DEPARTMENT OF STATE REVENUE

04-20170443.LOF

Letter of Findings Number: 04-20170443
Use Tax
For Tax Years 2013, 2014 & 2015

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 Indiana Department of Revenue'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 This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.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

Indiana Restaurant Franchisee was able to produce documentation and explanation showing a higher exemption rate for utility usage than originally determined by the Department, thus entitling Indiana Restaurant Franchisee to predominant use tax exemption on utility purchases.

ISSUE

I. Use Tax–Utilities - Predominant Use Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; *Aztec Partners, LLC v. Indiana Dep't of State Revenue*, 35 N.E.3d 320 (Ind. Tax Ct. 2015); *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; 45 IAC 2.2-4-13.

Taxpayer protests the imposition of use tax on utilities.

STATEMENT OF FACTS

Taxpayer owns and operates a franchised fast-food restaurant location in Indiana. The location operates 18 hours per day. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer did not pay sales tax on all of its taxable utility usage for the tax years 2013, 2014, and 2015. The Department therefore issued proposed assessments for use tax and interest for those years. The audit did not impose additional penalties on the use tax assessments.

Taxpayer had previously been granted partial exemptions based upon utility studies submitted by Taxpayer; Taxpayer submitted updated utility studies to the Department, claiming the predominant use exemption. The Department reviewed the application and granted the predominant use exemption and an ST-109 was issued to Taxpayer in September 2015. Taxpayer's electricity utility provider stopped assessing Indiana sales tax on Taxpayer's electricity purchases after March 2016.

The Department subsequently audited Taxpayer for tax years 2013, 2014, and 2015, and the utility exemptions were reviewed as part of that audit in order to determine whether Taxpayer was entitled to the predominant use exemption. Following a tour of Taxpayer's restaurant location, the Department determined that Taxpayer qualified for 42 percent exemption for sales tax paid on the purchase of electricity used in the production process for each store. The auditor relied upon metered results from a similar, but separately owned, restaurant to determine the kilowatt hours consumed by various pieces of equipment used in the food production process.

Taxpayer protested the imposition of use tax on the utility purchases, asserting that it was entitled to a 100 percent predominant use exemption per the Department's original approval. Taxpayer did not protest any other assessment in the audit. An administrative hearing was held at which Taxpayer and Taxpayer's representative explained the basis for the instant protest. This Letter of Findings results. Further facts will be supplied as required.

I. Use Tax– Utilities - Predominant Use Exemption.

DISCUSSION

The Department's audit found that Taxpayer was not entitled to the predominant use exemption on the purchase of electricity because Taxpayer did not meet the 50 percent usage threshold necessary for the exemption. Specifically, the audit found that some equipment included in Taxpayer's utility study was not present during the auditor's tour of the store, and after computing all the usages of the production equipment, the auditor determined that 42 percent of the Taxpayer's electricity is used for exempt purposes. The auditor did not get specific ratings on certain machines and instead used standard ratings that the Department had been using on other utility studies stating that these measurements were standard for these larger pieces. The auditor went on to state that the load factors, protested by Taxpayer, were consistent with load factors that the Department had been using for other utility studies.

Taxpayer protests the imposition of use tax on its purchase of utilities at the restaurant it owned and operated during the tax years at issue. Taxpayer argues that the audit improperly disregarded Taxpayer's 2015 utility study, which showed that it was entitled to a predominant use tax exemption, and instead relied on a study from a different location that used outdated information. Also, the metered results were for a 24-hour restaurant and had been completed 12 years prior to Taxpayer's audit.

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.
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> (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 if sales tax was not paid at the time of the transaction, unless an applicable exemption is available.

An exemption from sales and use tax is provided for tangible personal property purchased for use in direct production of other tangible personal property. This exemption is found in IC § 6-2.5-5-5.1, which states:

> (a) As used in this section, **"tangible personal property" includes electrical energy, natural or artificial gas, water, steam, and steam heat**.
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> (b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining,

repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

(**Emphasis added**).

