

Final Order Denying Refund: 04-20160649R
Sales Tax
For The Tax Year 2013

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

HOLDING

Business did not pour cement into oil and gas wells as part of its own production process. Therefore, refund of tax previously paid was properly denied.

ISSUE

I. Sales Tax–Refund.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-5-3; IC § 6-8.1-9-1; Indiana Department of Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 525 (Ind. 1983); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014); Merchandise Warehouse Co., Inc. v. Ind. Dept. of State Revenue, 67 N.E.3d 666 (Ind. Tax 2017); [45 IAC 2.2-5-12](#); [45 IAC 2.2-5-21](#).

Taxpayer protests the denial of a claimed refund of tax.

STATEMENT OF FACTS

Taxpayer is an Indiana business. Taxpayer pours cement into oil and gas wells which provides a stable and usable well for the extraction of oil or natural gas. In 2013, Taxpayer purchased two trucks for use in its cement pouring business. In 2016, Taxpayer filed a claim for refund of sales tax which it had paid at the time it purchased the trucks. After a review of the refund claim, the Indiana Department of Revenue ("Department") denied the claim for refund on the grounds that Taxpayer was a contractor making improvements to realty and that the equipment in question did not become a part of the improvements to realty. Taxpayer protested the denial of the claim for refund and an administrative hearing was held. This Final Order Denying Refund results. At the administrative hearing, Taxpayer informed the Department that it was no longer claiming refund of sales tax on one of the trucks initially at issue. Taxpayer's protest therefore is in reference to one truck upon which Taxpayer claims refund of sales tax previously paid. Further facts will be supplied as required.

I. Sales Tax–Refund.

DISCUSSION

Taxpayer protests the Department's denial of a claim for refund of sales tax paid at the time Taxpayer purchased a truck in 2013 which Taxpayer uses in its cement pouring business. The Department denied Taxpayer's claim for refund on the basis that Taxpayer was a contractor making improvements to realty and that the truck did not become part of the improvements to realty. Taxpayer protests that its cement pouring is part of an integrated production process which extracts oil or natural gas from the ground and that its use of the truck is therefore eligible for the mining and extraction exemption.

The Department notes that, "[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 shall be entitled to deference.

IC § 6-8.1-9-1(a) states:

If a person has paid more tax than the person determines is legally due for a particular taxable period, the person may file a claim for a refund with the department. Except as provided in subsections (f) and (g), in order to obtain the refund, the person must file the claim with the department within three (3) years after the

latter of the following:

- (1) The due date of the return.
- (2) The date of payment.

For purposes of this section, the due date for a return filed for the state gross retail or use tax, the gasoline tax, the special fuel tax, the motor carrier fuel tax, the oil inspection fee, or the petroleum severance tax is the end of the calendar year which contains the taxable period for which the return is filed. The claim must set forth the amount of the refund to which the person is entitled and the reasons that the person is entitled to the refund.

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. (Emphasis added).

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. (Emphasis added).

Also, the Department refers to [45 IAC 2.2-5-12](#), which provides:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.
- (b) The exemption provided by this regulation [[45 IAC 2.2](#)] applies only to tangible personal property to be directly consumed in direct production by manufacturing, processing, refining, or mining. It does not apply to machinery, tools, and equipment used in direct production or to materials incorporated into the tangible personal property produced.
- (c) The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; i.e., they have an immediate effect on the article being produced. The 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.
- (d) Pre-production and post-production activities.
 - (1) Direct consumption 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 process has altered the item to its completed form, including packaging, if required.
 - (2) **"Direct use in mining" begins with the drilling of the shaft or well or the first removal of overburden in surface mining or quarrying. It ends when the item being mined or extracted has been physically removed from the mine, well, or quarry.**
- (e) **"Have an immediate effect upon the article being produced or mined." Purchases of materials to be consumed during the production or mining process are exempt from tax, if the consumption of such materials has an immediate effect upon the article being produced and mined, or upon machinery, tools, or equipment which are both used in the direct production or mining process and are exempt from tax under these regulations [[45 IAC 2.2](#)].**
- (f) Other taxable transactions. Purchases of materials consumed in manufacturing, processing, refining, or mining activities beyond the scope of those described in subsection B above [subsection (e) of this section] are taxable. Such activities include postproduction activities; storage step) [sic.]; maintenance, testing and inspection (except where in direct production); (except where essential and integral to the process system); management and administration; sales; research and development; exhibition of products; safety or fire prevention; space heating; ventilation and cooling equipment for general temperature control; illumination; shipping and loading.
- (g) "Consumed" as used in this regulation [[45 IAC 2.2](#)] means the dissipation or expenditure by combustion, use, or application and does not mean or include the obsolescence, discarding, disuse, depreciation, damage, wear or breakage of tools, dies, equipment, machinery, or furnishings.

