DEPARTMENT OF STATE REVENUE

04-20180547R; 04-20180548R; 04-20180549R
04-20180627R; 04-20180628R; 04-20180629R
04-20180630R; 04-20180631R
04-20180632R.MOD

Memorandum of Decision: 04-20180547R; 04-20180548R; 04-20180549R; 04-20180627R; 04-20180628R; 04-20180629R; 04-20180630R; 04-20180631R; 04-20180632R
Gross Retail Tax
For the Years 2014 through 2017

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

The Department agreed with Indiana Fast Food Restaurants that they were entitled to an exemption of sales tax paid on the purchase of specific items of restaurant equipment directly used within the process of producing their completed food entrees; the Department was required to stand by detailed information on its website specifying the methodology used to calculate electricity consumed by exempt three-phase motors.

ISSUE

I. Gross Retail Tax - Predominant Use Utility Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-5-5.1; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Aztec Partners, LLC v. Indiana Dep't of State Revenue*, 35 N.E.3d 320 (Ind. Tax Ct. 2015); *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 2.2-4-13; Ind.gov Utility Study Workpaper, http://www.in.gov/dor/5317.htm.

Taxpayer argues that the Department erred in determining the extent to which its restaurants were entitled to a sales tax exemption on the purchase of utilities directly used in the preparation of Taxpayer's food offerings.

STATEMENT OF FACTS

Taxpayer is an Indiana company which operates Indiana fast food restaurants. On behalf of the restaurants, Taxpayer submitted nine GA-110L refund claims requesting a return of sales tax paid on the purchase of electric utilities. The Indiana Department of Revenue ("Department") reviewed the requests and granted the claims in part and denied the claims in part.

Taxpayer disagreed with the Department's decision denying in part the requested refund. Taxpayer did so on the ground that the restaurants "predominately" consumed electricity in the direct production of its food products. As such, Taxpayer argued that it was entitled to a refund of *all* sales tax paid on the purchase of the utilities. Taxpayer submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Memorandum of Decision results.

I. Gross Retail Tax - Predominant Use Utility Exemption.

DISCUSSION

The issue is whether the Department correctly calculated the amount and degree to which Taxpayer purchased utilities directly used in the production of Taxpayer's prepared food products.

A. Department's Review of Taxpayer's Refund Claims.

Taxpayer's refund claims sought refunds of all sales tax paid on the purchase of electric utilities. Taxpayer based

its claim on the ground that each of the restaurants was "predominately" engaged in the direct production of its menus items. The Department disagreed. After reviewing Taxpayer's claims, the Department found that each of the restaurants was entitled to a partial exemption. For example, the Department found that one restaurant was entitled to only a 41 percent exemption. In another case, the Department found that a second restaurant was entitled to a 32 percent exemption. In yet another case, the Department found that a third restaurant was entitled to a 37 percent exemption. In each case, the Department concluded that none of the restaurants were entitled to the predominate use - more than 50 percent - exemption.

B. Taxpayer's Response.

Taxpayer states that the Department's audit made three errors - or categories of errors - in calculating the amount of exempt utilities Taxpayer consumed while preparing its food entrees.

1. Restaurant Food Preparation Equipment.

The first purported error made by the Department was in failing to include eight items of equipment - common to each of the nine restaurants - as "exempt equipment." According to Taxpayer each of these equipment items is directly used in the "manufacturing or production" of Taxpayer's finished food products. According to Taxpayer, the Department erroneously omitted the following items of equipment:

- Frozen Latte Maker;
- Stainless Steel Chocolate Heater;
- Stainless Steel Carmel Heater;
- Walk-In Ice Cream Freezer;
- Orange Julius Blender;
- Microwave Oven;
- Vulcan Flat Griddle;
- Bunn Hot Water Heater.

Taxpayer explains that the walk-in ice cream freezer is entitled a partial exemption because the freezer is used 35 percent of the time to "manufacture" or "produce" Taxpayer's completed food items. Taxpayer explains that the Vulcan Flat Griddle is exempt because it is used to produce waffle cones.

