DEPARTMENT OF STATE REVENUE

04-20170916.LOF

Letter of Findings: 04-20170916
Gross Retail and Use Tax
For the Years 2011, 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 and is not part of the analysis contained in this Letter of Findings.

HOLDING

Automobile Parts Manufacturer established that it was entitled to an adjustment on the amount of use tax refund it had requested and an adjustment on the amount of sales tax it had been assessed; however, the Department was unable to agree with Parts Manufacturer that it established it was entitled to an exemption on many of the other requested items such as labels, forklift usage, welding equipment, and welding supplies.

ISSUES

I. Gross Retail and Use Tax - Equipment Used in Direct Production.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(c); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *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); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.,* 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Guardian Automotive Trim, Inc. v. Indiana Department of State Revenue*, 811 N.E.2d 979 (Ind. Tax Ct. 2004); *Rhoade v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); 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 2.2-5-8(k).

Taxpayer argues that the Department erred in assessing sales/use tax on the purchase of equipment used in the manufacture of Taxpayer's automobile parts.

II. Gross Retail and Use Tax - Safety Equipment.

Authority: 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); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); 45 IAC 2.2-5-8(c)(2)(F).

Taxpayer maintains that its purchases of various items of safety equipment are exempt from sales/use tax because the items are necessary for its employees to safely work within Taxpayer's manufacturing facility.

III. Gross Retail and Use Tax - Calculation Errors.

Authority: IC § 6-8.1-5-1(c).

Taxpayer argues that the Department's audit report contains errors including charges that were duplicated on both the audit's listing of both capital assets and statistical worksheets.

IV. Gross Retail and Use Tax - Research and Development Equipment.

Authority: IC § 6-2.5-5-40; IC § 6-2.5-5-40(a)(7); IC § 6-8.1-5-1(c); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Sales Tax Information Bulletin 75 (April 2017).

Taxpayer disagrees with the Department's assessment of sales/use tax on Taxpayer's purchase of "research and development equipment."

V. Gross Retail and Use Tax - Testing Equipment.

Authority: IC § 6-8.1-5-1(c); 45 IAC 2.2-5-8(b); 45 IAC 2.2-5-8(i).

Taxpayer argues that it is entitled to a sales/use tax exemption on the purchase of equipment used in "testing" and in "quality control/assurance" activities associated with the manufacture of its auto parts.

VI. Gross Retail and Use Tax - Calculation Errors / Invoices.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); *Wendt LLP v. Indiana Dep't of state Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.,* 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp*., 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer claims that the Department's audit "Summary Report" erred when it classified a particular transaction as "taxable" when there was no invoice evidencing the transaction.

VII. Gross Retail and Use Tax - Exempt Forklift Usage.

Authority: IC § 6-2.5-5-3; *General Motors Corp. v. Indiana Dep't of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); 45 IAC 2.2-5-8(f).

Taxpayer argues that the Department erred in rejecting Taxpayer's original "forklift study" and thereby erred in determining that its exempt forklift usage was less than the amount determined by Taxpayer.

VIII. Gross Retail and Use Tax - Containers Used to Transport Work-in-Process.

Authority: 45 IAC 2.2-5-8(e); 45 IAC 2.2-5-16.

Taxpayer argues its purchases of various containers and shelves are exempt because the containers are used to transport its automobile parts from one step in Taxpayer's production process to the next step and because the shelves are used to temporarily store the work-in-process auto parts.

IX. Gross Retail and Use Tax - Material Handling Equipment.

Authority: IC § 6-8.1-5-1(c); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-8(d); 45 IAC 2.2-5-8(e); 45 IAC 2.2-5-8(k).

Taxpayer maintains that the Department erred in concluding that "material handling machinery and equipment" used within its manufacturing facility was subject to sales/use tax.

X. Gross Retail and Use Tax - Labels.

Authority: IC § 6-8.1-5-1(c); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-14(d).

Taxpayer maintains that its purchases of labels and label printers are exempt from sales/use tax because the labels become an integral part of the auto parts sold to its customers.

XI. Gross Retail and Use Tax - Steel and Poly Strapping Materials and Strapping Equipment.

Authority: IC § 6-2.5-5-3(b); IC § 6-2.5-5-5.1(b); IC § 6-2.5-5-9(d); 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(d); 45 IAC 2.2-5-8(g); 45 IAC 2.2-5-16.

Taxpayer states that its purchase of steel and poly strapping materials along with the equipment associated with the application and installation of the strapping materials are exempt.

XII. Gross Retail and Use Tax - Exempt Services.

Authority: 45 IAC 2.2-4-2; 45 IAC 2.2-4-2(a).

Taxpayer argues that the Department's audit erroneously assessed sales/use tax on Taxpayer's purchase of exempt services.

XIII. Gross Retail and Use Tax - Statute of Limitations.

Authority: IC § 6-8.1-5-2(a); IC § 6-8.1-9-1(b); IC § 6-8.1-9-2(a), (c); 45 IAC 15-5-7(a).

Taxpayer maintains that the Department's audit incorrectly assessed use or sales tax on purchases of tangible personal property because the purchases were made prior to January 1, 2011, and the tax adjustments are barred by the three-year statute of limitations.

XIV. Gross Sales and Use Tax - Lump-Sum Contracts.

Authority: IC § 6-2.5-3-2(c); IC § 6-8.1-5-1(c); 45 IAC 2.2-4-26(a); Sales Tax Information Bulletin 60 (November 2017); Sales Tax Information Bulletin 60 (April 2011); *Designing Buildings*, https://www.designingbuildings.co.uk/wiki.

Taxpayer argues that the Department erred in assessing sales/use tax on payments for lump-sum contracts for improvements to Taxpayer's real property.

XV. Gross Retail and Use Tax - Purchases of Equipment Delivered Outside Indiana.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-3-2(e).

Taxpayer maintains that the Department's audit assessed sales/use tax on purchases of equipment which were delivered to locations outside Indiana and that these transactions are exempt from Indiana's sales/use tax.

XVI. Gross Retail and Use Tax - Taxable Ratios.

Authority: IC § 6-2.5-5-3(b); 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(g).

Taxpayer argues that the Department erred in determining the "taxable ratio" of items and equipment purchased from three different vendors.

XVII. Ten-Percent Penalty - Administration.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(2); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks that the Department exercise its authority to abate the ten-percent negligence penalty on the ground that Taxpayer did not act with willful negligence.

XVIII. Gross Retail and Use Tax - Best Information Available.

Authority: IC § 6-8.1-5-1(b); IC § 6-8.1-5-1(c).

Taxpayer argues that the Department's audit made numerous errors and omissions which had a significant and ill-considered impact on Taxpayer's refund claim and the resulting assessment of additional tax.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of manufacturing automobile parts. Taxpayer operates a manufacturing facility in Indiana. Taxpayer also operates a research and development facility located in the same Indiana municipality. In addition to performing research and development activities at this second facility, the facility manufactures prototype auto parts for sale to its customers. Taxpayer also operates manufacturing facilities located outside Indiana.

Taxpayer filed a claim for a refund of sales and use tax paid during 2011. Taxpayer based its claim on the ground that it had overpaid use tax on exempt purchases and that it had incorrectly paid sales tax on the purchase of exempt items.

The Indiana Department of Revenue ("Department") conducted a review of the 2011 refund claim. The Department decided to simultaneously conduct a review of Taxpayer's accounts payable records and capital asset acquisitions for 2011 through 2013. The Department's audit review commenced January 2015. The Department began actual review of Taxpayer's documents August 2015. The second of two "final conferences" was conducted June 2017.

Based on the substantial number of 2011 through 2013 Taxpayer's records, the Department decided to prepare a "statistical sampling" of those records. Taxpayer agreed to the sampling methodology and signed form AD-10A ("Agreement for Projecting Audit Results") to that effect.

In addition to the sampling projection, the Department's audit representatives toured Taxpayer's Indiana facilities on two separate occasions.

The Department's review resulted in a decision approving a refund of approximately $290,000 and denying a refund of approximately $170,000. However, the Department also determined that Taxpayer owed additional sales and use tax. Given the Department's review of the refund claim and the assessment, the Department determined that Taxpayer owed approximately $480,000 in tax.

Taxpayer disagreed with the Department's decisions and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Gross Retail and Use Tax - Equipment Used in Direct Production.

DISCUSSION

Taxpayer manufactures automobile parts. Taxpayer and the Department agreed that some of the manufacturing equipment purchased was exempt because the equipment was directly used in the direct production of Taxpayer's automobile parts. However, the Department determined that some of the equipment was not exempt because the equipment was not "directly used" in the direct production of the parts and/or because the equipment did not have an "immediate effect" on the manufactured auto parts.

1. Welding Equipment.

Taxpayer argues that these six items of welding equipment are exempt because the welding equipment is directly used in the production of Taxpayer's auto parts and because the equipment has an immediate effect on those parts.

- Welder Wire Feeders
- Welder Cables
- Welder Power Supplies
- Welder Motor Cables
- Network Cables
- "Insequence MES Software"

2. Nozzle Cleaners.

Taxpayer argues that its purchases of "Nozzle Cleaners" are exempt because the nozzles are "used directly in the integrated production of [automobile] parts."

3. Other Machinery & Equipment.

Taxpayer also argues that certain items it categorizes as "Other Machinery & Equipment" are exempt because these items are directly used in the direct production of its automobile parts and because these items have an immediate effect on the auto parts. Taxpayer maintains that the following items - or categories of items - are exempt:

- Chillers;
- Slag Pans;
- Fronius Plasma Cutters;
- CD&PD Drive Controls for Benders;
- Control Panels for Production Machinery & Equipment;
- Software to Operate Production Machinery & Equipment;
- Weld Mandrel on [auto part] lines and Flanger Lines;
- Turntables;
- Robotic Welders with Pedestals Added;
- De-Stackers;
- Laser Etchers;
- Spin Form Machines;
- Trim Machines;
- Weil Tube Former Machinery;
- *and* "other machinery and equipment . . . .";
- *and* "repair and replacement parts for aforementioned direct production machinery and equipment."

A. Audit Results / Welding Equipment.

The Department's audit review determined that the welding equipment was not exempt from sales and/or use tax because this equipment was "pre-production" equipment and did not have a direct and immediate effect on Taxpayer's automobile parts. The Department's audit report explains as follows:

> The [T]axpayer also purchased many items that were not directly used within [T]axpayer's direct production processes. [These] included wire feeders and various wire feeder accessories and repair parts. The wire feeders are used to guide wire from a welding wire source up to welding guns where the wire is then used to weld parts together. The feeding of this wire by these wire feeders is considered to be a pre-production activity and is subject to tax under 45 IAC 2.2-5-8(d) which discusses pre- and post-production activities. [45 IAC 2.2-5-8(d)] outlines the direct use of tangible personal property and states that "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. Since feeding welding wire to welding guns is not part of the integrated production process and is an activity happening steps removed from this process, the use of the wire feeders and all related repair parts and accessories are subject to tax.

The regulation on which the audit relied, 45 IAC 2.2-5-8(d), provides:

> 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.

B. Taxpayer's Response / Welding Equipment.

Taxpayer disagrees with the Department's conclusion arguing that the "Welder Wire Feeders," "Welder Cables," "Welder Power Supplies," "Welder Motor Cables," "Network Cables," and "Insequence MES Software" are exempt and explains:

> The auditor . . . inaccurately claims that the welder wire feeding process is an activity that is happening steps removed from the integrated production process. Despite two plant tours and a review of the purchase invoices, the auditor should have had a greater understanding and knowledge of the functional interrelationship between the welder wire feeders and the welding equipment at each weld cell within the plant. An examination of the purchase invoices indicates that each time a welder is purchased for a particular production weld cell, the welder wire feeder, welder power supply, and welder cabling for the welder is also purchased. This is because one unit simply cannot function without the other. The welder wire feeder, welder, power source and all cabling are interconnected and fully integrated to function as a single piece of manufacturing equipment to act on the weld wire within the weld cell. The welder wire feeders are powered and controlled and act on the weld wire during the welding process.

