

Letter of Findings Number: 04-20170539
Gross Retail Tax
For Tax Years 2012, 2013 & 2014

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Tire Manufacturer established that certain purchases were acquired for the direct use in the direct production of tangible personal property, and were therefore exempt from use tax. Tire Manufacturer was not subject to use tax on transactions in which it showed it paid sales tax at the time of purchase. Tire Manufacturer failed to establish that the Department imposed gross retail tax on non-taxable services, and failed to demonstrate error in the audit methodology.

ISSUES

I. Gross Retail Tax - Manufacturing Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-3; IC § 6-2.5-5-4; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; *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); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Mynsberge v. Indiana Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *Indiana Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax 2007); [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-8](#).

Taxpayer protests proposed assessments for additional use tax on expenses for items used in its manufacturing plant.

II. Gross Retail Tax - Services.

Authority: IC § 6-8.1-5-1; [45 IAC 2.2-4-2](#).

Taxpayer argues that it was improperly assessed use tax on services.

III. Use Tax - Exemption for Sales Tax Paid.

Authority: IC § 6-2.5-3-4; IC § 6-8.1-5-1.

Taxpayer argues that it is exempt from use tax on certain expenses because sales tax was paid at the time of the retail transaction.

IV. Audit - Sampling Methodology.

Authority: IC § 6-8.1-5-1.

Taxpayer argues that the Department made errors in its audit sampling methodology.

STATEMENT OF FACTS

Taxpayer is a tire manufacturer with a manufacturing plant location in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer made taxable purchases of tangible personal property ("TPP") during the tax years 2012, 2013, and 2014 ("Tax Years at Issue") without paying sales tax at the time of purchase and did not later remit use tax to the Department. The Department therefore issued

proposed assessments for use tax for those years. Taxpayer protested a portion of those proposed assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be presented as necessary.

I. Gross Retail Tax - Manufacturing Exemption.

DISCUSSION

Taxpayer protests the imposition of use tax on certain purchases included as taxable in an audit conducted by the Department for the tax years 2012 through 2014. The Department based its proposed assessments on a review of Taxpayer's operations and the available documentation such as invoices, receipts, and Taxpayer's accounting records. The Department determined that certain purchases of TPP were taxable, but Taxpayer did not pay sales tax at the time of purchase. The Department therefore issued proposed assessments for use tax. Taxpayer protests that some of the transactions determined to be taxable were actually exempt as property directly used or consumed in the manufacturing process.

Specifically, Taxpayer's protest is in regards to items included in a statistical sample the Department took to calculate Taxpayer's use tax compliance rate for the Tax Years at Issue. Due to the large number of purchases Taxpayer made during the audit period, the Department and Taxpayer agreed to a review of one year of expenses; Taxpayer refused to agree to a stratified statistical sample of the purchase invoices for the entire audit period. The auditor therefore performed a review of all 2012 expenses and projected use tax due in 2013 and 2014 based on the findings for 2012. Taxpayer protests that some items listed as taxable but without tax paid were actually exempt purchases and so should not be in the numerator of the calculation.

As a threshold issue, it is the taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing. . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Sales tax is imposed by IC § 6-2.5-2-1, which states:

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

Use tax is imposed under IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

[45 IAC 2.2-3-4](#) further explains:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

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, unless specifically exempted by a statute. [45 IAC 2.2-5-8\(a\)](#). 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 (quoting *Conklin v. Town of Cambridge City*

(1877), 58 Ind. 130, 133). Thus, in applying any tax exemption, the 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). The exemptions to which Taxpayer aspires, like all tax exemption provisions, are 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. Indiana Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999).

Taxpayer argues that the manufacturing exemption applies to several purchases that the auditor found to be taxable. Taxpayer argues that the TPP under protest is either directly used or consumed in the manufacturing process. The relevant statute is IC § 6-2.5-5-4, which, for the Tax Years at Issue, states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described in section 2 or 3 of this chapter.

In addition, the version of IC § 6-2.5-5-3(b) for the relevant tax years provides:

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

Finally, IC § 6-2.5-5-5.1(b) provides:

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. . . .

Taxpayer asserts that numerous classifications of TPP are exempt from use tax because they are directly used or consumed in Taxpayer's manufacturing process. The purchases include pallets, forklifts, uninterruptible power supply equipment, barcode readers, handheld scanners, silica and silane systems, plant wireless system, rented trailers, nitrogen gas, and miscellaneous manufacturing parts. Each category of purchases will be addressed in turn.