2. Power Ratings of Coffee Maker and Frozen Beverage Maker.

Taxpayer states that the Department erred in calculating the amount of electricity consumed by two particular items of equipment. In both cases, the Department categorized the equipment as exempt but at a lower power rating than Taxpayer sought.

In the first case, the Department rated Taxpayer's "Arctic Rush Machine" at 208 volts and 8 amps. Taxpayer states that the rating is mistaken and that the device is actually rated at 22.5 amps.

In the second case, the Department rated Taxpayer's "Bunn Coffee Maker" at 1,670 watts. Taxpayer states this rating is mistaken and the device is actually rated at 33.4 amps and 12,000 watts.

For both the "Arctic Rush Machine" and the "Bunn Coffee Maker," Taxpayer has provided a product specification sheet which purports to buttress Taxpayer's argument that the Department erred in its rating calculation.

3. Three-Phase Motor Energy Consumption.

Taxpayer argues that the Department miscalculated the amount of electricity consumed by its exempt three-phase equipment motors. As Taxpayer explains:

> The DOR was not using the correct formula for all of the 3-phase pieces of equipment. According to the IN DOR's guidelines . . . anything 200 Volts or more, you have to use the three-phase conversion. Volts x Amps x 1.73/1000.

To that end, Taxpayer cites to the Department's own website which provides:

> • If Volts are listed as one number exceeding 200, equipment is 3 phase. The Department requires KW be calculated using one of the following formulas:

- Volts x Amps/1000 (Single Phase)
- Volts (Average) x Amps/1000 (Two Phase - Volts lists as "208-240" would be 224)
- **Volts x Amps x 1.73/1000 (Three Phase)**
- HP x .746
- Watts x .001
- Kilowatts Actual if this rating is given on the panel.

Ind.gov Utility Study Workpaper, http://www.in.gov/dor/5317.htm. (Last visited March 14, 2018) (**Emphasis added**).

A. Statement of Law.

Indiana sales tax is imposed pursuant to IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

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

(a) As used in this section, **"tangible personal property" includes electrical energy,** natural or artificial gas, water, steam, and steam heat.

(b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

(**Emphasis added**).

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

(a) In general, the furnishing of electricity, gas, water, steam, or steam heating services by public utilities to consumer is subject to tax.

(b) The gross receipt of every person engaged as a power subsidiary or a public utility derived from selling electrical energy, gas, water, or steam to consumers for direct use in direct manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5 shall not constitute gross retail income of a retail merchant received from a retail transaction. Electrical energy, gas, water, or steam will only be considered directly used in direct production, manufacturing, mining, refining, oil or mineral extraction, irrigation, agriculture, or horticulture if the utilities would be exempt under IC 6-2.5-5-5.1.

(c) Sales of public utility services or commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5, based on a single meter charge, flat rate charge, or other charge, are excepted if such services are separately metered or billed and will be used predominantly for the excepted purposes.

(d) Sales of public utility services and commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, or horticulture, based on a single meter charge, flat rate charge, or other charge, which will be used for both excepted and nonexcepted purposes are taxable unless such services and commodities are used predominantly for excepted purposes.

(e) **Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall**

mean that more than fifty percent (50[percent]) of the utility services and commodities are consumed for excepted uses.

(**Emphasis added**).

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

IC § 6-2.5-5-5.1, 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). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding decision denying a portion of the requested refund, are entitled to deference.

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).

B. Analysis and Conclusion.

1. Restaurant Food Preparation Equipment.

In *Aztec Partners,* the Indiana Tax Court addressed the extent to which a restaurant's use of food preparation equipment was exempt on the ground that Aztec's food warmers and coolers were integral to the production of that restaurant's food entrees. *Id.* at 322. Aztec purchased warmers and coolers to hold "salsa, chicken, chorizo, eggs, rice, lettuce, and tortilla chips that [were] combined ultimately into the entrée[s] served at [Aztec's] restaurants." *Id*.