In addition to the welder wire feeder, welder, power source, and cabling, Taxpayer maintains that items purchased from its welding supply vendor - "Airgas" - are exempt from sales/use tax and "protests the

assessment [of] use tax or denial of refund of the following . . . purchases from Airgas" on the ground that the items purchased are directly used in the direct production of Taxpayer's auto parts and because the items have an immediate effect on those parts. The disputed items include the following:

- Welder wire feeders
- Welder wire feeder repair parts including, but not limited to:
  - Wire feeder connector kits
  - Wire feeder 2-way port valve 40 VDC
  - KT drives for welder wire feeders
  - Kit drive rolls
  - Locating spacers
  - Mig guns
  - Mig gun liners
  - Mig pliers
  - Guides and guide wires for welder wire feeders
  - LH adapters for welder wire feeders
  - V-grooved drive roll
  - Carrier drives
  - Kit user interface modules
  - Pressure roll top
  - Drive pinion
  - Guide caps
  - And "other parts not listed above related to welder wire feeders"
- Clamps and grounding clamps used for welding hoses and cabling for the welders in the weld cells,
- Water coolers, water cooler pumps, water chillers used to cool welders,
- Coolant used with water in the chillers and water coolers,
- Circulators to circulate the water and coolant,
- Conduit used to supply power to welding equipment,
- Cabling including network cabling used to operate the welders,
- Flow meters used to measure and regulate the flow of welding gases,
- Safety clutch,
- Welding torches, welding torch assemblies, and welding guns,
- Welding hoses used to supply gas to welders,
- Replacement pumps and filters for welders,
- Interfaces for welders,
- Nozzle cleaners for welders,
- Adapters, connector kits, cable bundlers,
- Sweatbands for workers to prevent sweat from getting in their eyes while they are welding. (Taxpayer explains, "This is a safety issue to prevent their vision from being impaired during welding operations which could result in bodily injury."),
- "Other Related Components."

C. Audit Results / Nozzle Cleaners.

The Department's audit determined that Taxpayer purchased "nozzle cleaners," and that Taxpayer owed use tax on these purchases. Other than noting that these items were subject to tax, the audit report itself contains no specific analysis or explanation of whether or not the cleaners were used in the production of the auto parts.

D. Taxpayer's Response / Nozzle Cleaners.

Taxpayer maintains that the nozzle cleaners are exempt because they are "used directly in the integrated production of [Taxpayer's auto] parts." Taxpayer explains:

> Nozzle cleaners are installed directly on the weld cells and robotic welders and fully integrated into the welding equipment. The nozzle cleaners are not located off-line or in a maintenance area, but operate within the weld cell itself. The nozzle cleaners are systems that clean the welder nozzles at pre-programmed intervals depending on the type of welding operations being performed and the types of parts being welded. Each part number requires a specific amount of weld and number of different welds, so the amount of wire that passes through the nozzle varies from part to part. One weld cell may require the nozzle to be cleaned every 50 parts where others may require the nozzles to be cleaned every 100 parts. The frequency of the required nozzle cleaning is programmed into the weld equipment. When the nozzle is cleaned, the welding

machine moves the nozzle from the "home" position, the nozzle is cleaned and then mechanically moved back to the home position and the next part is ready for welding. The cleaning process takes less than a minute and happens automatically. The nozzles at each weld station must be cleaned to allow for proper welding to take place. If the nozzle is not cleaned at the specified intervals, material builds up on the nozzle, preventing the equipment from making a quality weld. If the parts are not welded per the customer's specifications, the parts will be rejected, resulting in a part that is not marketable.

F. Taxpayer's Response / Other Machinery & Equipment.

Taxpayer also contends that certain "Other Machinery & Equipment" qualifies for the manufacturing exemption. Taxpayer explains that its chillers are exempt from sales/use tax because:

> [The] chillers [are] used to cool production machinery and equipment. These chillers are used throughout the plant to cool production machinery and equipment during production operations. Various pieces of machinery require chillers to be installed directly next to the production line or production cell. It is essential to cool machinery to prevent the machinery from being damaged or destroyed due to overheating.

Taxpayer states that its "slag pans" are exempt from sales/use tax because:

> [The slag pans] are installed and integrated into the welders to catch flux material that comes off the welders during production operations. This equipment is fully integrated into the welders and serve a functional interrelationship with the welders.

Taxpayer explains that its computer software and computer hardware are exempt because:

> During the audit period [Taxpayer] purchased and capitalized computer hardware and software used to operate direct production machinery and equipment. Computer hardware includes View [S]onic control panels and touch screens used to input instructions into the machines. Software and drives are used to operate production machinery and equipment including benders. The drives and software sends instructions to the machinery to direct the machinery's operations.

Taxpayer claims that its "mandrels" ("[A] round object against which material can be forged or shaped; or a tool component such as a chuck that grips or clamps materials to be machined in a lathe, or any other part which is to be spun or rotated.") are exempt because the mandrels are "used on production lines . . . ."

Taxpayer argues that its robotic welders and pedestals are exempt from sales/use tax.

Taxpayer maintains that its turntables are exempt from sales/use tax because the "turntables [are] used to turn parts during welding operations."

Taxpayer states that its laser etchers are exempt from sales/use tax because they "etch part number information on the [auto] parts."

Taxpayer claims that its spin form machines are exempt from sales/use tax because they "spin and form parts."

Taxpayer maintains that its "trim machines" are exempt from sales/use tax because they are "used to trim [auto] parts."

Taxpayer states that its "Weil Tube Forming" equipment is exempt from sales/use tax because the machinery has an immediate effect on the auto parts.

Taxpayer argues that its "Fronius plasma cutters" are exempt from sales/use tax because the cutters are used "to cut steel for production of [auto] parts."

Taxpayer does not explain how the remaining items classified as "other machinery and equipment . . ." are exempt from sales/use tax.

G. Hearing Analysis.

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 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). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.,* 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). 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, interpretations of Indiana tax law contained within this decision, as well as the preceding audit reference, are entitled to deference.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" 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." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is functionally equivalent to the sales tax. See *Rhoade v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

Taxpayer is in the business of manufacturing automobile parts. The general rule is that *all* purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property - such as Taxpayer's auto parts - *are* taxable. 45 IAC 2.2-5-8(a).

However, the Department's regulation, 45 IAC 2.2-5-8, explains that a taxpayer is entitled to purchase machinery, tools, and equipment without paying 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." The regulation further states that "[p]roperty 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." *Id*. *See* IC § 6-2.5-5-3(b). However, it should also be noted that - as pointed out in the audit report - "[t]he fact that a particular property may be considered essential to the conduct of the business of manufacturing because its use is required . . . by practical necessity does not itself mean that the property 'has an immediate effect upon the article being produced.'" 45 IAC 2.2-5-8(g).

Proper application of this particular exemption requires determining at what point "production" begins and at what point "production" ends. 45 IAC 2.2-5-8(d) states:

> 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.

(*Emphasis added*).

Finally, 45 IAC 2.2-5-8(k) specifies that, in order to qualify for the exemption, the articles being produced have undergone a "substantial change."

> "Direct production, manufacture, fabrication, assembly, or finishing of tangible personal property" is performance as a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change, and it must result in a transformation of property into a different product having a distinctive name, character, and use. Operations such as compounding, fabricating, or assembling are illustrative of the types of operations which may qualify under this definition.

To summarize, every item of machinery, tools, and equipment purchased for use in the production of goods is subject to sales or use tax unless the property has a direct, immediate and substantial effect on the goods produced and is essential to an integrated process used to produce those marketable goods.

The issue in this case is whether such items as "Welder Wire Feeders," "Welder Cables," "Welder Power Supplies," and "Nozzle Cleaners" are exempt because these items are "directly used in the production process because they have an immediate effect on the article being produced." 45 IAC 2.2-5-8(c); IC § 6-2.5-5-3(b).

IC § 6-2.5-5-3(b) like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

On the issue of the nozzle cleaners, Taxpayer also relies on the Indiana Tax Court's decision in *Guardian Automotive Trim, Inc. v. Indiana Department of State Revenue*, 811 N.E.2d 979 (Ind. Tax Ct. 2004), *transfer denied,* 831 N.E.2d 737 (Ind. 2005). In that case, the tax court held that solvents used to clean paint masks were exempt because the use of the solvents occurred during Taxpayer's production of automotive parts, because the solvents were inextricably linked to the production of the parts, and because parts production did not halt during the time the masks were being cleaned. *Id.* at 985.

The Department agrees that Taxpayer's reliance on *Guardian Automotive* is not unfounded because - like the use of the solvents in *Guardian* - the function of Taxpayer's nozzle cleaners is synchronized with and an essential and integral part of Taxpayer's production of its various automobile parts. *Guardian*, 811 N.E.2d at 985.

However, the Department is unable to agree with Taxpayer's more wholesale request to exempt the numerous other items on Taxpayer's list. The Department acknowledges that Taxpayer has provided photographs and extensive descriptions of these items but the photographs and descriptions - without knowing how, where, or when these items are utilized - are simply insufficient to meet Taxpayer's burden of establishing that the assessment was "wrong." IC § 6-8.1-5-1(c). The Department acknowledges the likelihood that Taxpayer could not produce automobile parts without many of the items on Taxpayer's list but sheer practical necessity does not solely drive the exemption analysis. As the Department has long explained, "practical necessity does not mean that the property 'has an immediate effect upon the article being produced.'" 45 IAC 2.2-5-8(g) (1982).

In the end, do Taxpayer's robotic welders and turntables have a direct and immediate effect on Taxpayer's auto parts? It's possible and perhaps even likely but simply unknowable based on the information available. Do Taxpayer's sweatbands, "other machinery and equipment . . ." and "other items not listed" have an immediate effect on those automobile parts? It's unlikely but ultimately also unknowable.

However essential they may be, it is not possible to determine with any certainty that any of the items have an "immediate effect" on Taxpayer's products. IC § 6-2.5-5-3(b). The Department notes that the law mandates that the "manufacturing" exemption statute be "strictly construed against exemption from the tax." *Tri-States*, 706 N.E.2d at 283; 45 IAC 2.2-5-8(g).

FINDING

With the exception of the nozzle cleaners, Taxpayer's protest is respectfully denied.

II. Gross Retail and Use Tax - Safety Equipment.

DISCUSSION

Taxpayer purchased equipment which it believes is exempt from sales or use tax on the ground that the equipment is necessary for its employees to safely participate in Taxpayer's auto parts production. Taxpayer maintains that the purchases of the following items are exempt from sales/use tax.

