DEPARTMENT OF STATE REVENUE

04-20180001.LOF

Letter of Findings: 04-20180001
Gross Retail Tax and Use Tax
For the Year 2016

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Travel and Fuel Centers failed to establish that the Department should consider utilities consumed by its onsite biodiesel blending equipment - along with utilities consumed in the preparation of food items - in determining to what extent each Fuel Center was entitled to the predominate use utility exemption.

ISSUE

I. Gross Retail Tax - Predominant Use Utility Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-5-3(b); IC § 6-2.5-5-5.1; IC § 6-8.1-5-1(c); *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); *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*); General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); 45 IAC 2.2-4-13; 45 IAC 2.2-5-10(k); Utility Study Workpaper - Electric, https://www.in.gov/dor/5317.htm.

Taxpayer argues that the Department erred in determining the extent to which its fuel stations were entitled to a sales tax exemption on the purchase of utilities directly used in the preparation of Taxpayer's food offerings and the "manufacturing" or "processing" of blended fuel sold to its customers.

STATEMENT OF FACTS

Taxpayer owns and operates travel centers in the United States. The travel centers provide their travel customers gasoline, diesel fuel, fast food, beverages, and prepared sandwiches. Some of the centers also provide additional services such as ATM access, Internet kiosks, check cashing services, laundry services, audio book rental, truck washes, and truck weigh scales.

Taxpayer operates travel centers in Indiana. Some of those Indiana locations provide only fuel while some of the locations also provide restaurant and other services.

Taxpayer filed multiple claims for refunds of sales tax paid on the purchase of electricity and natural gas used in preparing restaurant food. The claims included purchases made in 2012, 2013, 2014, and a portion of 2015. The Indiana Department of Revenue ("Department") reviewed the claims finding that - in certain cases - the business location was entitled to the "predominate use exception" because more than 50 percent of the utilities were consumed in preparing food at that particular location.

However, the Department also found that some of the exempt percentages claimed by Taxpayer were incorrect and that Taxpayer "had overstated their production use." The audit concluded that some of the business locations were no longer entitled to the "predominate use" exemption.

The Department's audit resulted in the assessment of additional sales/use tax for 2016 as well as the disallowance of certain of the originally claimed utility exemptions.

Taxpayer disagreed with the Department's findings 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 Tax - Predominant Use Utility Exemption.

DISCUSSION

Taxpayer argues that the Department's audit resulted in "erroneous, unsupportable findings with regard to electric utility consumption in [its Indiana travel stations]." In particular, Taxpayer argues that the additional assessment of approximately $67,000 was erroneous and that its "various facilities in Indiana should be exempted from paying use or sales tax on utilities specifically electrical service . . . ." Taxpayer concludes that correction of the audit's errors will result in additional "refunds on use or sales tax previously paid . . . ."

Taxpayer argues that the Department's audit made four major errors in determining the extent to which is was consuming utilities in exempt functions. According to Taxpayer:

- The biofuel blending operation at each travel station qualifies as exempt production equipment;
- The Department used an erroneous formula in calculating electrical consumption by its three-phase equipment;
- The Department's audit overstated the electrical consumption of its non-exempt fuel and diesel pumps;
- The Department used incorrect calculations in calculating electricity used by its walk-in coolers, freezers, icemakers, and toaster ovens.

A. Statement of Law and Burden of Proof.

Because the Department's audit resulted in an assessment of additional tax, it is the Taxpayer's responsibility to establish that the pending 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." See also *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).

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 audit decision denying a portion of the requested refund and assessing additional tax, 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 Conclusions.

1. Local Biodiesel Blending Process.

Taxpayer maintains that it operates local biofuel blending equipment at sixteen of its travel centers and that the electricity used to operate this equipment is entitled to the "manufacturing" or "processing" exemption because the local equipment operates in the same manner as its Indiana bulk blending facilities. Taxpayer explains how these local blending facilities operate.

The blending system consists of a separate biofuel tank that holds either B99.9 or B100 product, i.e., essentially pure biodiesel. The biofuel tank is plumbed into a pump manifold system consisting of inlet flows from the UST diesel tanks and UST biofuel tank as well as an injection, blender, and sump system. All of

> these items make up the bio blending shed. The outlet side of the shed consists of a two outflows, one to the diesel dispensers and one to auto diesel dispensers, known as the trunk lines. The biodiesel blend percentage is controlled by software that monitors the diesel flow needed in the diesel trunk lines as well as the injected amount of B100 needed to blend to maintain the desired biodiesel blend percentage being dispensed at the pumps. The typical range of percentages can be from 5[percent] to 20[percent] biodiesel (referenced as B5 at the low end or B20 at the high end). The makeup of B20 consists of 20[percent] of the B100 biodiesel and 80[percent] of petroleum diesel. These adjustments can be made based on the season, outdoor temperature, humidity, or other conditions that impact environmental concerns. The percentage also can be changed because of product deliveries or system malfunction. The process of blending is controlled by [Taxpayer], often from a remote location via computer software, but the blending equipment all is on site and is powered by electricity service to that location.