1. Pallets

The audit report concluded that Taxpayer used pallets to store finished products in its warehouse until time for shipment, finding that the pallets were color-coded based upon customer. The audit report found that the purchase of these pallets are subject to use tax under [45 IAC 2.2-5-8\(e\)](#), which provides that "[t]angible 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.*" (*Emphasis added*)

Taxpayer asserts that plastic pallets - specifically orange plastic pallets - are used in its plant exclusively during the manufacturing process. These orange pallets are used to hold and move "wig-wag rubber" once it comes out of that stage of production at the plant. "Wig-wag rubber" is a term for the long strips of rubber that are produced within the plant prior to being formed and molded into a tire. The wig-wag rubber is stacked by a machine in a back-and-forth motion onto the orange pallets for storage prior to moving to the next phase of manufacturing. Taxpayer explained that the wig-wag rubber can only be placed on the orange plastic pallets so as not to damage the rubber during the manufacturing process. This stage of production involves work-in-process.

Taxpayer argues that the purchases of the orange plastic pallets, primarily from the supplier PDQ Plastics, Inc., are exempt under [45 IAC 2.2-5-8\(e\)\(3\)](#), which states "[s]torage 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." Additionally, [45 IAC 2.2-5-8\(e\)\(1\)](#) provides, "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." Because the orange plastic pallets are used exclusively for storage of wig-wag rubber prior to the next phase of the manufacturing process, the purchase of orange plastic pallets qualifies for exemption as a container used for storing items currently undergoing production during the production process.

With respect to the beige plastic and wooden pallets, which are the only other pallets separately purchased by Taxpayer, Taxpayer acknowledges that these pallets are not used in the manufacturing process. Rather, the beige plastic pallets were used in the plant's battery shop, and the wooden pallets are used only in the post-production area of the plant to hold finished tires. Taxpayer provided sample invoices showing the purchase of both orange plastic pallets and a smaller number of beige pallets.

Thus, the Department concludes that only those purchases designated as "orange plastic pallets" from the supplier PDQ Plastics, Inc. are exempt from use tax. These include invoice numbers 18263, 18600, 18636, and 18640. Invoice number 18526 contains both orange and beige pallets; thus only \$21,100 of this invoice is exempt from use tax. The remaining invoices listed in Taxpayer's protest schedule are either taxable beige and wooden pallets or are unclear as to the type of pallets purchased, and are therefore deemed taxable.

Taxpayer's protest with respect to expenses for pallets is sustained in part and denied in part.

2. Forklifts

Taxpayer argues that a greater percentage of forklift (also referred to as forklifts) usage is exempt from use tax than what was provided for in the audit report. The audit report allowed a fifty (50) percent exemption on the rental of forklifts and the purchase of repair parts for the forklifts, primarily based upon a tour of Taxpayer's plant and the lack of documentation to support Taxpayer's application of a seventy-six and a half (76.5) percent exemption. Taxpayer relied on a plant tour done by its tax consultant to determine that seventy-six (76) percent of expenses for forklifts should be exempt.

[45 IAC 2.2-5-8\(f\)](#) provides:

Transportation equipment.

- (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.

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...

- (3) A forklift is used exclusively to move work-in-process from a temporary storage area in a plant and to transport it to a production machine for processing. Because the forklift functions as an integral part of the integrated system comprising the production operations, it is exempt.
- (4) A forklift is used exclusively to move finished goods from a storage warehouse and to load them on trucks for shipment to customers. The forklift is taxable because it is used outside the integrated production process.
- (5) A forklift is regularly used 40 [percent] of the time for the purpose described in Example (3) and 60 [percent] of the time for the purpose described in Example (4). The taxpayer is entitled to an exemption equal to 40 [percent] of the gross retail income attributable to the transaction in which the forklift was purchased. (*Emphasis added*).

Based upon [45 IAC 2.2-5-8\(f\)](#) and the examples thereunder, the use of the forklifts to transport work-in-process between various production processes in the plant would be exempt from gross retail tax. To the extent the supplemental audit finds that the forklifts are used to transport work-in-process between various stages within the manufacturing process, this percentage of usage is exempt from gross retail tax. Forklifts used to transport

finished products or materials outside of the manufacturing process are subject to tax. However, Taxpayer's study is not supported by additional documentation that would support its claimed exemption rate. The say-so of its consultant is not sufficient to rebut the presumption that the findings of the audit are correct.

Taxpayer's protest with respect to expenses for forklifts is denied.

3. Trailer Rental

Taxpayer argues that trailer rental expenses should be exempt from gross retail tax because the trailers at issue are used for storage of work-in-process during the manufacturing process.

[45 IAC 2.2-5-8](#)(e) provides:

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.