- Light Curtain Emitters
- Laser Scanners
- Fencing
- Guarding
- Roll-Up Curtains
- Welding Curtains

A. Audit Results.

The Department's audit found that the items listed above were subject to sales/use tax because the items were not necessary to allow Taxpayer's employees to safely work within Taxpayer's production facility and because the items did "not have an immediate and direct effect upon the product being produced." The Department's audit report explains:

> [T]axpayer also purchased safety equipment to upgrade production machinery within the [Indiana] manufacturing plant. The safety equipment purchased included safety scanners and safety sensors, light curtains, E-stop switches, machine guarding systems, safety mats, safety relays, and many other safety-related equipment and materials. These items were purchased as singular units separate from any production equipment but at some point were installed in or around production machinery. Each of these pieces of safety equipment were found to have been used to make the areas surrounding production equipment safer but did not increase or restrict a production employee's ability to work around these machines. In essence, the safety equipment purchased did not play a role in one's ability to work around these machines. For example, safety scanners were purchased from multiple vendors. An online search provided that safety scanners are used to safeguard any area through customizable protection and warning zones. To further explain how these items are subject to tax, one must look at the nature of the transactions themselves. Each of these items were purchased after the production machinery was installed at the [Indiana] plant, an add-on if you will. These items are taxable under 45 IAC 2.2-5-8(c)(2)(F) due to the fact that the safety equipment purchased was not found to be required safety equipment that would allow a worker to participate in the production process without injury or contaminating products during production. Furthermore, the use of this safety equipment does not have an immediate and direct effect upon the product being produced.

The regulation on which audit cites, 45 IAC 2.2-5-8(c), example (2)(F), provides in relevant part as follows:

> The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

. . . .

> Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

B. Taxpayer's Response.

> The fencing, guarding, gates, and other structures surrounding the machinery and equipment restrict the production worker's movement around the machinery while it is operating. The equipment prevents them from reaching inside the machine while it is operating. It also prevents the workers from inadvertently coming into contact with the machinery either by slipping, falling, or stumbling in the work area. The auditor also attempts to disqualify this equipment because it was purchased separately from the original equipment and that it was purchased from several vendors.

. . . .

> [Taxpayer's] light curtain emitters, which are attached to both sides of each machine, emit a light beam across the face of the machine. If during the production operation, the light beam is broken, the machine automatically shuts down and production stops. This prevents a production worker from having any part of his/her body come in contact with the machine while it is operating and thus prevents the operator from losing or damaging a portion of their body. Likewise, [Taxpayer] installed laser scanners on production machinery and equipment. These laser scanners operate in much the same way as the light curtain emitters. They emit a light beam in front of the machine that shuts down the machine if a worker gets too close and breaks the light beam. If the machinery shuts down due to the light beam being broken, the machine has to be manually restarted for production to continue. Roll-up curtains are curtains that are installed in the weld cells. These curtains are physical barriers installed on the weld cells and roll down prior to the weld taking place. The curtains allow the welding to [] take place while the production worker monitors the process on a nearby screen. The intense light from the welders can cause serious and permanent damage to the production worker's eyes even if the production worker is not looking directly at the welder. Fencing and guarding installed around the machinery and equipment is used where light curtains and laser scanners are not

practical. This fencing and guarding prevents the production worker from getting too close to the machine while it is operating, thus preventing bodily injury. All fencing and guarding must be closed and locked while a machine is in operation.

C. Hearing Analysis.

45 IAC 2.2-5-8(c), example (2)(F), like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). To the extent that the Department assessed tax on these items, Indiana law, IC § 6-8.1-5-1(c), places squarely on Taxpayer the responsibility of establishing that the tax assessment is incorrect. "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).

Bearing in mind Taxpayer's responsibility for establishing that any assessment was wrong and that the sought-after exemption is "strictly construed," the Department is prepared to agree that there is sufficient information to establish that the purchase of the, "Light Curtain Emitters," "Laser Scanners," "Roll-Up Curtains," and "Welding Curtains" are exempt from sales/use tax. The only discernible use of these items within Taxpayer's facility is to "allow [] worker[s] to participate in the production process without injury." 45 IAC 2.2-5-8(c) example (2)(F). The Department does not agree with the audit's argument that items purchased after installation of the primary equipment are - by their nature as an "add-on" - subject to tax. However, the information provided concerning the use and necessity of the "Fencing" and "Guarding" is at best ambiguous. It is quite possible that Taxpayer purchased the items in order to enable its employees to work in Taxpayer's facility without injury. However, there is nothing which established that *all* of the Fencing and Guarding was purchased for that exempt purpose. Taxpayer has not established that the items were purchased for taxable security or convenience purposes. Therefore, Taxpayer is not entitled to either a refund or abatement of any assessment associated with the "Fencing" and "Guarding."

FINDING

Taxpayer's protest is sustained in part and denied in part. The Department agrees that the "Light Curtain Emitters," "Laser Scanners," "Roll-Up Curtains," and "Welding Curtains" are exempt from sales/use tax.

III. Gross Retail and Use Tax - Calculation Errors.

DISCUSSION

Taxpayer argues that the Department's audit report contains calculation errors. Taxpayer points to two separate categories of calculation errors. Taxpayer explains the first category of calculation errors:

> [Taxpayer's] tax representative found . . . duplication. After carefully reviewing the capital assets worksheets, the statistical [Taxpayer] worksheets and the provided invoices, [Taxpayer's] tax representative identified entries that were duplicated on both worksheets. This duplication overstates the actual use tax liability and creates undue hardship on the [T]axpayer.

Taxpayer identifies a separate category of errors in which "tax was previously paid." Taxpayer explains:

> During the audit period, [Taxpayer] paid sales tax to certain vendors for purchases of tangible personal property. [Taxpayer] also had a system in place for remitting and documenting use tax paid on certain purchases. The audit assessed use tax on purchases in which sales tax was paid to the vendor or use tax remitted directly to the Department. Assessing use tax on purchases in which tax was previously paid overstates the tax liability and creates an undue hardship on the taxpayer.

The Enforcement Division is requested to review Taxpayer's documentation and to make whatever adjustments to its original decision the Division finds are fully warranted.

FINDING

Taxpayer's protest is sustained subject to the review and conclusions of the Department's Enforcement Division.

IV. Gross Retail and Use Tax - Research and Development Equipment.

DISCUSSION

During the period under audit review, Taxpayer purchased items of "research and development" equipment and other related property. Taxpayer explains that these items are exempt from sales and use tax because the items are used in the "development of new parts or to make improvements to existing parts." Taxpayer argues it is entitled to the sales/use tax exemption on the following nine specific categories of equipment and software:

- Computers;
- Test cells;
- Gauges;
- IBM systems;
- Multigas sampling systems;
- Sound test systems;
- Software used to collect data;
- Software used to operate lab equipment;
- Computer equipment in the Research and Development (R&D) lab.

A. Audit Results.

The Department found that Taxpayer failed to establish that the purchases at issue qualified for the exemption. The audit report states these items "could not be documented by the [T]axpayer directly used in direct research activities . . . ." In doing so, the audit cited to IC § 6-2.5-5-40 (2013) which provides as follows:

(a) As used in this section, "research and development activities" 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 literary, historical, or similar projects.
(7) Testing for purposes of quality control.
(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) 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.
(e) A retail transaction:
(1) involving research and development property; and
(2) occurring after June 30, 2013;

is exempt from the state gross retail tax.
(f) The exemption provided by subsection (e) 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).
(g) 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.

(*Emphasis added*).

The Department's audit report also cited to Sales Tax Information Bulletin 75 (April 2017), (20170226 Ind. Reg. 045170335NRA). The Bulletin provides in part as follows:

> With regard to the exemption available for research and development property purchased after June 30, 2013, there is no longer a requirement that the property have a useful life of one year or more, nor are consumables or hand-powered tools excluded from the definition. The only restrictions are that the property must not have been previously used in Indiana for any purpose and must have been acquired by the purchaser for the purpose of research and development activities. Thus, if an item that is originally purchased for an unrelated purpose--such as inventory held for resale or machinery used for a different purpose--is subsequently used in research and development activities, the use of the item in research and development activities is taxable.
>
> [T]o qualify for the exemption, the property must be used directly in research and development activities. Office supplies, consumables, hand-powered tools, and repair parts are all examples of items that may be exempt from sales tax as research and development property when directly used in research and development activities.
>
> Office furniture, furnishings, storage equipment, and other items that are not used directly in research and development activities are subject to tax.
>
> Additionally, to qualify for the exemption, the property must be devoted to a research and development activity that is considered essential and integral to experimental or laboratory research and development.

The Department's audit concluded as follows:

> Since the [T]axpayer did not demonstrate that the aforementioned items had been used directly in research and development activities, the items are subject to tax in accordance with Indiana Code 6-2.5-5-40 and Sales Tax Information Bulletin 75.

B. Taxpayer's Response.

Taxpayer argues that the Department's audit representatives misunderstood the activities which were conducted in Taxpayer's different facilities. As explained by Taxpayer:

> [T]he auditor does not distinguish the very different activities that take place in the four buildings on the [Taxpayer] campus. As such, he confuses purchases used in manufacturing facility, Building 1, with purchases used strictly for R&D in Building 2.

Taxpayer claims that equipment used within its research and development facility qualify for the sales/use tax exemption set out at IC § 6-2.5-5-40.

> Items that would qualify for an R&D exemption would include computers, test cells, gauges, IBM systems, Multigas sampling systems, sound test systems and software used to collect data and to run the lab equipment and computer equipment in the R&D lab.

Taxpayer concludes:

> During the audit period, [Taxpayer] purchased tangible personal property that qualifies for the R&D exemption under the statutes and regulations effective prior to July 1, 2013. [Taxpayer] also purchased tangible personal property that qualifies for exemption under the current statutes and regulations effective July 1, 2013.

C. Hearing Analysis.

Because the Department's audit resulted in an assessment of additional tax, Taxpayer continued to bear the burden of establishing that the assessment was wrong. IC § 6-8.1-5-1(c). In addition, as with any exemption from tax, IC § 6-2.5-5-40, is strictly construed in favor of taxation. IC § 6-8.1-5-1(c); *Tri-States*, 706 N.E.2d at 283; *Mynsberge*, 716 N.E.2d at 636.

Based on the evidence presented, Taxpayer asks that the Department conclude that the computers, test cells, software and so on are used in designing, refining, and testing "activities directly related to experimental or laboratory research and development for . . . new products . . . new uses of existing products . . . or improving or testing existing products" and "[have] not been previously used in Indiana for any purpose." IC § 6-2.5-5-40(b)(3); IC § 6-2.5-5-40(b)(2). In addition, Taxpayer asks that the Department conclude that its research does not consist of "[t]esting for purposes of quality control." IC § 6-2.5-5-40(a)(7).

The statute, IC § 6-2.5-5-40, is precise and detailed; the statute specifically excludes entire areas of investigation and specifically includes only activities coming within the purview of the statute. The Department does not agree that Taxpayer has met its burden under IC § 6-8.1-5-1(c) of establishing that the audit's conclusion were "wrong" or that the disputed items undisputedly fall within the exemption's parameters. As before, the disputed items may very well be used in the manner described but, based on the information provided, it is not possible to reach the conclusion Taxpayer seeks.

FINDING

Taxpayer's protest is respectfully denied.

V. Gross Retail and Use Tax - Testing Equipment.

DISCUSSION

Taxpayer states that the Department erred in denying it a sales/use tax exemption on the purchase of equipment used to test its automobile parts and/or used in its quality control manufacturing regime.

Taxpayer argues that it is entitled to the exemption on the purchase of the following four items or categories of items:

- Camera Systems;
- Tensile Tester[s];
- Torque Tester;
- "Other Machinery and Equipment Used to Test [auto parts]."

As authority for its position that these four categories of equipment are exempt from sales/use tax, Taxpayer cites to 45 IAC 2.2-5-8(i). The cited regulation provides in relevant part:

> Testing and inspection. Machinery, tools, and equipment used to test and inspect the product as part of the production process are exempt.

