

DEPARTMENT OF STATE REVENUE

04-20171230.LOF

Letter of Findings Number: 04-20171230
Sales and Use Tax
For Tax Years 2014 and 2015

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 document.

HOLDING

Indiana business failed to establish that it was entitled to the statutory exemptions on its purchases and use of various capital assets, including "Creep Feeders" and a "skid loader."

ISSUE

I. Sales and Use Tax - Exemptions.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-8; IC § 6-8.1-5-1; *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Mumma Bros. Drilling Co. v. Indiana Dep't of State Revenue*, 411 N.E.2d 676 (Ind. Ct. App. 1980); *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520 (Ind. 1983); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Rhoads v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466 (Ind. Tax Ct. 1993); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); [45 IAC 2.2-3-4](#); [45 IAC 2.2-3-14](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-15](#).

Taxpayer protests the assessments concerning sales/use tax on "Creep Feeders" and a "skid loader," claiming that it was entitled to the statutory exemptions.

STATEMENT OF FACTS

Taxpayer is an Indiana company which sells and spreads fertilizer on farmers' fields. In 2017, the Indiana Department of Revenue ("Department") audited Taxpayer's records for tax years 2014 and 2015. Pursuant to the audit, the Department found that Taxpayer failed to pay sales tax or use tax on items which were used during the course of its business but did not qualify for any statutory exemption. The audit thus imposed additional sales/use tax.

Taxpayer timely protested the Department's assessment on "Creep Feeders" and a "skid loader." A phone hearing was held during which the representative of Taxpayer explained the basis of Taxpayer's protest. This decision ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax - Exemptions.

DISCUSSION

The Department's audit assessed sales/use tax on Taxpayer's purchases of the "Creep Feeders" and the "skid loader" because Taxpayer did not pay sales tax or self-assess use tax for its purchases. Specifically, the audit determined that Taxpayer's use of these items did not qualify for any exemptions. The audit noted in relevant part:

The taxpayer purchased creep feeders . . . which were capitalized. The presumption is they were for the use of the taxpayer[;] therefore they are subject to use tax.

The taxpayer also purchased a skid loader . . . exempt from tax. The skid loader was used to lift the fertilizer from the ground into the spreaders. This activity does not qualify for the agricultural exemption according to

Taxpayer, to the contrary, claimed that it was entitled to the manufacturing exemption on the "skid loader" and the purchase-for-resale exemption on the "Creep Feeders."

Accordingly, the issue in this case is, as a business which sells and spreads fertilizer on farmers' fields, whether Taxpayer's use of these items qualified for the manufacturing exemption and the purchase-for-resale exemption.

As a threshold issue, all tax assessments are *prima facie* evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment 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).

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

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Rhoads*, 774 N.E.2d at 1048; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468 - 69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. *Rhoads*, 774 N.E.2d at 1047 - 50 (explaining that, generally, states impose a use tax to prevent the erosion of the state's tax base when its residents make purchases in other states). To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a); *USAir, Inc.*, 623 N.E.2d at 468. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

Moreover, all purchases of tangible personal property generally are taxable unless specifically exempted by Indiana law. [45 IAC 2.2-5-8\(a\)](#). An exemption from the use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4 and [45 IAC 2.2-3-4](#). There are various tax exemptions available under IC § 6-2.5-5; these enumerated exemptions also apply to transactions which are subject to Indiana use tax. [45 IAC 2.2-3-14](#). A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[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." *Id.* at 101 (internal citations omitted). In applying any tax exemption, "[t]he general rule is that tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

In its protest letter, Taxpayer contended that:

Items 1-4 . . . "Creep Feeders" are resale items. Item 5 is a skid loader utilized in an exempt manner in the chemical blending process, loading raw materials in the various stages of producing the final product sold to the consumer (farm).