As supported by documentation provided by Taxpayer, the trailers are used to store "chute rubber" that is being held temporarily during the manufacturing process, to be later re-incorporated into the tire production mixing process. Because the trailers in question are used for the temporary storage of work-in-process, the rental is exempt from gross retail tax.

Taxpayer's protest with respect to expenses for trailer rentals is sustained.

4. Nitrogen Gas

The audit report found that Taxpayer had purchased "welding gasses" from Praxair, Inc. and concluded that the gasses were used by Taxpayer's maintenance department to repair and maintain machinery. Taxpayer provided copies of the Praxair invoices that show that the gas purchased was nitrogen gas, which is a material consumed in the curing process of tire manufacturing and is not used in welding. The nitrogen gas is therefore exempt under IC § 6-2.5-5-5.1 as materials directly consumed in the production process. Taxpayer's protest with respect to the purchase of gas from Praxair, Inc. is sustained.

5. Uninterruptible Power Supply

Taxpayer argues that its uninterruptible power supply ("UPS") Battery Storage and UPS Control Panels qualify for the manufacturing exemption because they are used to power the production process in the event of a catastrophic power failure. The audit report concluded that the UPS system provides power to maintain communication with the administrative office and the plant personnel, and were used in managerial and non-operational activities. The audit report concluded that the UPS system was not directly used in the manufacturing process and was therefore not exempt in accordance with [45 IAC 2.2-5-8](#)(j).

[45 IAC 2.2-5-8](#)(c) provides:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. *Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.*

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(2) 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.*

(A) Air compressors used as a power source for exempt tools and machinery in the production process.

(B) *An electrical distribution system, including generators, transformers, electrical switchgear, cables inside or outside the plant, and related equipment used to produce and/or supply electricity to exempt manufacturing equipment used in direct production. (Emphasis added).*

During the protest, Taxpayer explained that the plant has primary and secondary electricity providers. In the event the primary power supplier experiences a failure, the UPS provides backup power to the manufacturing software for up to 2.5 hours until the secondary power supply comes online. The UPS allow the manufacturing process to continue uninterrupted and prevents work-in-process from going to waste. Based upon a plant tour by Taxpayer's tax consultant, Taxpayer estimated that ninety-five (95) percent of the power from the UPS was to power the manufacturing software—thus having a direct and immediate impact on the manufacturing process—and five (5) percent was used to power the lights in the server room.

According to Taxpayer, its manufacturing equipment would be non-operational without the functioning of the software utilized by its manufacturing equipment; thus, the software is part of its integrated manufacturing process. Because the audit did not specifically address the UPS system, and because the software has an integral role in the manufacturing process and the UPS supplies electricity, in part, to Taxpayer's manufacturing software, to the extent the UPS is used to power the manufacturing software in the event of a power outage, that percentage of usage is exempt from gross retail tax. A supplemental audit is necessary in order to determine the percentage of exempt usage.

Taxpayer's protest with respect to the UPS is sustained subject to supplemental audit.

6. Digital Barcode Readers and Handheld Scanners

Taxpayer protests the assessment of additional use tax on digital barcode readers and handheld scanners. The barcode readers and handheld scanners perform similar functions within the plant by scanning a tiny barcode placed on each tire at each stage of the production process. Digital barcode readers are mounted on manufacturing equipment, while the handheld scanners are used by the machine operators where a machine does not have an integrated barcode reader. The audit report found that both the barcode readers and handheld scanners were used by Taxpayer to keep track of each tire during the production process for inventory and quality control purposes. The audit report therefore concluded that these items were not essential and integral parts of the production process.

Taxpayer argues that the barcode readers and handheld scanners are exempt in accordance with [45 IAC 2.2-5-8\(g\)](#), which states:

"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.

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...

(4) Equipment which constitutes an essential and integral part of the integrated process is exempt. *The fact that such equipment is built in a manner to service various pieces of exempt equipment, as an alternative to building the equipment into each of the pieces of exempt machinery, is not determinative.*

...

(6) *Computers which are interconnected with and control other production machinery or are used to make tapes which control computerized production machinery are exempt from tax. (Emphasis added).*

Taxpayer explained during the protest that the barcodes placed on each tire do not just keep track of the location of the tire in the production process; rather, the barcodes, when scanned by the barcode scanner mounted on manufacturing equipment or by the handheld scanner used by the machine operator, communicates to the manufacturing equipment the type of processing that must be done to each type of tire. According to Taxpayer, the barcodes also indicate which manufacturing processes are complete and which remain, as well as inform forklift drivers where to deliver work-in-process within the manufacturing area. As noted by the auditor, "[i]t allows the automation of each process of the tire from after it leaves the machine until it is stacked on a pallet and put in the warehouse." *Audit Report: Explanation of Adjustments*, at 7. Taxpayer explained that different models of tires can run simultaneously through the manufacturing process because the scanning system tells each machine how each tire is to be processed. As noted in Example 6 under [45 IAC 2.2-5-8\(g\)](#), the barcodes, barcode readers, and handheld scanners are integral to Taxpayer's production process because they control computerized production machinery that have an immediate impact on the tires being produced.