45 IAC 2.2-5-8(i) provides an example as follows:

> Selected parts are removed from production according to a schedule dictated by statistical sampling methods. Quality control equipment is used to test the parts in a room in the plant separate from the production line. Because of the functional interrelationship between the testing equipment and the machinery on the production line and because of the product flow, the testing equipment is an integral part of the integrated production process and is exempt.

Taxpayer states that the camera systems - and the system's associated upgrades - are entitled to the exemption.

> During the audit period, [Taxpayer] purchased camera systems that are installed and integrated within the production work cells. The camera system examines and inspects work-in-process parts as they are being processed in the work cell. If the camera system detects a defect with a part, the part is pulled for further examination to be either reworked or rejected.

. . . .

> The production process does not stop while the parts are being examined by the camera systems. In certain cases, the camera systems are upgrades to existing machinery and equipment. For newer equipment, the camera systems are original parts that needed repair or replacement.

Taxpayer explains that the "Tensile Tester" is exempt from sales/use tax. According to Taxpayer, "Other machinery and equipment used to test in-process parts include[] a tensile tester to test the breaking point of the parts."

Taxpayer established that it purchased a camera system, tensile tester, and torque tester. Taxpayer asserts that it also purchased "Other Machinery and Equipment" which qualifies for the 45 IAC 2.2-5-8(i) exemption. It is - of course - impossible to tell what is or is not exempt "Other Machinery and Equipment." It is equally impossible, based on the information provided, to determine whether the camera and the two testers are "used by the purchaser [within] the direct production or finishing of tangible personal property" and are an "integral part of the [Taxpayer's] production process . . . ." 45 IAC 2.2-5-8(b); 45 IAC 2.2-5-8(i).

The Department does not agree that Taxpayer has met its statutory burden under IC § 6-8.1-5-1(c) of establishing that the audit's conclusions were "wrong" or that the disputed items undisputedly fall within the exemption's parameters.

FINDING

Taxpayer's protest is respectfully denied.

VI. Gross Retail and Use Tax - Calculation Errors / Invoices.

DISCUSSION

Taxpayer maintains that the Department erred when it classified a particular transaction as "taxable" in the absence of an invoice documenting the transaction. Taxpayer claims that the particular transaction was charged to the same account the Department classified as exempt.

The audit report explains:

> Items where no invoices had been provided by the taxpayer. These items were denied in accordance with 45 IAC 2.2-3-27 which states that the person who stores, uses, or consumes tangible personal property in Indiana may avoid paying the use tax to the Department if such person retains for inspection by the Indiana Department of Revenue a receipt evidencing payment of the tax.

Taxpayer states that in the place of invoices, it is able to "provide[] photographs and detailed descriptions for purchases listed in the auditor's capital asset worksheets."

In addition, Taxpayer states that it has now provided invoices which recently became available.

As noted above, the principle is well and long established. "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *RCA Corp.,* 310 N.E.2d at 101 (internal citations omitted).

A taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. IC § 6-8.1-5-1(c). Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.,* 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486, fn. 9 (Ind. Tax Ct. 2012).

It is not possible to exempt a transaction unless the Taxpayer has maintained records sufficient to establish whether or not a specific transaction is or is not exempt. "Every person subject to a listed tax must keep books

and records so that the department can determine the amount, if any, of the person's liability for tax by reviewing those books and records." IC § 6-8.1-5-4(a).

The Department is not prepared to exempt a transaction based simply on Taxpayer's own internal classification of that transaction or because Taxpayer has presented a photograph of the item. However, Taxpayer indicates that it has now provided invoices which were missing at the time of the original audit. Although this Memorandum of Decision takes no position on the extent to which these invoices might or might not mitigate any assessment or result in an increased refund, however the Enforcement Division is requested to review Taxpayer's documentation and to make whatever adjustments to the original finds as fully warranted.

FINDING

Taxpayer's protest is sustained subject to the review and conclusions of the Department's Enforcement Division.

VII. Gross Retail and Use Tax - Exempt Forklift Usage.

DISCUSSION

During the years under review, 2011 through 2013, Taxpayer rented forklifts. During the same period, Taxpayer purchased forklift repair parts and propane forklift fuel. The Department's audit found that Taxpayer paid use tax on a portion of the rental charges and purchases.

In order to determine the extent to which Taxpayer used the forklifts in an exempt manner, the Department requested that Taxpayer provide a "forklift study" differentiating exempt usage and non-exempt usage. Taxpayer provided the study but the Department found that the information contained in the study was "unreliable."

In subsequent discussions with Taxpayer's representative and after Department personnel toured Taxpayer's facility, "[T]axpayer and their representative accepted a 55 [percent] taxable usage."

Taxpayer now regrets having accepted the 55 percent calculation. Taxpayer disagrees with the audit's conclusion and argues that its original forklift study authoritatively establishes that rental of forklifts and purchase of forklift parts and fuel is entitled to a 65.26 percent exemption.

A. Audit Results.

The Department's audit assessed Taxpayer additional use tax on the rental of the forklifts and the purchase of forklift parts and forklift propane fuel. The Department's audit report sets out the reasons for rejecting Taxpayer's forklift study.

> The [T]axpayer's representative stated that the calculations being presented to the auditors in [Taxpayer's] forklift study included information taken from this previous examination. The auditors disagreed with the use of these calculations for several reasons. The calculations provided data taken from an unrelated entity's operations. Also, the extrapolated calculations were applied to the [T]axpayer's 2015 forklift fleet. None of the forklift units on the [T]axpayer's forklift study were found on the statistical sample and refund claim worksheets and the [T]axpayer provided no details as to how the units on the invoices reviewed compared to those units included in their study. As a result, the auditors did not accept the information that the [T]axpayer had provided but did formulate a taxable percentage of use based upon the two plant tours that were taken. A taxable percentage of 55[percent] was discussed with the [T]axpayer and their representative. Feedback was requested and received in regards to these matters. The [T]axpayer and their representative *accepted the taxable percentage*. This percentage was applied to all invoices pertaining to the purchase or rental of forklifts as well as the purchase of forklift repair parts and propane fuel in accordance with 45 IAC 2.2-5-8(f).

(*Emphasis added*).

Based on the field examiners' tour of the facility, the Department found that Taxpayer - in part - used the forklifts in a taxable manner including:

- Loading finished goods into/onto trailers;
- Unloading raw materials from trailers;
- Moving raw materials to the first stage of production;
- Moving scrap bins;

- Unloading miscellaneous items from trucks that required forklift participation to unload;
- Moving empty containers of various types - knock-down containers, etc.;
- Moving raw material tubing around in the tubing yard.

The Department's audit found that the forklifts were used in both a taxable and exempt manner "but that the taxable activities were taking place more frequently than exempt activities" Therefore, the audit concluded that "the taxable percentage of 55 [percent] was drawn forth as both a reasonable and reliable approach to addressing the taxability of the forklifts in use that the taxpayer was in agreement with."

The regulation on which the audit relied, 45 IAC 2.2-5-8(f), provides as follows:

> (1) Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process *is taxable*.
> (2) Tangible personal property used for moving finished goods from the plant after manufacture *is subject to tax*.
> (3) Transportation equipment used to transport work-in-process or semi-finished materials to or from storage *is not subject to tax* if the transportation is within the production process.
> (4) Transportation equipment used to transport work-in-process, semi-finished, or finished goods *between plants is taxable*, if the plants are not part of the same integrated production process.

(*Emphasis added*).

B. Taxpayer's Response.

Taxpayer explains that it only "reluctantly" agreed with the Department's audit that the forklifts were used 55 percent of time in a taxable manner. However, Taxpayer now states that the audit made "significant errors, omissions, and misstatements of fact . . . ."

In addition, Taxpayer discounts the reliability and sufficiency of the plant tours conducted by the Department's field examiners stating that "[t]he Department's limited and narrow observations of forklift activity are simply not adequate enough to make any substantive conclusions with respect to forklift usage."

Taxpayer argues that the audit omitted significant, exempt usage of its forklifts. Taxpayer states that the audit ignored use of the forklifts to move materials which were originally processed at other Taxpayer locations and that inter-facility movement constitute "a continuous flow of the [Taxpayer's] integrated production process." The audit ignored forklift usage to move "out-going parts . . . shipped to other [Taxpayer] plants for further processing." Taxpayer also states that the audit ignored forklift usage to deliver "work-in-process" parts to "outside processors for specialty work and returned to [Taxpayer] for further processing."

Taxpayer concludes that the Department should have relied on its original forklift study allowing Taxpayer to a 65.26 percent exemption because the original study "was prepared by plant personnel based on current activity," and because Taxpayer's "plant personnel believe[] that the current forklift activity and the use of the current forklift fleet is not substantially different than the usage during the audit period."

Taxpayer concludes that its own forklift study is "reasonable because the types of equipment used and the activity did not substantially change from the audit period to the current period."

In part, Taxpayer's protest relies on the premise that forklift usage between its different facilities on the ground that this forklift usage is integral to "a continuous flow of the [Taxpayer's] integrated production process." Taxpayer also states that the forklifts are used to move "out-going parts . . . shipped to other [Taxpayer] plants - both within and outside the state - for further processing" and to deliver "work-in-process" parts to "outside processors for specialty work and returned to [Taxpayer] for further processing." In making the argument that forklift usage between disparate locations is entitled to the exemption, Taxpayer necessarily relies on the Tax Court's decision in *General Motors Corp. v. Indiana Dep't of State Revenue*, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991). In that decision case, General Motors owned several plants which made components which were assembled at another General Motors plant. The court determined that General Motors' integrated production process began at the various General Motors individual plants and ended upon the completion of the actual end product that was marketed, which in General Motors' case was a finished vehicle, at another General Motors plant. *Id.* at 402.

In *General Motors*, the automobile manufacturer shipped component automobile parts to its plants and claimed an

exemption for the purchase of items employed in the interdivisional transfer of those component parts. The court held that the automobile manufacturer's packing materials were part of the integral process whereby the manufacturer produced its finished product. Therefore, the automobile manufacturer's packing materials were exempt under IC § 6-2.5-5-3. The court reached that decision after finding the automobile manufacturer's widely separated production facilities formed a cohesive, singular production unit in which the claimant's "manufacture of finished marketable automobiles [was] accomplished by one continuous integrated production process within which the transport of parts from component plants to assembly plants [was] an essential and integral part." *General Motors*, 578 N.E.2d at 404.

In finding that the automobile manufacturer's production process encompassed manufacturing activities performed at multiple sites, the court identified a number of significant facts. Specifically, the court found that "[t]he facts in the case as well as previous judicial findings indicate GM's production process is by nature highly integrated. The court's sole concern, however, is whether GM's manufacturer of finished automobiles qualifies as one continuous integrated production process for the purpose of exemption from sales/use tax." *Id*. at 402.

Footnote three gives an indication of the evidence which the court relied in arriving at a conclusion that GM's production was both "continuous" and "integrated." Specifically, the court found that "GM's component plant personnel collaborate with the assembly plant personnel (1) to develop new product concepts, (2) to individually design, engineer, and test the performance of new parts and packing materials, (3) to plan the layout and production processes for new parts, (4) to coordinate production schedules because delays at one plant would have an immediate effect on the other plants, and (5) to solve problems and ensure quality control." *Id*. at n.3. In addition, the court noted that a "continuity of production exists between GM's different plants [which is] demonstrated by the standard practice of shifting certain production operations back and forth between component and assembly plants when necessary for more efficient operation." *Id*.