This Letter of Findings addresses Taxpayer's arguments concerning (1) the manufacturing exemption and (2) the purchase-for-resale exemption on as follows:

A. Manufacturing Exemption

The Department's audit determined that Taxpayer's purchase and use of the skid loader did not qualify for the

agricultural exemption. Taxpayer contended that its use of the item qualified for the manufacturing exemption. The relevant statutory provision is IC § 6-2.5-5-3(b), which provides:

[T]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it **for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. (Emphasis added).**

Thus, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture . . . of other tangible personal property." In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. [45 IAC 2.2-5-8\(a\)](#). "[F]airly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Indiana Dep't of State Revenue*, 411 N.E.2d 676, 677 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "[T]he test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* (citing *Department of Revenue v. U. S. Steel Corp.*, 425 N.E.2d 659 (Ind. App. Ct. 1981)).

An exemption applies to "manufacturing machinery, tools, and equipment directly used by the purchaser in direct production." [45 IAC 2.2-5-8\(b\)](#). Manufacturing machinery, tools, and equipment are directly used in the direct production process "if they have an immediate effect on the article being produced." [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. *Id.* An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#), example (1). "Equipment used to remove raw materials from storage prior to introduction into the production process or to move finished products from the last step of production" is not exempt because the use of the equipment lacks "an essential and integral relationship with the integrated production system." [45 IAC 2.2-5-8\(c\)](#), example (4)(G).

[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. The change must be substantial resulting in a transformation of the property into a different and distinct product. *Id.*

[45 IAC 2.2-5-8\(g\)](#) further explains:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. **The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property. (Emphasis added).**

Accordingly, when a taxpayer demonstrates that it directly uses a piece of equipment - the equipment has an immediate effect upon the article being produced - in its direct production, the taxpayer may qualify for the manufacturing exemption pursuant to the above mentioned Indiana law.

In this instance, Taxpayer stated that "in the chemical blending process," it used the item to "load[] raw materials in the various stages of producing the final product sold to the consumer (farm)." Taxpayer did not provide additional documentation to further support its protest.

Upon review, however, Taxpayer is mistaken. First, the Department is not able to agree that Taxpayer is in the business of "producing the final product" for sale because Taxpayer did not establish that it is in the business of manufacturing fertilizer. Even if, for the sake of argument, Taxpayer is assumed to be manufacturing fertilizer, "The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property 'has an immediate effect upon the article being produced'." "[L]oading raw materials" is a pre-production activity because

the skid loader does not have an immediate effect upon the fertilizer being produced. Thus, Taxpayer's use of the skid loader is not exempt.

In short, given the totality of the circumstance, in the absence of other supporting documentation to demonstrate otherwise, Taxpayer's use of the skid loader was pre-production because the item was "loading raw materials," which does not qualify for the manufacturing exemption.

B. Purchases for Resale, Rental, or Leasing

Taxpayer claimed that its purchases of "Creep Feeders" were not subject to sales tax or use tax pursuant to IC § 6-2.5-5-8(b) because "they are resale items."

To qualify for the exemption under IC § 6-2.5-5-8(b), [45 IAC 2.2-5-15](#) explains:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property to **a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.**
- (b) General rule. Sales of tangible personal property for resale, rental or leasing are exempt from tax **if all of the following conditions are satisfied:**
 - (1) **The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;**
 - (2) **The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and**
 - (3) **The property is resold, rented or leased in the same form in which it was purchased.**
- (c) Application of general rule.
 - (1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.
 - (2) **The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.**
 - (3) The property must be resold, rented or leased in the same form in which it was purchased.

(Emphasis added).

In this instance, Taxpayer did not provide any additional documentation to support its protest. As mentioned earlier, the audit noted that Taxpayer is an Indiana company which sells and spreads fertilizer on farmers' fields. Taxpayer purchased, capitalized, and depreciated the Creep Feeders. Thus, Taxpayer is presumed to purchase the items to perform its services of spreading fertilizer on farmers' fields.

In short, given the totality of the circumstances, Taxpayer did not qualify for the exemption under IC § 6-2.5-5-8(b) on its purchase of the "Creep Feeders." Since Taxpayer purchased and used the items without paying sales tax to perform its services, use tax is properly imposed.

FINDING

Taxpayer's protest is respectfully denied.

Posted: 03/28/2018 by Legislative Services Agency
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