To the extent the barcode readers and handheld scanners are used to control the actions of the machine in processing each tire and in directing movement of the tires to the next step in the manufacturing process they are integral parts of manufacturing units that have an immediate impact on the articles being produced as set forth under [45 IAC 2.2-5-8\(g\)](#), they are therefore exempt from gross retail tax. To the extent the barcode readers are used for inventory and quality control before, during and after the manufacturing process, they are not exempt from gross retail tax. A supplemental audit will determine the percentage of exemption.

Taxpayer's protest with respect to the barcode readers and handheld scanners is sustained in part and denied part subject to supplemental audit.

7. Silica and Silane Systems

Taxpayer asserts that the equipment used to transport silica and silane into holding bins prior to being introduced into the production process should be exempt from gross retail tax. According to Taxpayer, the silica and silane equipment is used for the purpose of transporting and injecting the silica and silane into the wig-wag rubber that is being produced. Taxpayer disagrees with the audit's conclusion that this equipment is not exempt because it is used to move raw material prior to being introduced into the manufacturing process.

According to [45 IAC 2.2-5-8\(c\)\(4\)\(G\)](#), "[e]quipment used to remove raw materials from storage prior to introduction into the production process" is not exempt "[b]ecause of the lack of an essential and integral relationship with the integrated production system[.]" Because this equipment is used to move raw materials from their storage area in the plant into the area where they are introduced into the production process, this equipment is not exempt from gross retail tax.

Taxpayer's protest with respect to the silica and silane systems is denied.

8. Plant Wireless System

Taxpayer asserts that upgrades to its plant wireless system made during the audit period should be exempt from tax as being integral to its manufacturing system. The audit report concluded that the wireless system was used in managerial and non-operation activities and was not directly used in the manufacturing process under [45 IAC 2.2-5-8\(j\)](#), which states:

Managerial, sales, and other non-operational activities. Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading.

Taxpayer explained that the wireless system is used to track the location of raw materials, work-in-process, and finished tires; ensure raw materials are injected in certain amounts to create wig-wag rubber; communicate with barcode readers throughout the manufacturing process by queuing manufacturing machines' actions; communicate manufacturing machines' problems with maintenance; and communicate where a machine operator is to move in the case of the machine operator's machine breaks down. Taxpayer asserts that 81.1 percent of the wireless system qualifies for the manufacturing exemption.

The Department is not prepared to agree that the plant wireless system is directly used in direct manufacturing, and thus is exempt from tax. The wireless system, while used during the manufacturing process, does not have an immediate effect on the products being manufactured and is a non-operational activity. Therefore, the Department concludes that the plant wireless system is not exempt from gross retail tax.

Taxpayer's protest with respect to the plant wireless system is denied.

9. Safety Equipment

The next group of transactions at issue is in regards to safety equipment expenses, including goat-skin gloves and steel-toed boots, which Taxpayer states are required to allow its employees to participate in the manufacturing process without incurring injury and without damaging the work-in-process. The relevant exemption is found at [45 IAC 2.2-5-8\(c\)](#), which states in relevant part:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be *directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process*; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

-EXAMPLES-

...

(2) *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.*

...

(F) *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.*
(*Emphasis added*).

As noted by the auditor, the steel-toed boots are required by OSHA; employees are required to wear these boots in order to prevent injury. Additionally, as explained by Taxpayer and noted by the auditor, the goat skin gloves are necessary in order to prevent contamination to the work-in-process. The steel-toed boots and the goat skin gloves are not used solely for the comfort and convenience of Taxpayer's employees; rather, they are required to allow workers to participate in the production process. Therefore, the Department concludes that these safety items are exempt from gross retail tax.

Taxpayer's protest with respect to gloves and steel-toed boots is sustained.

10. Miscellaneous Manufacturing Parts

Taxpayer provides a list of miscellaneous parts and supplies that it argues are used in the manufacturing process and are therefore exempt from gross retail tax. Exhibit 5 of Taxpayer's protest materials provides a list of purchases that Taxpayer claims should be exempt.

[45 IAC 2.2-5-8\(h\)\(1\)](#) provides, "Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax." Because the items listed are used to maintain manufacturing equipment, they do not qualify for an exemption from gross retail tax.