As provided above and bearing in mind the requirement that all exemptions are "strictly construed," it was in the specific context of particularized facts and findings that the court held that GM's manufacture of automobiles represented one "continuous integrated production process." *Id*. at 404. It was in the context of those particularized facts and findings that the Tax Court held that GM's assembled automobiles, and not the automobile's component parts, constituted GM's most marketable product and that the production of that "most marketable product" constituted the conclusion of GM's integrated but physically discontinuous manufacturing process.

However, based on the information provided, the Department is not prepared to agree that the use of the forklifts to move Taxpayer's automobile parts from one plant to another or to use forklifts to move automobile parts back and forth to "outside processors" necessarily entitles Taxpayer to claim the exemption.

The production of Taxpayer's automobile parts may well be coordinated between the different facilities and between Taxpayer's own facilities and its "outside processors, but because that production occurs among and between distinct entities, the production of the products is not necessarily a "continuous integrated process . . . ."*General Motors*, 578 N.E.2d at 404. The Department is unable to agree that Taxpayer's production process meets the standard set out in *General Motors*. There is no evidence of an integrated collaboration within Taxpayer's facilities, coordination of production facilities, of "shifting certain production operations back and forth between . . . plants when necessary for more efficient operation," or of collaboration between the facilities to produce new products. *Id.* at n.3.

Taxpayer asks that the Department reject the audit's conclusion that Taxpayer's forklifts were used 55 percent of the time in an exempt fashion and to accept Taxpayer's assertion that the forklifts are used in exempt fashion 65.26 percent of the time. Especially because Taxpayer has not established that the use of the forklifts occurs between different manufacturing facilities and even different subcontractors in a manner which is "continuous" and "coordinated," the Department is unable to agree.

FINDING

Taxpayer's protest is respectfully denied.

VIII. Gross Sales and Use Tax - Containers Used to Transport Work-in-Process.

DISCUSSION

Taxpayer protests both the assessment of sales/use tax and the denial of a refund of sales/use tax on purchases

of various containers on the ground that the containers are used to "handle temporarily store, and transport in-process parts and materials from one integrated production step to the next."

Taxpayer argues that the following categories of items are exempt from sales/use tax:

- Plastic Containers;
- Knock-Down Totes;
- Blue Totes;
- Shelving;
- Heavy Duty Totes;
- Pallets;
- "Other Equipment."

A. Audit Results.

The Department's audit reviewed invoices documenting Taxpayer's purchases of containers, totes, "racking," "racks with dividers," and "shelf racks for 16 x 2 totes." According to the audit report, "The [T]axpayer did not provide any specific details on how these racks and shelves were used . . . ."

The audit cited to 45 IAC 2.2-5-8(e) for the Department's position that the items were subject to sales/use tax. The regulation provides as follows:

> Storage equipment. Tangible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.

The audit report explains the applicability of the exemption found at 45 IAC 2.2-5-8(e).

> The exemption afforded by temporarily storing goods extends only to tangible personal property used in or for the purpose of storing work-in-process or semi-finished goods only if the work-in-process or semi-finished goods are ultimately completely produced for resale and are in fact resold. Furthermore, storage facilities or containers for materials or items that are currently undergoing production during the production process are deemed temporary storage facilities and containers and are not subject to tax. The use of storage containers for storing finished goods after completion of the production process are subject to tax.

The audit report also notes that "[T]axpayer had also purchased plastic stacking containers, plastic stacking pallets, and plastic tops for these pallets." According to the audit report, "The taxpayer did not provide any specific details as to how these containers and pallets were used." The Department's audit report cited to 45 IAC 2.2-5-16 as authority for its decision that these items were subject to sales/use tax. The Department's regulation, 45 IAC 2.2-5-16, provides as follows:

> The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.

The audit report explains the applicability of the regulation and the reason the Department found that the containers were subject to sales/use tax.

> Since the taxpayer did not provide documentation to illustrate where, when, and how these containers were used, the containers purchased by the taxpayer do not meet any exemptions afforded by this code citation and do not meet the requirements to be considered non-returnable packaging. These containers are subject to tax.

B. Taxpayer's Response.

Taxpayer states that the Department's representatives were provided an opportunity to tour its manufacturing facility during the course of the audit. However, Taxpayer states that "considering the complexity of the manufacturing process, the size of the plant, and the length of time it took to process the audit, it is understandable why the auditors [erred] in their tax determinations with respect to this equipment."

Taxpayer cites to 45 IAC 2.2-5-8(e) as authority for its position that the items are exempt from sales/use tax. Taxpayer quotes the portion of the regulation it believes relevant.

> Storage equipment. Tangible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.
> (1) Temporary storage. Tangible personal property used in or for the purpose of storing work-in-process or semi-finished goods is not subject to tax if the work-in-process or semi-finished goods are ultimately completely produced for resale and in fact resold.
> (2) Storage containers for finished goods after completion of the production process are subject to tax.
> (3) Storage facilities or containers for materials or items currently undergoing production during the production process are deemed temporary storage facilities and containers and are not subject to tax. 45 IAC 2.2-5-8(e).

In particular, Taxpayer cites to the example set out in 45 IAC 2.2-5-8(e):

> Parts undergoing various machining operations are transported from a machine operation to a storage rack where they are held for periods of time, as required by the processing schedule for the next machine operation in the integrated production process. The length of time required for storage in the processing schedule is not determinative. As the processing schedule dictates, the parts removed from storage racks and transported to the next machine operation. The storage racks are exempt.

Taxpayer estimates the items cited are used to transport work-in-process 50 percent of the time. Based on the Taxpayer's own analysis, these items "qualif[y] for a partial exemption from sales and use tax." As the basis for allowing a determination in its favor, Taxpayer "included pictures and video of material handling equipment throughout the plant."

C. Hearing Analysis.

The Department is unable to agree that Taxpayer has established it is entitled to the 50 percent exemption on the purchase of these items. The photos and videos are not dispositive because these illustrations simply establish that the containers are used to transport auto parts. The illustrations do not definitively establish that the containers are used to move auto parts "being manufactured from one . . . machine to another or from one . . . production step to another." More importantly, the illustrations do not establish that these items are used in an exempt fashion *50* percent of the time.

FINDING

Taxpayer's protest is respectfully denied.

IX. Gross Retail and Use Tax - Material Handling Equipment.

DISCUSSION

Taxpayer disagrees with the Department's decision assessing sales/use tax or denying a refund of sales/use tax on the purchase of equipment used to transport its auto parts during the period of time in which the parts are being manufactured.

Taxpayer claims that the following items or groups of items are exempt from sales/use tax.

- Roller Conveyors;
- Conveyor Racks;
- Gravity Feed Racks;
- Chrysler LS Racks;
- Overhead Cranes;
- Jib Cranes;
- Floor Mounted Cranes;
- Hoists;
- Allen Bradley Electrical Components;
- Lift Assist Cranes;
- Gorbel Overhead Cranes;

- Bridge Mounted Cranes;
- Destackers;
- In-Feed Tables;
- Suction Cups;
- Accumulator Tables.

A. Audit Results.

The audit report contains no detailed substantive discussion of *many* of the items here in protest although the "Adjustments Summary" lists certain of these items as subject to sales/use tax.

The audit report does contain a substantive discussion of certain items. In relevant part, the audit report provides as follows:

> Other specific, taxable purchases that were made within the scope of this examination included the purchase of undermotion rollers, automatic destackers, pallet solutions, and infeed and accumulator tables for a piece of equipment listed as an Ecostar . . . . A de-stacker was also purchased for use with an Acrotech roll machine. Additional and specific details were requested from the [T]axpayer about the use of this equipment. However, the [T]axpayer did not provide any additional details, photographs, or otherwise that would support the [T]axpayer's claims that an exemption from tax for these items should be made. Furthermore, two plant tours were taken of the [T]axpayer's facilities during which these pieces of equipment were not identified by the [T]axpayer. Therefore, the equipment in question has not been verified as being exempt production equipment.

. . . .

> With only the invoices themselves to rely upon in determining the taxability of the strapping machine repair parts, de-stacking equipment, pallet solutions, and infeed and accumulator tables, the equipment was found to be subject to tax because the equipment could not be substantiated by the [T]axpayer as being directly used within any of the [T]axpayer's direct production processes and having an immediate effect upon the items being produced. Because of this, it was deduced that the equipment had actively been used in pre- and postproduction activities. The lack of additional information regarding these pieces of equipment and the fact that no evidence was provided to show that these pieces of equipment play a direct role in any one of the [T]axpayer's direct production activities ultimately reinforced the application of tax to said equipment. In the end, the [T]axpayer bears the burden of proving that these purchases would qualify for exemption from tax. The [T]axpayer did not meet this burden of proof.

The audit report cited to the Department's regulation, 45 IAC 2.2-5-8(d), as the basis for denying exemption. The cited regulation provides:

> 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 audit separately considered the taxability of Taxpayer's conveyors as follows:

> [S]everal conveyors were purchased during the period under examination. These conveyors were not specifically identified during the plant tours that were taken nor did the [T]axpayer provide any substantiating proof, such as pictures, to show the manner in which these conveyors were used. As such, these conveyors were included in the adjustments being proposed and are taxable under 45 IAC 2.2-5-8(d).

The Department's audit separately considered the taxability of Taxpayer's "de-stacker" and "roll machine."

> A de-stacker was also purchased for use with an Acrotech roll machine. Additional and specific details were requested from the [T]axpayer about the use of this equipment. However, the [T]axpayer did not provide any additional details, photographs, or otherwise that would support the [T]axpayer's claims that an exemption from tax for these items should be made. Furthermore, two plant tours were taken of the [T]axpayer's facilities during which these pieces of equipment were not identified by the [T]axpayer. Therefore, the equipment in question has not been verified as being exempt production equipment. As a result, all of the strapping machine repair parts, undermotion rollers, de-stacking equipment, pallet solutions, and infeed and accumulator tables were found to be subject to tax under 45 IAC 2.2-5-8(d).

The Department separately considered "suction cups." The audit described the use of the suction cups.

> As part of the [T]axpayer's production processes, sheets of steel are used to make some of the various exhaust components that the [T]axpayer produces and sells. These sheets of steel are made in-house but are also purchased from outside sources. The purchase of the steel sheets from outside vendors was found to be 20[percent] of all steel sheets used by the [T]axpayer in their production processes. Since these steel sheets were produced by a manufacturing vendor unrelated to the [T]axpayer, the steel sheets are raw materials. The movement of those raw materials is subject to tax at 20[percent]. During the plant tours that were taken, the process to get the sheet steel to the point of the first stage of production included the use of suction cups to pick [them] up. The suction cups picked up these sheets of steel and the machine with which the suction cups were attached helped to guide these steel sheets to the point at which the sheet was bent into shape. Therefore, the use of the suction cups to pick up and deliver the steel sheets to the first stage of production was found to be pre-production activities through the moving of raw materials to the first stage of production. The [T]axpayer was asked to provide taxable and exempt percentages of use for these suction cups. Percentages of use were provided directly from the [Taxpayer's] manufacturing plant. The plant stated that approximately 20[percent] of the time, the suction cups were used to pick up and move raw materials. As a result, 20[percent] of the invoice totals for the purchase of the suction cups were found to be taxable under 45 IAC 2.2-5-8(d) that stipulates that pre-production use of tangible personal property is subject to tax.
>
> **B. Taxpayer's Response.**

Taxpayer disagrees arguing that the items listed above are wholly exempt from sales/use tax because the items are used *within* the production of Taxpayer's auto parts and are not used before (pre-production) or after (post-production) the manufacture of the parts.