Taxpayer's consumption of utilities to prepare food items is, of course, distinguishable from its consumption of electricity used to blend various biodiesel and petroleum based products. But the utility exemption applies equally to both functions.

Taxpayer argues that the Department's audit ignored the blending process taking place in its local biodiesel blending "sheds" but by combining the exempt consumption percentage of its blending "sheds" with the partial exemption granted to the adjoining restaurant location, Taxpayer meets the "predominate" use threshold at all but two of the Indiana travel centers.

Taxpayer necessarily relies on IC § 6-2.5-5-3(b) which 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.

Therefore, tangible personal property - such as Taxpayer's blending sheds - must be directly used in the direct production of other tangible personal property in order to qualify for the exemption found in IC § 6-2.5-5-3(b).

The Department's regulation, 45 IAC 2.2-5-10(k) provides:

> Processing or refining is defined as the performance by 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*. Operations such as distilling, brewing, pasteurizing, electroplating, galvanizing, anodizing, impregnating, cooking, heat treating, and slaughtering of animals for meal or meal products are illustrative of the types of operations which constitute processing or refining, although any operation which has such a result may be processing or refining. *A processed or refined end product, however, must be substantially different from the component materials used.*

(*Emphasis added*).

The Department is unable to agree that Taxpayer has met its burden of demonstrating that the blending devices are exempt from sales/use tax because the equipment is not used for "direct use in the direct production . . . [or] processing . . . of other tangible personal property." IC § 6-2.5-5-3(b). The facility is equipped to blend different grades of liquid fuels which, although altering the characteristics of the final product, does not produce an end product which is "substantially different from the components used." 45 IAC 2.2-5-10(k). Blended fuel is still essentially "fuel." Blended diesel is still essentially "diesel." Blending a biodiesel component with diesel fuel produces a product which is still recognizably and functionally diesel fuel.

2. Three-Phase Consumption Formula.

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. As explained by Taxpayer:

> [The Department] used an incorrect formula to calculate usage on three-phase outlet equipment. [Taxpayer's consultant] discovered that IDOR auditors [applied] a .85 factor to the kilowatts and then against the load factor.

In this case, Taxpayer is wrong and the Department's calculation is correct. The .85 factor is correct and is found at Utility Study Workpaper - Electric. *Available at* https://www.in.gov/dor/5317.htm (last visited May 15, 2018).

3. Electrical Usage at Fuel and Diesel Pumps.

Taxpayer states that the Department "materially and substantially overstated [non-exempt] electrical usage at fuel and diesel pumps." Taxpayer explains that the Department found that the gasoline and diesel pumps operated at 230 volts but that its own independent study found that its pumps operated at 115 volts. Taxpayer explains the significance.

> By substantially overstating the pump electrical usage, IDOR's audit results in a skewed ratio of electrical consumption for exempt purposes. The ratio at issue, obviously, is how much electrical consumption is exempt (the numerator) as a percentage of total usage (the denominator). If the denominator is erroneous and, in this case, vastly overstated because of a faulty understanding of the volts used, the resulting quotient dilute materially the percent attributable to exempt usage.

In this case, the Department agrees in theory that overstating the amount of electricity consumed by its gasoline and diesel pumps would potentially "skew" the calculation results because this nonexempt usage would tend to "dilute" the percent of exempt usage. However, other than Taxpayer's bare assertion to that effect, there is nothing independently substantive which would verify that the gasoline pump and diesel pumps at each of its travel center locations operates at 120 volts.

4. Cooler, Freezer, Icemaker, and Toaster Oven Electrical Consumption.

Taxpayer states that the Department's audit misstated the amount of electricity consumed by its walk-in coolers, freezers, icemakers, and toaster ovens.

Taxpayer states that its coolers and freezers "are all one unit with one electrical supply junction." Taxpayer further states that its consultant "corrected the calculation for each unit."

As to its toaster ovens - used in some of its restaurants but not in others - Taxpayer explains that each "is a high speed forced air convection oven" but that the Department "used incorrect voltage and amperage." Finally, Taxpayer states that the Department "used incorrect voltage and amperage for [its] ice makers."

As with the gasoline and diesel fuel pumps, Taxpayer makes its case by stating a desired outcome but has not met its statutory burden of establishing that the assessment was wrong. IC § 6-8.1-5-1(c). There is nothing to verify that the numbers in the audit report were wrong and that the numbers that it seeks to introduce are correct.

FINDING

Taxpayer's protest respectfully denied.

June 8, 2018

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