(Emphasis in original) (**Emphasis added**).

Finally, the Department refers to [45 IAC 2.2-4-21](#), which states:

- (a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.
- (b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt.

Taxpayer refers to *Indiana Department of Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983), in which the taxpayer was claiming that its trucks were exempt under the double-direct test. The Indiana Supreme Court explained:

In the present case, the transportation equipment in question was directly used by the purchaser, not some other entity, and it was used in the direct production and processing of crude stone into aggregate stone. The transportation equipment moved the unfinished stone in a continuous flow from one production step to another.

Therefore, an item must directly affect the thing being produced in order to qualify for the exemption. In *Cave Stone*, the trucks directly affected the stone by moving it in a continuous flow from one production step to another. Taxpayer believes that oil or gas extraction begins with the drilling of the well, as provided by [45 IAC 2.2-5-12\(d\)\(2\)](#), and that its cement pouring activities qualify as one of a series of production steps in the process of extracting oil or natural gas from the ground and that the cement is required to make a usable well from which the oil or gas may be extracted. This, Taxpayer states, qualifies for the exemption under both *Cave Stone* and IC § 6-2.5-5-3(b).

The Department does not agree with this position. The Indiana Tax Court recently reaffirmed the well-established requirement that a taxpayer claiming the exemption listed under IC § 6-2.5-5-3(b) use the equipment in question in its own production process. In *Merchandise Warehouse Co., Inc. v. Ind. Dept. of State Revenue*, 67 N.E.3d 666 (Ind. Tax 2017), the court provided:

Merchandise Warehouse's argument, however, ignores one salient point: both the Consumption and Equipment Exemptions employ a "double direct" standard. See I.C. §§ 6-2.5-5-3, -5.1. As this Court has previously explained, the minimum threshold requirement of the double direct standard is that the taxpayer who purchases the electricity or equipment in question must use those purchased items as part of its own process to produce other tangible personal property, "not as part of an alleged process of another taxpayer." See *Indiana Waste Sys.*, 633 N.E.2d at 362-63. See also *Interstate Warehousing*, 783 N.E.2d at 252. *Id.* at 671-72, (Emphasis in original).

In the instant protest, Taxpayer provided explanation and documentation in support of its position that the pouring of cement into a well is a required and specific step in an overall oil or gas extraction process. After review of the documentation, the Department does not agree that Taxpayer was performing a production step in its own process, as required by IC § 6-2.5-5-3(b) and as confirmed by the court in *Merchandise Warehouse*. Rather, Taxpayer performed a service to the entities who were extracting oil or gas from the ground through the well. While Taxpayer's activities are certainly required to create a functioning well, the production process of extracting oil or gas is not Taxpayer's. The production process is Taxpayer's customer's process. Therefore, Taxpayer's cement pouring activities do not qualify for the exemption found under IC § 6-2.5-5-3(b) and Taxpayer's claim for refund of sales tax was correctly denied.

FINDING

Taxpayer's protest is denied.

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