

Letter of Findings Number: 04-20160297
Use Tax
For Tax Years 2013-14

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 did not produce sufficient documentation and explanation to establish that certain purchases were eligible for the research and development exemption. Therefore, those purchases were properly subject to use tax.

ISSUE

I. Use Tax–Imposition.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-40; 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); [45 IAC 2.2-3-4](#).

Taxpayer protests the imposition of use tax on certain transactions.

STATEMENT OF FACTS

Taxpayer operates a testing business in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales or use tax on certain purchases during the tax years 2013 and 2014 ("Tax Years"). The Department therefore issued proposed assessments for use tax, penalty, and interest for those years. Taxpayer protested the imposition of use tax on some purchases. 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 its purchase of certain tangible personal property ("TPP") during the tax years 2013-14. Taxpayer states that these purchases qualified for the research and development exemption and that neither sales nor use tax were due. The Department based its determination on the fact that Taxpayer did not own the products being tested, that it was performing quality control on existing products, and that it did not play an integral part in creating the products for their customers. Therefore, the Department considered that the TPP in the form of laboratory supplies did not qualify for the exemption in question.

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.

IC § 6-2.5-5-40 provides:

(a) As used in this section, "research and development activities" includes design, refinement, and testing of prototypes of new or improved commercial products before sales have begun for the purpose of determining facts, theories, or principles, or for the purpose of increasing scientific knowledge that may lead to new or enhanced products. The term does not include any of the following:

- (1) Efficiency surveys.
- (2) Management studies.
- (3) Consumer surveys.
- (4) Economic surveys.
- (5) Advertising or promotions.
- (6) Research in connection with nontechnical activities, including literary, historical, social sciences, economics, humanities, psychology, or similar projects.
- (7) Testing for purposes of quality control.
- (8) Market and sales research.
- (9) Product market testing, including product testing by product consumers or through consumer surveys for evaluation of consumer product performance or consumer product usability.
- (10) The acquisition, investigation, or evaluation of another's patent, model, process, or product for the purpose of investigating or evaluating the value of a potential investment.
- (11) The providing of sales services or any other service, whether technical or nontechnical in nature.

(b) As used in this section, "research and development equipment" means tangible personal property that:

- (1) consists of or is a combination of:
 - (A) laboratory equipment;
 - (B) computers;
 - (C) computer software;
 - (D) telecommunications equipment; or
 - (E) testing equipment;
- (2) has not previously been used in Indiana for any purpose; and
- (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:
 - (A) new products;
 - (B) new uses of existing products; or
 - (C) improving or testing existing products.

(c) As used in this section, "research and development property" means tangible personal property that:

- (1) has not previously been used in Indiana for any purpose; and
- (2) is acquired by the purchaser for the purpose of research and development activities devoted to experimental or laboratory research and development for:
 - (A) new products;
 - (B) new uses of existing products; or

- (C) improving or testing existing products.
- (d) For purposes of subsection (c)(2), a research and development activity is devoted to experimental or laboratory research and development if the activity is considered essential and integral to experimental or laboratory research and development. The term does not include activities incidental to experimental or laboratory research and development.
- (e) For purposes of subsection (c)(2), an activity is not considered to be devoted to experimental or laboratory research and development if the activity involves:
 - (1) heating, cooling, or illumination of office buildings;
 - (2) capital improvements to real property;
 - (3) janitorial services;
 - (4) personnel services or accommodations;
 - (5) inventory control functions;
 - (6) management or supervisory functions;
 - (7) marketing;
 - (8) training;
 - (9) accounting or similar administrative functions; or
 - (10) any other function that is incidental to experimental or laboratory research and development.
- (f) A retail transaction:
 - (1) involving research and development equipment; and
 - (2) occurring after June 30, 2007, and before July 1, 2013; is exempt from the state gross retail tax.
- (g) A retail transaction:
 - (1) involving research and development property; and
 - (2) occurring after June 30, 2013; is exempt from the state gross retail tax.
- (h) The exemption provided by subsection (g) applies regardless of whether the person that acquires the research and development property is a manufacturer or seller of the new or existing products specified in subsection (c)(2).
- (i) For purposes of this section, a retail transaction shall be considered as having occurred after June 30, 2013, to the extent that delivery of the property constituting selling at retail is made after that date to the purchaser or to the place of delivery designated by the purchaser. However, a transaction shall be considered as having occurred before July 1, 2013, to the extent that the agreement of the parties to the transaction is entered into before July 1, 2013, and payment for the property furnished in the transaction is made before July 1, 2013, notwithstanding the delivery of the property after June 30, 2013. This subsection expires January 1, 2017.

Therefore, IC § 6-2.5-5-40 provides that purchases were exempt from sales and use taxes if specific conditions were met.

Taxpayer states that it qualified for the exemption provided by IC § 6-2.5-5-40 since it provided testing services for other businesses who were developing products and may not have had the laboratory facilities or expertise to perform the testing required by the appropriate federal agencies. Taxpayer also argues that IC § 6-2.5-5-40(h) specifically states that the exemption applies regardless of whether the person that acquires the research and development property is a manufacturer or seller of the new or existing product being tested. Moreover, Taxpayer states that it was specifically registered with a federal agency for evaluation and research for specific products before they are sold. Taxpayer also states that the Department's audit incorrectly states that it was hired to validate equipment and methods after the products are ready to be manufactured. Rather, Taxpayer states that it validated certain equipment because it was a required part of a federal agency's protocols for the research phase. All of these factors, Taxpayer argues, show that it qualified for the exemption provided by IC § 6-2.5-5-40.

In the course of the protest process, Taxpayer provided substantial documentation in the form of test reports. These reports list which tests were performed and what results were observed. They also list what equipment and consumables were used in performing the tests. What they do not list, however, is how the testing fits in with Taxpayer's customers' research and development process. As provided by IC § 6-2.5-5-40(d), "For purposes of subsection (c)(2), a research and development activity is devoted to experimental or laboratory research and development if the activity is considered essential and integral to experimental or laboratory research and development. The term does not include activities incidental to experimental or laboratory research and development." The testing listed on Taxpayer's test reports could be activities incidental to Taxpayer's customers' experimental or laboratory research and development. The documentation provided in the protest process does not meet the burden imposed by IC § 6-8.1-5-1(c) of proving the proposed assessment wrong.

FINDING

Taxpayer's protest is denied.

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