In the case of electrical usage, 45 IAC 2.2-4-13 explains:

> (a) In general, the furnishing of electricity, gas, water, steam, or steam heating services by public utilities to consumer is subject to tax.
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> (b) The gross receipt of every person engaged as a power subsidiary or a public utility derived from selling electrical energy, gas, water, or steam to consumers for direct use in direct manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5 shall not constitute gross retail income of a retail merchant received from a retail transaction. Electrical energy, gas, water, or steam will only be considered directly used in direct production, manufacturing, mining, refining, oil or mineral extraction, irrigation, agriculture, or horticulture if the utilities would be exempt under IC 6-2.5-5-5.1.
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> (c) Sales of public utility services or commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5, based on a single meter charge, flat rate charge, or other charge, are excepted if such services are separately metered or billed and will be used predominantly for the excepted purposes.
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> (d) Sales of public utility services and commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, or horticulture, based on a single meter charge, flat rate charge, or other charge, which will be used for both excepted and nonexcepted purposes are taxable unless such services and commodities are used predominantly for excepted purposes.
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> (e) **Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall mean that more than fifty percent (50[percent]) of the utility services and commodities are consumed for excepted uses.**
> (**Emphasis added**).

Therefore, if 50 percent or more of electricity sold from a single meter is used in an exempt manner, the purchaser/taxpayer is considered to have predominantly used the electricity for exempt purposes and the electricity sold through that meter is wholly exempt from sales tax and use tax. In order to qualify for the exemption, a taxpayer must show that "1) it is engaged in production, 2) it has an integrated production process, and 3) the electricity is essential and integral to its integrated production process." *Aztec Partners, LLC v. Indiana Dep't of State Revenue*, 35 N.E.3d 320, 324 (Ind. Tax Ct. 2015).

The audit determined that Taxpayer's restaurant did not qualify for the predominant use exemption and recalculated the percentage of exempt use of the utilities. The Department recalculated the exempt usage rate as 42 percent. The Department based its determination that the restaurant's utility usage was not predominantly exempt on metered results based on the standard utility study used by the Department for similar establishments.

Taxpayer presented documentation showing that the Department's load factor calculations were understated for many pieces of equipment. Taxpayer also contested the "demand factors" used by the Department. Both these factors are key variables in determining the energy consumption of each piece of electrical equipment. Taxpayer also specifically stated that the Department's study omitted equipment and that the Department understated ratings of two pieces of equipment. Taxpayer provided information from equipment manufacturers showing the load factors for equipment currently being used by Taxpayer, which is the percentage of time the equipment is operating at full power.

Taxpayer also provided pictures of omitted equipment. Taxpayer stated that heated production counters and landing zones, a water booster pump, a bun steamer, and an exhaust fan were not included in the Department's study. Taxpayer explained that the heated production areas are used to keep buns and proteins at serving temperature while condiments are added and packaged. Taxpayer stated the water booster pump is used to increase the pressure for the beverage system. The bun steamer is used to warm the buns for customers. The exhaust fans are used over the grills and fryers during all store hours. As stated in *Aztec Partners, LLC*, electricity

is exempt if the equipment is engaged in production, has integrated production process, and is essential and integral to the production process.

Taxpayer provided pictures of the heated production counters and landing zones, water booster pump, and bun steamers to show that they are engaged in and integral to Taxpayer's integrated production process. While the photos are useful evidence, the photos do not show the full context of use, the Taxpayer is sustained subject to the review and verification of the presence and use of the equipment. The exhaust fan however does not meet the standard laid out by the Tax Court in *Aztec Partners*, thus Taxpayer is denied on its protest regarding the exhaust fan.

Taxpayer also protested the watts rating on the microwave ovens and toasters. The Department listed the microwave ovens at 2000 watts and the toasters at 3400 watts and 3700 watts. Taxpayer provided pictures from the equipment with the manufacturing specifications. The pictures show the microwave ovens operate at 3200 watts and the toasters operate at 9600 watts and 3400 watts. The Department will review the pictures and documentation to verify the ratings.

Taxpayer also provided statements from manufacturers and franchise equipment installers and repairmen to protest the Department's understated load factors. Taxpayer specifically protested the load factors for the ice cream machine, heated cabinets, orange juice machine, toasters, and tea brewers. Taxpayer was able to provide manufacturer documentation to verify these statements thereby meeting the burden of providing the Department's proposed assessment wrong.

Taxpayer also protested the demand variable of the equipment on the Department's utility study. The Department based its demand variables on standards it developed in prior utility studies. The usage, or demand variable, is used to calculate Taxpayer's exemption, a higher usage a higher exemption percentage. Taxpayer stated its demand variable is higher than what the Department used in its utility study. Taxpayer provided no evidentiary support to justify its demand variable. Thus, Taxpayer's protest of the demand variables is denied. Taxpayer's protest of the exhaust fan exempt is also denied. Based on the information provided by the Department and Taxpayer, Taxpayer is sustained on all its protested items, subject to audit review and verification, except for the exhaust fan.

FINDING

Taxpayer's protest is sustained subject to audit review and verification. Taxpayer is denied on its protest regarding the exhaust fan and the demand variable.

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