As authority for its argument, Taxpayer cites to 45 IAC 2.2-5-8(e) which provides as follows:

> (e) Storage equipment. Tangible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.
> (1) Temporary storage. Tangible personal property used in or for the purpose of storing work-in-process or semi-finished goods is not subject to tax if the work-in-process or semi-finished goods are ultimately completely produced for resale and in fact resold.
> (2) Storage containers for finished goods after completion of the production process are subject to tax.
> (3) Storage facilities or containers for materials or items currently undergoing production during the production process are deemed temporary storage facilities and containers and are not subject to tax.

Taxpayer also relies on the regulation's accompanying example 2:

> Parts undergoing various machining operations are transported from a machine operation to a storage rack where they are held for periods of time, as required by the processing schedule for the next machine operation in the integrated production process. The length of time required for storage in the processing schedule is not determinative. As the processing schedule dictates, the parts are removed from the storage racks and transported to the next machine operation. The storage racks are exempt.

Taxpayer explains:

> [Taxpayer] purchased and capitalized this type of equipment which is essential to the flow of production operations. [Taxpayer] utilizes various pieces of material handling equipment to store, hold, and transport work-in-process parts at various stages of operations. This includes, but is not limited to, roller conveyors, gravity feed conveyors, wheeled carts and flow racks that handle in-process parts at robotic welders and weld cells. This equipment holds and feeds the in-process parts for the next stage of operations and is integral to the flow of [automobile] parts and therefore exempt from sales and use tax.

. . . .

> Throughout the plant, [Taxpayer] has de-stacking equipment that is an integrated part of larger pieces of machinery and equipment such as a tube formers or canning machines. The de-stackers have suction cups that pick up sheet steel, which has previously been stamped with a part number and logo, and it loads the sheet steel in the machine for further processing. The auditor assessed tax on all de-stackers at a rate of

> 20[percent]. This rate was used by the Department based on the assumption that the de-stackers are handing raw materials 20[percent] of the time. At the time the audit was closed, the Department was unaware that all sheet steel is stamped with a part number and logo before proceeding to the de-stackers.

. . . .

> The infeed tables and accumulator tables are integral parts of the Weil Ecostar Tube formers, which are large machines used to process[] steel tubing. Infeed tables and accumulator tables[,] handles and feeds the tubes through the formers as they are being processed. Before entering the tube formers, the steel tubes were first processed by the cut-off saws. During the audit period, [Taxpayer] purchased and capitalized de-stackers, auto de-stackers, infeed tables and accumulator tables which are integral to the flow of emissions control parts and therefore exempt from sales and use tax.

In addition, Taxpayer states that it is entitled to any exemption on any of the "Allen Bradley electrical components used to repair various production machinery and equipment throughout [its] plant." Although not substantively addressed in the audit report's analysis, Taxpayer points out that "[t]hese items are specifically identified in the refund claim and audit worksheets." To that extent, Taxpayer is correct; for example, the audit assessed $1.05 in tax on the purchase of an "Allen Bradley contract block screw termination."

However, Taxpayer explains that it "purchases thousands of [Allen Bradley] parts each month to repair direct production equipment throughout its plant." Although Taxpayer's "plant supervisor could not provide specific information on each individual item and its functionality," the supervisor assured the Department's representative that the Allen Bradley parts were "replacement parts for direct production equipment and not used for building repairs or repairs to maintenance equipment." Taxpayer therefore concludes that it is entitled to a sales/use tax exemption on the thousands of parts purchased from Allen Bradley.

C. Hearing Analysis.

Taxpayer concludes that the equipment for which it seeks the exemption "holds and feed the in-process parts for the next stage of operations and is integral to the flow of [automobile parts] and therefore exempt from sales and use tax."

Because the Department's audit resulted in an assessment of additional tax, Taxpayer continues to bear the burden of establishing that the assessment was wrong. IC § 6-8.1-5-1(c). In addition, as with any exemption from tax, 45 IAC 2.2-5-8(e), is strictly construed in favor of taxation. IC § 6-8.1-5-1(c); *Tri-States*, 706 N.E.2d at 283; *Mynsberge*, 716 N.E.2d at 636.

The audit report found that the items were not exempt pursuant to 45 IAC 2.2-5-8(d) which states as follows:

> "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.

45 IAC 2.2-5-8(d) is relevant because the exemption would not apply to equipment used to move materials before production has begun or after the manufactured products have reached their final form.

The audit noted that Taxpayer did not identify the equipment for which it sought the exemption nor did it offer "substantiating proof, such as pictures, to show the manner in which [the equipment] was used." Relying on 45 IAC 2.2-5-8(d), the audit was unable to determine whether the equipment was utilized within Taxpayer's integrated production process or whether it was utilized outside the process.

Generally, *all* purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property *are* taxable. 45 IAC 2.2-5-8(a). There are also additional, particularized exemptions from sales tax and use tax such as 45 IAC 2.2-5-8(e) relied upon here by Taxpayer.

The cited exemption, 45 IAC 2.2-5-8(e), applies storage equipment necessary for moving manufactured products from one production machine to the next or from one production step to the next.

45 IAC 2.2-5-8(k) describes "direct production" as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired, and that

the change must be substantial resulting in a transformation of the property into a different and distinct product. Finally, 45 IAC 2.2-5-8(d) states, "'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."

Taxpayer is in the business of manufacturing automobile parts. Presumably it does so within an "integrated process" which starts at the "first operation or activity" in manufacturing the parts and ends when the parts have reached their "completed form." Clearly the exemption is not applicable to equipment used to move materials before production begins or after production has been completed. For example, the exemption would not apply to equipment used to move Taxpayer's auto parts within a warehouse because the parts have reached their "completed form."

Are Taxpayer's cranes, rollers, tables, racks, suction cups, conveyors, and "thousands of [Allen Bradley] parts" used *within* an "integrated process" or are these items used separately or in combination prior or subsequent to the manufacture of Taxpayer's automobile parts? It's entirely possible Taxpayer is correct but that is not the question Taxpayer here poses to the Department. Taxpayer asks for a wholesale conclusion that the audit was wrong, that it is right, and that thousands of items of equipment and parts are exempt from both sales and use tax. Both the Department and Taxpayer are held to the same standard; Indiana law requires that Taxpayer meet is burden of establishing that the assessment was wrong and requires that any exemption from tax be narrowly construed. Although Taxpayer has provided photographs, videos, and extensive written descriptions, it is not possible to give Taxpayer the definitive answer it seeks because the evidence provided does not definitely establish that the items are "directly used" in the "direct production" of Taxpayer's auto parts.

FINDING

Taxpayer's protest is respectfully denied.

X. Gross Retail and Use Tax - Labels.

DISCUSSION

Taxpayer purchased various labels and label makers (printers) during the period under audit review. Taxpayer explains that the labels and printers are exempt from sales/use tax because "the labels are [i]ncorporated as a material or an integral part of tangible personal property for sale by such purchaser." In other words, the labels become an integral component of the automobile parts Taxpayer manufactures and which Taxpayer's customers purchase.

A. Audit Results.

The Department's audit concluded that Taxpayer had failed to establish that the purchase of the labels - and by extension the label printers - were entitled to an exemption from sales/use tax. The audit report explains as follows:

> The [T]axpayer was found to have purchased several different types of labels during the examination period. This included 3"x12" labels, barcode labels, 40mm X 25mm labels, catchword labels in 9.625" and 8.875" sizes, 4"x6.5" white thermal labels, label and ribbon combo kits that included 4"x6.5" white thermal labels, and 2" circle labels. The [T]axpayer provided only a vague description stating that these labels were used in direct production and were incorporated into products that were resold. However, the [T]axpayer did not provide any supporting evidence to validate this assertion including any photographic evidence to show how these labels were used. These labels were not pointed out by the [T]axpayer during either of the plant tours.

The audit report cites to the Department's regulation, 45 IAC 2.2-5-8(a), as authority for its position that the labels and printers were not exempt from sales/use tax. The regulation cited by the Department's audit in denying the exemption states:

> 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.

The audit report concluded as follows:

> Since the [T]axpayer has not been able to substantiate their claims that these labels are indeed exempt from tax through incorporation of said labels into the [T]axpayer's products that are resold, the labels are being included as part of the adjustments being proposed.

B. Taxpayer's Response.

Taxpayer disagrees with the Department's audit results explaining as follows:

> [Taxpayer] purchases various types of labels for its production of [] control parts. Labels are printed for a variety of reasons including inventory control and production flow. Labels are also printed with detailed product information and affixed directly to the [automobile] control parts and sold with the parts.

Taxpayer does not maintain that *all* of the labels are exempt. Instead,

> [Taxpayer] reasonably estimates that fifty percent (50[percent]) of all labels printed are incorporated and physically attached directly to the [automobile] parts produced for sale to the customer. All labels and label makers therefore qualify for a fifty percent (50[percent]) exemption from Indiana sales and use tax.

In support of its argument, Taxpayer provided photographs of its bar-coded identification labels attached to its automobile parts.

C. Hearing Analysis.

45 IAC 2.2-5-14(d) as follows:

> The purchase of tangible personal property which is to be incorporated by the purchaser as a material or an integral part is exempt from tax. "Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:
> (1) That the material must be physically incorporated into and become a component of the finished product;
> (2) The material must constitute a material or an integral part of the finished product; and
> (3) The tangible personal property must be produced for sale by the purchaser.

The Department's audit was unable to determine the degree to which labels were incorporated into and became an integral part of the auto parts Taxpayer resold to its customers because Taxpayer failed to provide "evidence how these labels were used." Taxpayer admits that not all of its labels - and by extension the label printers - are exempt because it was apparent that some of Taxpayer's "[l]abels [were] printed for a variety of reasons including inventory control and production flow."

Taxpayer's use of labels to control its inventory of auto parts or to track those parts within the production process is not exempt because the law requires that exempt labels be incorporated as an "integral component" of the auto parts sold to Taxpayer's customers. 45 IAC 2.2-5-8(a).

Nonetheless, Taxpayer now asks the Department to conclude that Taxpayer's labels and label printers "qualify for [a] fifty percent . . . exemption from Indiana sales and use tax." In other words, Taxpayer concludes that it has established that 50 percent - not 40 or 60 - are incorporated into and become an integral part of its auto parts. Taxpayer misapprehends the statutory authority the Legal Division has to make such determinations. Under IC § 6-8.1-5-1(c), it is Taxpayer's responsibility to establish that the Department's decision was "wrong." The audit's conclusion is a "reasonable interpretation" of the facts and issues presented it. *Caterpillar, Inc.* 15 N.E.3d 583. In this case, the Department will not second-guess the audit's decision and substitute its own quantitative, arbitrary analysis of the degree to which the labels and printers are or are not exempt.

FINDING

Taxpayer's protest is respectfully denied.

XI. Gross Retail and Use Tax - Steel and Poly Strapping Materials and Strapping Equipment.

DISCUSSION

The issue is whether Taxpayer can purchase nonreturnable steel and poly strapping materials without paying sales tax and/or whether Taxpayer is entitled to a refund of use tax.

Taxpayer argues that it is entitled to an exemption from sales/use tax on the purchase of steel and poly strapping materials because the strapping materials are acquired "for use as non-returnable packages for selling" the auto parts Taxpayer manufactures.

A. Audit Results.

The Department's audit report does not apparently address Taxpayer's purchase of steel and poly strapping materials although it does discuss strapping equipment and equipment replacement parts. As explained in the audit report:

> [T]axability of the strapping machine repair parts . . . [This] equipment was found to be subject to tax because the equipment could not be substantiated by the [T]axpayer as being directly used within any of the [T]axpayer's direct production processes and having an immediate effect upon the items being produced.