Taxpayer's protest with respect to the miscellaneous manufacturing parts listed in Exhibit 5 is denied.

FINDING

Taxpayer's protest is sustained with respect to safety equipment, trailer rentals, and nitrogen gas. Taxpayer's protest is sustained in part and denied in part with respect to forklifts, uninterruptible power supply battery storage, barcode readers, and handheld scanners, subject to supplemental audit. Taxpayer's protest with respect to the purchase of pallets is sustained in part and denied in part. Taxpayer's protest with regard to miscellaneous manufacturing parts, the silica and silane equipment, and the plant wireless system is denied.

II. Gross Retail Tax - Services.

DISCUSSION

Taxpayer argues that the Department assessed gross retail tax on non-taxable services. Taxpayer refers to [45 IAC 2.2-4-2\(a\)](#), which states:

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.

Although, as a general matter, some services are exempt from gross retail tax, Indiana does impose tax when transactions also involve the transfer of TPP in connection with the service. Taxpayer states that it was unable to discover invoices for all services being protested; thus it is impossible to determine whether the services are taxable or exempt under [45 IAC 2.2-4-2\(a\)](#). Because Taxpayer has failed to support its argument that the Department assessed tax on exempt services, Taxpayer has not met its burden under IC § 6-8.1-5-1(c) of showing that the Department's assessment with respect to these protested items is wrong.

FINDING

Taxpayer's protest with respect to expenses listed as services is denied.

III. Use Tax - Exemption for Sales Tax Paid.

DISCUSSION

Taxpayer asserts that it has located invoices, not available at the time of the audit, showing that sales tax was paid at the time of three listed transactions (documented on two invoices) and therefore use tax should not have been assessed. These invoices include The Landmark Conference Center, showing sales tax paid in the amount of \$852.74, and Little Vegas, Inc., showing sales tax paid in the amount of \$207.55. "The storage, use, and consumption of tangible personal property in Indiana is exempt from the use tax if . . . the property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property[.]" IC § 6-2.5-3-4.

The audit workpapers originally noted that no invoice was provided for these transactions, and therefore assessed use tax. However, Taxpayer has shown that sales tax was paid on these three transactions. Therefore, Taxpayer has met its burden under IC § 6-8.1-5-1(c) of demonstrating that use tax should not have been assessed on the protested transactions.

FINDING

Taxpayer's protest with respect to the transactions from the above listed vendors is sustained.

IV. Audit - Sampling Methodology.

DISCUSSION

Taxpayer argues that the Department made errors in its audit methodology. Taxpayer asserts that some transactions audited from the 2012 statistical sample have been double-counted, leading to an artificially high percentage of transactions deemed taxable for all years under audit. Taxpayer asserts that, for assets and expenses that the Department deemed taxable, the auditor referred back to the invoice and included the entire invoice amount as the taxable amount, despite the fact that multiple asset or expense items could be included on one invoice.

Taxpayer provided a list of transactions which it asserts were over-counted, but does not provide any invoices to support the assertion that the auditor erroneously included the entire invoice amount for multiple asset or expense entries. In addition, as noted in the audit report Explanation of Adjustments, there were several purchases that were not listed in Taxpayer's expense accounts in the general ledger, so the auditor used the expense accounts as reported on Taxpayer's Federal Income Tax Return as the denominator for the projection calculation. Based upon the documentation provided, Taxpayer has not met its burden under IC § 6-8.1-5-1(c) of showing that the auditor double counted expenses and/or assets, and thus has not shown that the audit methodology is inaccurate.

FINDING

Taxpayer's protest with respect to errors in the audit methodology is denied.

SUMMARY

Taxpayer's protest has been sustained in part and denied in part consistent with this final determination, subject to supplemental audit.

Taxpayer's protest is sustained with respect to safety equipment, trailer rentals, and nitrogen gasses. Taxpayer's protest is sustained in part and denied in part with respect to the uninterruptible power supply battery storage, barcode readers, and handheld scanners, subject to supplemental audit. Taxpayer's protest with respect to the purchase of pallets is sustained in part and denied in part. Taxpayer's protest with regard to forklifts, miscellaneous manufacturing parts, the silica and silane equipment, and the plant wireless system is denied.

Taxpayer's protest with respect to the taxability of protested services is denied. Taxpayer's protest with respect to the assessment of use tax where Taxpayer has shown that sales tax was paid is sustained. Taxpayer's protest with respect to errors in the audit methodology is denied.

Following supplemental audit, the Department's compliance rate will be recalculated and applied to Taxpayer's total purchases for the audit years. This Letter of Findings shall not become final until the Department completes its supplemental audit.

May 22, 2018

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