materials into the initial decomposition pile which initiated the transformation from raw materials into mulch. As provided by IC § 6-2.5-5-3(b), equipment directly used in the direct production of tangible personal is exempt from sales and use taxes. Since the skid steer was used for both a non-production purpose when it was unloading raw materials and for a production purpose when it was moving the raw materials onto the decomposition pile, repair parts for the skid steer will be considered fifty percent exempt and fifty percent taxable.

Regarding the five tractors in question, Taxpayer explained its production process, including: piling of raw materials, grinding, re-piling, and colorization of the mulch. Of those steps, Taxpayer explained that the tractors are used in ninety point nine (90.9) percent of their time in production and nine point one (9.1) percent of the time in post-production distribution. Since use in the production process is exempt and use outside the production process is taxable, repair parts for the five tractors will be considered 90.9 percent exempt and 9.1 percent taxable. These taxable and exempt percentages will also be applied to the rental expenses for the tractor which Taxpayer rented during these years.

Finally, Taxpayer also protested that certain purchases which the Department considered subject to use tax were either exempt from sales and use taxes or had sales tax paid at the time of purchase. Taxpayer provided invoices in support of its position. After review, the Department agrees with Taxpayer that the three invoices for Intuit software and the four invoices for Amazon.com had sales tax paid at the time of purchase. Also, the Department agrees that the two remaining invoices under protest were payments for exhibition space at home and garden shows. There was no transfer of tangible personal property and therefore no sales or use tax is due on those transactions.

In conclusion, Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) of proving the proposed assessments wrong. The Department will recalculate the amount of use tax due when considering repair parts for the skid steer at fifty percent exempt and fifty percent taxable, and also considering repair parts for the five tractor/loaders which Taxpayer owned as 90.1 percent exempt. Also, the tractor/loader which Taxpayer rented will be considered as 90.1 percent exempt. Finally, the transactions for which Taxpayer has provided documentation and analysis showing that sales tax was collected or that the transactions were exempt will be removed from the Department's recalculation of use tax due.

FINDING

Taxpayer's protest is sustained in part as provided above.

Posted: 01/25/2017 by Legislative Services Agency
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