The Department's audit report cites to the Department's regulation, 45 IAC 2.2-5-8(d) as authority for its position that the strapping equipment was subject to sales/use tax. The cited regulation provides:

> 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 report explains its reliance on 45 IAC 2.2-5-8(d):

> The exemption set forth in 45 IAC 2.2-5-8(d) states that tax does not apply to the purchases of manufacturing machinery, tools, and equipment if that equipment is to be directly used by the purchaser within direct production processes in Indiana. Direct production use, per Indiana sales and use tax laws, 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. Furthermore, said machinery, tools, and equipment must have an immediate effect on the article being produced to fulfill the exemption requirements.

B. Taxpayer's Response.

Taxpayer maintains that the steel and poly strapping materials - along with the equipment and equipment parts used to apply the strapping - are exempt from sales/use tax. Taxpayer explains:

> Steel strapping and poly strapping are used to secure sheets of steel that have been cut from the 40 ton and 60 ton presses. The strapping equipment is used to apply the strapping so that it can be safety handled and transported to the next stage of production operations. Steel and poly strapping is also used to secure finished goods for shipment to the customer or shipment of in-process parts to other [Taxpayer] plants for further processing.

Taxpayer cites to IC § 6-2.5-5-9(d) as authority for its position that the poly and steel strapping is exempt:

> Sales of wrapping material and empty containers are exempt from the State gross retail tax if the person acquiring the material or containers acquires them for use as non-returnable packages for selling the contents that he adds.

Taxpayer also relies on the Department's regulation, 45 IAC 2.2-5-16, as buttressing its position that the poly and steel strapping materials are exempt. In relevant part, the regulation provides:

> (a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.
> (b) In general the gross proceeds from the sale of tangible personal property in a transaction of a retail merchant constituting selling at retail are taxable. This regulation *[45 IAC 2.2]* provided an exemption for

wrapping materials and containers.
(c) General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property *are exempt* from state gross retail tax:
(1) Nonreturnable containers and *wrapping materials including steel strap and shipping pallets* to be used by the purchaser as enclosures for selling tangible personal property.
(2) Deposits for returnable containers received as an incident to a transaction of a retail merchant constituting selling at retail.
(3) Returnable containers sold empty for refilling.
(d) Application of general rule.
(1) Nonreturnable wrapping material and empty containers. To qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way:
(A) The purchaser must add contents to the containers purchased; and
(B) The purchaser must sell the contents added.

(*Emphasis added*).

Taxpayer states that the steel and poly strapping materials are used as "enclosures" for "transporting semi-finished goods from one integrated production step to the next" and as "enclosures" for delivering "finished goods to customers."

Taxpayer maintains that the equipment used in applying the strapping materials is exempt because the equipment "is applying the first level of packaging to the finished goods." According to Taxpayer, the manufacture of its auto parts "is not complete until the [auto parts] are packaged." Taxpayer concludes that "the strapping equipment used to secure finished parts as well as in-process parts, qualifies for exemption from Indiana sales and use tax."

As with any such assessment, it is the Taxpayer's responsibility to establish that the assessment of additional sales and/or use tax 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 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).

In this case, Taxpayer uses the steel and poly strapping materials for two different purposes; it uses the materials to transport materials within its facility and uses the materials to transport the finished auto parts to Taxpayer's auto part customers. The Department agrees that the materials are exempt but not quite in the way that Taxpayer - in at least part - describes.

To the extent that the strapping materials are used to ship finished parts to its customers, the materials fall within the exemption cited. IC § 6-2.5-5-9(d) provides an exemption for materials acquired by taxpayer "for use as non-returnable packages for selling the contents."

However, to the extent that the strapping materials are used *within* the production process as Taxpayer explains, the materials do not fit within the IC § 6-2.5-5-9(d) exemption because the "packaging exemption" is separate from the "manufacturing exemption." Instead, the materials fall within the exemption set out at IC § 6-2.5-5-5.1(b) which provides as follows:

> 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*).

To the extent that Taxpayer purchases steel and poly strapping materials for transporting materials within its production process, those materials are exempt because they are "*consumed* in the direct production" of Taxpayer's auto parts.

The equipment and equipment parts used to install the strapping materials does not fall within either the IC § 6-2.5-5-9(d) or the IC § 6-2.5-5-5.1(b) exemptions because this equipment and parts are not "consumed" and

does not consist of "nonreturnable wrapping materials and empty containers."

In addition, the Department does not agree that the strapping equipment is entitled to claim the IC § 6-2.5-5-3(b) "manufacturing" exemption because the strapping equipment does not have an "immediate effect upon the article being produced." 45 IAC 2.2-5-8(g).

FINDING

Taxpayer's protest is sustained in part and denied in part; the steel and poly strapping materials are exempt for sales/use tax but the equipment and equipment parts are not.

XII. Gross Retail Tax - Exempt Services.

DISCUSSION

Taxpayer states that it purchased "non-taxable services and separately stated labor charges." Taxpayer explains that these purchases are listed on the audit's "worksheets and refund claim worksheets." According to Taxpayer, "Non-taxable services and separately stated labor include[] . . . . calibration fees for equipment, ga[u]ges, and tools, software installation services, and separate[] service labor and installation charges.

Taxpayer cites to 45 IAC 2.2-4-2 as authority for its position that these purchases are exempt from sales/use tax.

45 IAC 2.2-4-2 provides as follows:

> (a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:
>
> (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
>
> (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
>
> (3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and
>
> (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.
>
> (b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.
>
> (c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.
>
> (d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

The regulation on which Taxpayer relies, 45 IAC 2.2-4-2, contains a provision exempting the purchase of services from sales tax. 45 IAC 2.2-4-2(a) states that, "Professional services, personal services, and services in respect to property not owned by the person rendering such services are not transactions of a retail merchant constituting selling at retail, and are not subject to gross retail tax." However, "Where, in conjunction with rendering professional services . . . the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail . . . ." *Id.*

Taxpayer provided invoices which separately state service charges. For example, Taxpayer provided a copy of an

invoice from BoMar Pneumatics which separately states the price of installing "lift assist equipment." In addition, Taxpayer provided an invoice from "Tree City Tool" which separately states the costs of "installation."

The Department's Enforcement Division is requested to review the invoices provided by Taxpayer and to adjust the assessment to the extent that Taxpayer has substantiated that it paid for exempt services.

FINDING

Subject to review by the Department's Enforcement Division, Taxpayer's protest is sustained.

XIII. Gross Retail and Use Tax - Statute of Limitations.

DISCUSSION

The issue is whether audit decisions on the taxability of items purchased prior to January 1, 2011 are barred by the three-year statute of limitations.

The Department's audit report addressed the 2011 adjustments as follows:

> This investigation covers the sales & use tax refund claim . . . that was filed by the [T]axpayer's representative on December 23, 2014 that covered 2011 only. Statistical samples & a capital asset review were carried out for 2011-2013. The refund claim was partially denied. Due to the fact that the statute of limitations for 2011 had expired prior to the creation of this case file, no extension of time was obtained to keep the statute open. As a result, the items found to be subject to tax in 2011 will be used to offset any amounts approved for refund. Since the statute of limitations has expired for 2011, this report cannot make any adjustments for additional taxes due for 2011 but will be used as an offset to the total amount approved to be refunded.

Taxpayer argues that the offsetting adjustments were made outside the three-year statute of limitations. Indiana law, IC § 6-8.1-5-2(a), provides as follows:

> Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed, or either of the following:
> (1) The due date of the return.
> (2) In the case of 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, the end of the calendar year which contains the taxable period for which the return is filed.

See also 45 IAC 15-5-7(a).

The Department does not agree that adjustments to the amount of refund sought by Taxpayer are barred by the three-year statute of limitations set out in IC § 6-8.1-5-2(a). Simply stated, the Department did not issue a "proposed assessment" of additional 2011 sales or use tax that might otherwise have been barred by the three-year limitation. Instead, the Department simply offset amounts owed by Taxpayer against the amount of refund to which Taxpayer was otherwise entitled an action clearly not barred by the limitations period on which Taxpayer relies. In doing so, the Department acted entirely within its statutory authority. *See* IC § 6-8.1-9-2(a), (c); IC § 6-8.1-9-1(b).

FINDING

Taxpayer's protest is respectfully denied.

XIV. Gross Sales and Use Tax - Lump-Sum Contracts.

DISCUSSION

Taxpayer explains it entered into a 2010 contract with Honeywell Building Solutions to "install a substrate security system" and that Taxpayer is not subject to either sales or use tax on the payments for the completion of this contract.

Taxpayer also entered into a contract with Forster Electrical Systems to "reorganize electrical and data lines" in buildings located at its Indiana facility.

A. Audit Response.

The substantive portion of the Department's audit report makes no mention of the Honeywell "lump-sum" contract. However the list of sampled purchases and the list of capital asset purchases include approximately $79,000 in charges for "Honeywell Building Solutions," $29,000 to Forster Electric for "electrical work on building 3 and 4 as a "lump-sum improvement to real property."

B. Taxpayer's Response.

Taxpayer argues that payments to Honeywell, for the cost of a "substrate security system, and payments to Forster, for costs associated with an electrical and data line project, are exempt because the payments were made pursuant to lump-sum contracts.

Taxpayer cites to IC § 6-2.5-3-2(c) as authority for its position that the Honeywell and Forster charges are exempt.

> The use tax is imposed on a contractor's conversion of construction material into real property if that construction material was purchased by the contractor. However, **the use tax does not apply to conversions of construction material described in this subsection, if:**
>
> **(1) the state gross retail or use tax has been previously imposed on the contractor's acquisition or use of that construction material;**
>
> (2) the person for whom the construction material is being converted could have purchased the material exempt from the state gross retail and use taxes, as evidenced by a properly issued exemption certificate, if that person had directly purchased the construction material from a retail merchant in a retail transaction; or
>
> (3) the conversion of the construction material into real property is governed by a time and material contract as described in IC 6-2.5-4-9(b).

(**Taxpayer's emphasis**).

Taxpayer also cited to the Department's regulation, 45 IAC 2.2-4-26(a), as further authority for its position that the Honeywell and Forster payments were not subject to sales or use tax. The regulation provides:

> A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used.

Taxpayer concludes that Honeywell and Forster had the responsibility for paying any sales or use tax associated with the installation of the security system and implementation of the electrical and data line project. As Taxpayer explains:

> [U]nder the language provided in 45 IAC 2.2-4-26(a), the contractor assumed the tax liability on the materials being provided. In this case the contractor paid sales or use tax on the materials it consumed on the job. Since tax is imposed on the contractor, [Taxpayer] is relieved of its tax liability under Indiana Code § 6-2.5-3-2(c). As a result, the tangible personal property transferred in conjunction with a lump-sum contract for an improvement to real estate is not subject to sales or use tax.

Taxpayer also argues that *any* imposition of tax is barred by the three-year statute of limitations because "all three progress payments for this [security] project were invoiced in 2010 and therefore outside the Statute of Limitations." However, the statute of limitations issue was addressed separately in Part XIII above. As was the case in Part XIII, the Department did not issue an assessment but "simply offset amounts owed by Taxpayer against the amount of refund to which Taxpayer was otherwise entitled . . . ."

C. Hearing Analysis.

Taxpayer entered into lump-sum contracts for improvements to Taxpayer's facilities, *i.e.* its "realty." A "lump-sum" contract "is the traditional means of procuring construction, and still the most common form of construction contract. Under a lump sum contract, a single 'lump sum' price for all the works is agreed before the works begin." *Designing Buildings*, https://www.designingbuildings.co.uk/wiki. (Last visited November 28, 2017).