The court concluded that the warmers and coolers "changed the individual food items into new, marketable products that [had] a character and form different from the food items first acquired." *Id*. After Aztec made use of the warmers and coolers, Aztec combined those constituent items into the final food items eventually sold its customers. *Id.* at 234.

The court held that Aztec's warmers, coolers, and similar devices consumed electricity in the direct production of its food items and that Aztec's purchase of the electricity was exempt from Indiana's sales tax; Aztec's equipment was used *within* the production process and - as the court noted - there was no evidence that Aztec ever sold its eggs, shredded lettuce, and salsa separately. *Id*. at 325.

The Department agrees with Taxpayer that its latte maker, chocolate heater, caramel heater, orange blender, microwave oven, griddle, and hot water heater fall within the exemption. In the case of these devices, there is sufficient evidence to agree that the devices either act upon a prepared food item (griddle, microwave) or are used to maintain the temperature of a food constituent (caramel, chocolate) that is itself well within the process of preparing the completed entrée. For example, there is no evidence that the restaurants sell heated caramel or chocolate directly to its customers.

The Department does not agree that Taxpayer has established that it is entitled to a refund on any portion of the electricity used to operate its walk-in freezer. Taxpayer's suggestion that it the freezer is directly engaged in producing its customer entrees 35 percent of the time is speculative; granting an exemption on any portion of this utility consumption would fly in the face of the rule that exemption statutes are "strictly construed against exemption from the tax." *Tri-States*, 706 N.E.2d at 283.

2. Power Ratings or Coffee Maker and Frozen Beverage Maker.

Taxpayer states that the Department miscalculated the electricity used by its particular coffee makers and its frozen beverage makers. To that end, Taxpayer has provided product specification sheets for a "Titan Single DBC 120/208V Brewer" and an "Electro Freeze Model 812 Slush and Cocktail Freezer." Those documents contain electrical specifications which are different from the utility usage specified in the Department's original calculations.

However, the Department reviewed the specifications of an "Arctic Rush Machine" and a "Bunn Coffee Machine." Perhaps these are the same devices detailed on Taxpayer's specification sheets but perhaps not. In addition, a cursory review of the manufacturer's Electro Freeze, Bunn, and Titan websites indicates that each manufacturer produces a variety of coffee makers and frozen beverage makers - some large some small - many of which have different electrical specifications.

In this case, the Department is unable to agree that Taxpayer has met its burden of establishing that the Department's original evaluation was incorrect. The Department notes that the original determination was made after an on-site visit by one of the Department's representatives; a distinct advantage over the circumstances of an administrative hearing. Although the electrical requirements contained in Taxpayer's specification sheets may well correspond to every single machine at every single one of Taxpayer's restaurants - given that exemption statutes are "strictly construed against exemption" - it is not possible to sustain Taxpayer on this issue.

3. Three-Phase Motor Energy Consumption.

Taxpayer concludes that the Department underestimated the amount of electricity consumed by its exempt three-phase equipment motors. According to Taxpayer, the Department employed the wrong mathematical formulation in calculating that consumption amount. That particular formulation (Volts x Amps x **1.73**/1000) is found on the Department's website. However, the Department maintains the website formulation is wrong; the correct formulation is Volts x Amps x 1.73 x **.85**/1000.

In this particular case, the Department is required to stand by the information promulgated on its website. If the website information requires correction, then it needs to be corrected but this Taxpayer was entitled to rely on the published formulation.

The Department's Compliance Division is requested to review the three-phase calculation and make whatever correction necessary consistent with the Department's then current website formulation.

FINDING

Taxpayer's protest is sustained in part and denied in part. The Department's Compliance Division will adjust the three-phase motor consumption consistent with the Department's original website formulation. The Compliance Division is also requested to make an adjustment to the refund issued Taxpayer consistent with the finding that certain items of restaurant equipment are used in an exempt fashion.

March 20, 2018

Posted: 05/30/2018 by Legislative Services Agency
An html version of this document.