DEPARTMENT OF STATE REVENUE

04-20160313.SLOF

Supplemental Letter of Findings: 04-20160313
Gross Retail and Use 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 is not part of the analysis contained in this Supplemental Letter of Findings.

HOLDING

The Department repeated its finding that Petroleum Company was not required to pay sales tax on materials and equipment which were directly used - and had an immediate effect - on Petroleum Company's fuel products; however, it was Petroleum Company's responsibility to differentiate between equipment which had such an immediate effect from post-production equipment which merely delivered the processed fuel to its jobbers' vehicles.

ISSUE

I. Gross Retail and Use Tax - Exempt Manufacturing Equipment.

Authority: 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); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 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); 45 IAC 2.2-5-8(g); 45 IAC 2.2-5-10(k).

Taxpayer argues that the Department erred when it determined that purchases of kerosene handling equipment and "Load Rack" equipment were not exempt from Indiana's sales or use tax.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of producing, marketing, and distributing petroleum products. Taxpayer operates distribution terminals in Indiana.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit review of Taxpayer's purchase records, sales records, work papers, and tax returns. The audit resulted in an assessment of additional sales and use tax.

Taxpayer disagreed with the assessment 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 (04-20160313) was issued September 7, 2016, sustaining Taxpayer's protest in part and denying it in part.

The Letter of Findings stated as follows:

> [T]he Department does not agree that the kerosene handling equipment meets the exemption's requirement. In addition, the Department does not agree that the "load rack" equipment is exempt because this equipment constitutes "post-production" equipment as specified in 45 IAC 2.2-5-8(d).

The original Letter of Findings did not agree that the kerosene handling equipment was exempt because the kerosene was delivered to Taxpayer's customers (jobbers) in the same form as Taxpayer received the fuel from the refineries.

The Letter of Findings also did not agree that the "load rack" equipment was exempt because the load rack equipment was post-production equipment. In other words, Taxpayer blended and processed the various fuels before the fuel entered into and transferred by what the Letter of Findings treated as simple delivery equipment.

In all other respects, Taxpayer's protest was sustained.

Taxpayer disagreed with a portion of the Letter of Findings and submitted a request for a rehearing on the matter. The rehearing was granted and was conducted on November 14, 2016. Taxpayer's representatives again explained the reason that both the kerosene handling equipment and the load rack equipment were exempt. This Supplementary Letter of Findings results.

I. Gross Retail and Use Tax - Exempt Manufacturing Equipment.

FINDING

The issue is whether Taxpayer has met its burden of establishing that the kerosene handling equipment and load rack equipment are exempt because this equipment is directly involved in the production of fuel delivered to its customers; in other words, does the kerosene handling equipment and the load rack equipment cause a "substantial" change to the "form, composition, or character" of the fuel?

This Supplemental Letter of Findings incorporates the analysis set out in the September Letter of Findings but at least a portion of that analysis bears repeating here.

As always, it is the Taxpayer's responsibility to establish that any proposed assessment of sales and use tax is "wrong."

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).

Taxpayer - as previously - cites to IC § 6-2.5-5-3 as authority for its argument that the equipment in question is exempt from sales and use tax. That statute provides 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 without payment of 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."

A. Kerosene Handling Equipment.

The original Letter of Findings declined to provide any exemption for kerosene handling equipment because - as Taxpayer explained - the kerosene "is delivered to the jobbers in the same form as received from the refineries . . . ." There can be no exemption on the kerosene handling equipment because - by definition - nothing is done with this fuel; Taxpayer's process does not refine, process, change, add, or subtract from the kerosene fuel.

However, Taxpayer now explains that its terminals "do not have handling equipment strictly dedicated to kerosene." In other words, Taxpayer has no equipment which would be subject to tax because there are no purchases of equipment dedicated to processing, handling, or transporting kerosene.

Since there is no kerosene handling equipment to tax, the issue is entirely moot.

B. Load Rack Equipment.

Taxpayer seeks clarification of the Department's definition of "load rack" equipment. The original Letter of Finding stated that "As used in the petroleum distribution business, a 'load rack' is a loading and unloading platform."

The original Letter of Findings found that none of the equipment associated with the "load rack" was exempt on the ground that this equipment constituted "post production" that was - under 45 IAC 2.2-5-8(d) - not exempt from sales or use tax.

> 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.

The original Letter of Findings agreed that much of the equipment at Taxpayer's distribution terminals caused a material, substantial change to the petroleum products which were delivered to the terminals. As explained in the conclusion to that document:

> The question is whether the product Taxpayer delivers at it distribution terminals has undergone a "substantial change" into a product which has a "distinctive name, character, and use" as required by 45 IAC 2.2-5-10(k). With the exception of kerosene - which is delivered to the jobbers in the same form as received from the refineries - the remaining distillates cannot be sold without being modified in a process which occurs within the four corners of the terminals. As delivered, these distillates and additives are not acceptable to Taxpayer's jobber/customers because these products do not meet performance, safety, or EPA standards. As detailed in Section B above, these raw materials undergo a complex, exacting, and - for all practical purposes - chemically irreversible transformation into one of the 25 products required by the upstream retailers.

Taxpayer explains that the "load rack" equipment includes:

> • Valves, pumps, and metering and injection systems which control the component and additive movements;
> • Piping to transport the components and additives within the loading rack;
> • Loading arms; and
> • Computer systems and preset consoles which control the blending specification requirements per regulatory requirements and the customer's request.

However, the Letter of Findings was clear on this issue. Equipment which caused a change to the fuel was exempt; equipment which modified the fuel was clearly exempt. Equipment which caused a "chemically irreversible transformation into one of [Taxpayer's] 24 products . . ." was exempt. The Letter of Finding agreed that "injection systems" and "computer systems and preset controls which control[ed] the blending" of the fuel fell specifically within the realm of equipment which qualified for the exemption. There was no disagreement with Taxpayer in the original Letter of Findings and there is no disagreement with Taxpayer now.

What is not exempt are the hoses, nozzles, platforms, and associated, passive equipment which merely deliver the already processed fuel to the jobbers' delivery vehicles. It is Taxpayer's responsibility to delineate that delivery equipment from equipment which causes a "complex, exacting, and - for all chemically irreversible transformation . . ." to Taxpayer's petroleum products. In other words, not everything Taxpayer purchases qualifies for the exemption.

Taxpayer is reminded that "[t]he fact particular property that may be considered essential to the conduct of the business of manufacturing because its use is required . . . by practical necessity does not mean that the property 'has an immediate effect upon the article being produced.'" 45 IAC 2.2-5-8(g).

The Department is entirely cognizant of the difficulties imposed in making these distinctions but it is a tax regime that all taxpayers, manufacturers, processors, and the Department live with and under which we are required to make these distinctions.

FINDING

To the extent outlined in this Supplemental Letter of Findings, Taxpayer's protest is sustained in part and denied in part. The issue of the kerosene handling equipment is rendered moot. Equipment which acts upon, changes, and transforms Taxpayer's petroleum products is - as explained in the September Letter of Findings - exempt from tax. "Load Rack" equipment which merely delivers the fuel into jobbers' vehicles is not exempt because this particular class of equipment does not have the requisite "immediate effect on the [petroleum products] being produced . . ." because it is "post-production" equipment.

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