The Department's previous Sales Tax Information Bulletin 60 (April 2011), 20110427 Ind. Reg. 045110247NRA, explained:

> "Lump-sum contract" is a contract in which all of charges are quoted as a single price. A construction contractor may furnish a breakdown of the charges for labor, materials and other items without changing the nature of the lump-sum contract.

The flip-side of a "lump-sum" contract is a "time and materials contract" which the current Sales Tax Information Bulletin 60 (November 2017), **explains is** "a contract in which the cost of construction material and the cost of labor or other charges are stated separately."

The current Information Bulletin explains the tax consequences of a "lump-sum" contracts:

> Contractors operating in this manner [lump sum contracts] purchase construction material for their own use or consumption in the fulfillment of contractual obligations to provide real property improvement services. As such, contractors using contracts that do not meet the definition of a time and material contract are not reselling construction material and should not charge their customers sales tax. They should (1) pay sales tax at the time the construction material is purchased, or (2) self-assess and remit use tax at the time the construction material is converted into real property if that construction material was purchased or otherwise acquired without paying tax.

There is an exception. The contractor is not required to pay sales tax or self-assess use on purchases of tangible personal if the contractor's customer was legitimately entitled to purchase items exempt from the tax. For example, if a church could have purchased shingles for its new roof because the church is exempt from sales/use tax, the contractor for the roof project is not required to pay sales/use tax on the shingles. However, current information bulletin 60 cautions, "A customer's ability to purchase construction material exempt from tax is evidenced by the customer's properly completed Form ST-105 General Sales Tax Exemption Certificate." *Id.*

Sales Tax Information Bulletin 60 (April 2011) explains the tax consequences of these forms of contracts.

> If a construction contractor purchases construction materials pursuant to a lump-sum contract, the construction contractor pays either: (1) sales tax at the time the construction materials are purchased, or (2) use tax at the time the construction materials are incorporated into real property if the contractor purchased or acquired the construction materials exempt from sales tax and the owner of the real property could not have purchased the materials exempt from sales tax.

Therefore, a lump-sum contractor pays sales tax at the time it purchases materials necessary to fulfill those contracts unless the customer issues the contractor an exemption certificate.

D. Conclusion.

Taxpayer provided a copy of its "Building Systems Agreement" with Honeywell Building Solutions. The agreement calls for Honeywell to provide "equipment and services in accordance with the . . . work scope of documents and terms and conditions . . . ." The agreement calls for Honeywell to provide and install "servers," a "software license," "door contacts," a "fixed indoor camera," "access control panel," and the similar items. As such, the "Building Systems Agreement" constitutes a "lump-sum" contract for which Honeywell is responsible for paying either the sales tax or self-assessing use tax on the cost of the tangible property. Taxpayer has met its statutory burden under IC § 6-8.1-5-1(c) of establishing that Taxpayer is not responsible for paying sales or use tax on the price it paid for the September 22, 2010, lump-sum contract with Honeywell.

Taxpayer was unable to provide a copy of its original agreement with Forster for work associated with the costs of an "electrical and data line project." Taxpayer did provide copies of individual progress payment invoices and copies of a letter from Forster's controller. The controller states that the original agreement called for the provision of both materials and labor. The controller states that the project was very "labor intensive" and that "materials purchases were a small portion of the project cost."

However, the controller also states that "Indiana Sales Tax on the material purchases for this project was not charged or paid by Forster" because Taxpayer's purchase orders issued Forster "indicated that this was a Non-Taxable project." There is nothing which establishes - as Taxpayer represented to Forster - that this was an exempt project. There is nothing which establishes that Forster's "customer could have purchased the construction material exempt from tax had the customer purchased the construction material directly from the supplier." Sales Tax Information Bulletin 60 (November 2017).

The Department is prepared to agree that Taxpayer entered into a lump-sum contract with Honeywell Building Solutions and that Taxpayer is not responsible for sales/use tax on the $79,000 contract price. The Department is unable to agree that Taxpayer is not responsible for sales/use tax on the price paid for the Forster project because - as Forster itself indicates - Taxpayer incorrectly represented that the data and electrical line project was exempt from tax.

FINDING

Taxpayer's protest is sustained in part and denied in part.

XV. Gross Retail and Use Tax - Purchases of Equipment Delivered Outside Indiana.

DISCUSSION

Taxpayer argues that the Department erroneously assessed sales/use tax on the purchase of "machinery and equipment that are located outside the state of Indiana." Taxpayer explains:

> During the audit period, [Taxpayer] purchased and capitalized certain pieces of machinery and equipment that were shipped to and installed in other [Taxpayer] plants located outside the state of Indiana. These plants are other [Taxpayer] production plants located in [] Michigan and [] Missouri. The machinery and equipment was purchased and installed in those facilities, but was paid for by the Shared Services Accounts Payable group located in [] Indiana.

Without specifically stating as such, Taxpayer relies on the "temporary storage" provision found at IC § 6-2.5-3-2(e) which states:

> (e) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:
> (1) the property is delivered into Indiana by or for the purchaser of the property;
> (2) the property is delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and
> (3) the property is subsequently transported out of state for use solely outside Indiana.

Taxpayer is correct in part. IC § 6-2.5-3-2(e) provides a "temporary storage" exclusion from *use* tax when tangible personal property is purchased from an out-of-state vendor, shipped to an Indiana location, but then subsequently "transported out of state for use solely outside Indiana."

Taxpayer provided invoices directing the shipment of goods to locations outside the state or for which Taxpayer believes the "assets may have been relocated to [out-of-state location]." However in each case the vendor was located within Indiana. Indiana does not have an exemption for the sale of goods purchased within the state and subsequently sent outside Indiana. In this case, IC § 6-2.5-3-2(e) is inapplicable because the goods were purchased within this state. In such cases, Indiana's gross retail tax (or sales tax) is imposed on retail transactions which occur within Indiana. IC § 6-2.5-2-1(a).

FINDING

Taxpayer's protest is respectfully denied.

XVI. Gross Retail and Use Tax - Taxable Ratios.

DISCUSSION

Taxpayer purchased equipment and other items from three different vendors some of which items - according to Taxpayer - are used in an exempt fashion allows Taxpayer to claim an exemption from sales/use tax. Taxpayer

disagrees with the "taxable ratios calculated by the auditor for [three] vendors." The three vendors are "Airgas," "Dunham Rubber," "Kirby Risk and Motion Industries."

Taxpayer explains that it has previously established that purchases from Airgas and Kirby Risk "as it relates to purchases of welding supplies and safety equipment." In addition, Taxpayer further explains that the taxability ratios will weigh more heavily in its favor based on a determination that the following items are correctly classified as exempt.

- Heavy Duty Grounding Clips;
- Flux Off;
- Light Stacks;
- Indicator Lights;
- Hercules Switch;
- Safety TC Welder;
- Vacuum Pumps;
- Bender Drive Chains;
- Safety Relay Switches;
- E-Safety Stops;
- Safety Relay Banners;
- Safety Circuits;
- Gate Lock Switches;
- Safety Roller Switches;
- Joy Plugs
- Guardmaster Contactors;
- Allen Bradley Integrated Modules.

Taxpayer explains that "these items were all purchased to replace original parts on direct production machinery and equipment" and this direct production "machinery and equipment shuts down and is non-functional when these parts fail."

Taxpayer further explains that these items "are replacement parts for direct production machinery and equipment that are essential for integrated production of [automobile] control parts."

45 IAC 2.2-5-8, explains that a taxpayer is entitled to purchase machinery, tools, and equipment without paying 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." The regulation further states that "[p]roperty 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." *Id*. *See* IC § 6-2.5-5-3(b). However, "[t]he fact particular property 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 unable to agree that Taxpayer has established that - other than those items addressed elsewhere in this Letter of Findings - the vendors' taxability ratios require modification. As described by Taxpayer, the items sold by the three vendors may well be required by virtue of their "practical necessity," but there is nothing to definitively establish that the items are "directly used" in the "direct production" of Taxpayer's auto parts or that these items have an "immediate effect" on the automobile parts.

FINDING

Taxpayer's protest is respectfully denied.

XVII. Ten-Percent Penalty - Administration.

DISCUSSION

Taxpayer argues that it is entitled to an abatement of the ten-percent penalty. Taxpayer argues that it (1) "is in good standing with respect to Indiana's state and local taxes," that it has (2) "timely filed all tax returns," that it (3) has in place "a system for remitting use tax to the Department for taxable purchases of tangible personal property," that (4) in many instances, it "overpaid use tax on . . . purchases resulting in credits that were applied

against the audit," and (5) that any liability "was not due to negligence but due to other factors including a misinterpretation of the tax code due to a prior audit as well as an inability to secure invoice documentation necessary to prove an exemption applies or tax was paid."

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id*.

Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment - including the negligence penalty - is presumptively valid.

The Department believes that taxpayer erred in determining its cumulative sales and use tax liability and, in doing so, Taxpayer acted with "willful neglect." Based on a "case-by-case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department agrees that the ten-percent negligence penalty should be abated.

FINDING

Taxpayer's protest is sustained.

XVIII. Gross Retail and Use Tax - Best Information Available.

DISCUSSION

Taxpayer cites to numerous errors and omissions on the part of the Department's audit. Taxpayer explains that the errors and omissions resulted in an erroneous denial of its original refund claim and an equally erroneous assessment of additional sales/use tax.

Taxpayer maintains that there were "significant errors" in the audit's original findings and that the Department's audit personnel were not "willing to review additional information and documentation that . . . became available with respect to capital purchases assessed in the audit." Further, Taxpayer states that the Department's auditors "did not fully utilize the information provided," "did [not] match up invoices to the reports provided" and "should have had a greater understanding and knowledge of the functional interrelationship of [i]ts equipment." As a consequence according to Taxpayer, errors within the audit "overstate[d] the actual use tax liability and create[d] undue hardship on the [T]axpayer."

In its protest, Taxpayer asked the Legal Division to address and correct the errors and omissions, to grant the refund claim, and - in large part - abate the assessment of additional sales/use tax.

The Department does not agree that the audit's findings should be so lightly set aside. IC § 6-8.1-5-1(b) expressly requires the Department to issue assessments based on the best information available to the Department.

> If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. *Id.* (*Emphasis added*).

The audit report is replete with references to the Taxpayer's failure to describe, document, or explain in detail its basis for setting aside the assessment and granting the requested refund. In the absence of that information, the

Department's representatives - who were in the very best position possible to make these determinations - were required to render a decision based on the "best information available" in order to fill in the gaps left by Taxpayer. Having rendered that decision - and as repeatedly cited above - Taxpayer bears the burden of establishing that the assessment was wrong because the decision - on its face - is presumed correct. IC § 6-8.1-5-1(c).

Taxpayer bases its protest on the argument that the audit was seriously deficient on its face and asks that the Department now override many aspects of the audit because of those purported "significant errors," misunderstandings, and failures to "fully utilize the available information . . . ." Although the Department does not discount Taxpayer's experience and expertise, Taxpayer is essentially asking the Department to defer to Taxpayer's own judgment and analysis concerning many thousands of items and transactions. Taxpayer asks the Department to now conclude that grab-bag categories of items such as "repair and replacement parts," "other related components," "other machinery and equipment," "other equipment," and "thousands of [Allen Bradley] parts" are exempt from sales and use tax based on what is essentially Taxpayer's say-so. Taxpayer invites the Department to undertake an impossible task given that there is no evidence that the Department's two-year audit was arbitrary, hasty, ill-informed, or driven by anything other than an effort to arrive at a considered and detailed decision based on the "best information available."

FINDING

Taxpayer's protest is respectfully denied.

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