

**Letter of Findings: 04-20180450
Sales & Use Tax
For the Years 2014 - 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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Company did not establish that the shrink wrapping of stacks of product bundles, when the product bundles had already been shrink wrapped, was part of its production process.

ISSUE

I. Sales & Use Tax—Post-Production.

Authority: IC § 6-8.1-5-1; *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); *Scopelite v. Indiana Dept. of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *North Central Industries, Inc. v. Indiana Dept. of State Revenue*, 790 N.E.2d 198 (Ind. Tax Ct. 2003); *Wendt LLP v. Indiana Dept. of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); [45 IAC 2.2-5-10](#); [45 IAC 2.2-5-8](#).

Taxpayer protests the Department's proposed assessments.

STATEMENT OF FACTS

Taxpayer manufactures packaging materials from recycled materials. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for the tax years 2014 through 2016. The Audit Report states that regarding Indiana sales tax, "[n]o changes are proposed for sales tax for the period January 1, 2014 through December 31, 2016." However, the Audit Report did find "purchases of tangible personal property where sales tax was not paid at the time of purchase nor was use tax self-assessed." As a result of the Department's audit, Taxpayer was issued proposed assessments for base tax and interest. Taxpayer filed a protest. An administrative hearing was held and this Letter of Findings results. More facts will be provided below as needed.

I. Sales & Use Tax—Post-Production.

DISCUSSION

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. The Department also notes that when an agency is charged with enforcing a statute, the courts defer to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

Taxpayer states in its protest letter that the auditor found, in general, that the items at issue in the protest "are used outside of the manufacturing process and, therefore, are not exempt from the Use Tax." Taxpayer states that the Audit Report is incorrect regarding its process:

The Auditor states that "The product comes out of the dryer, is stacked and then is shrink wrapped. This completes the packaging of the product." That is incorrect; it completes the bundling of the product but not the end of the integrated production process.

And further, Taxpayer states that "[u]ntil the appropriate number of bundles of the product is grouped in a pallet stack, the integrated production process is not complete." Taxpayer's protest is organized into four categories: Miscellaneous, Stretch Wrap Machine, Manuals, and Capital Assets. The protested categories are addressed below.

Miscellaneous

The items within the rubric of the category "Miscellaneous" are as follows: tape dispensers, mini-base hand wrapper, and hand wrappers. Taxpayer states that "these items [are] use[d] in the integrated production process to properly package the product for the customer and is the same as the final packaging onto the case palletizers in the whiskey example" That example from the Indiana Administrative Code is found at [45 IAC 2.2-5-10\(2\)\(D\)](#), and states:

A bottling and packaging process, which includes equipment such as case and bottle *conveyors used during the filling operations, equipment to fill the bottles with product* and to place labels on the bottles, and case filling equipment and case palletizers. The exempt production process begins after the bottles are introduced onto the bottle conveyors *for the filling step of production* and ends with the final packaging of the product onto the case palletizers.
(*Emphasis added*).

Taxpayer states, "[o]ur integrated production process is the same as the whiskey production example" It should be noted that Taxpayer's process is in fact not *the same* as the whiskey production example—Taxpayer does not produce whiskey—but the two processes may be *similar* (that issue is addressed below).

Turning to the Audit Report, it states that the hand wrapper is "used after the product has been packaged"

The drink carriers and [] cartons are placed into stacks as they come off the dryer. These stacks are packaged by applying shrink wrap around the stack. They are then moved into the area where they are placed on pallets. The stretch wrap machine and the hand wrapper are used in this area to apply shrink wrap around the completed shrink wrapped packages that are on the pallet. These items are used outside the manufacturing process.

The auditor cites to [45 IAC 2.2-5-8\(a\)](#) for the taxability of the hand wrappers; that regulation states:

In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

Taxpayer, as noted, cites to the whiskey production example found at [45 IAC 2.2-5-10\(2\)\(D\)](#). Since Taxpayer believes that this example is germane to its protest, it is incumbent upon Taxpayer to establish that its facts are materially similar to the items in whiskey example. Taxpayer fails to establish this similarity. Taxpayer's operation is not a "filling operation," which is what the whiskey example involves (e.g., "equipment to fill the bottles with product"). In the whiskey example, Taxpayer manufactures not the content but the package itself. Thus the whiskey example is inapplicable to the specific facts of Taxpayer's case. Taxpayer has not met its burden of proof found at IC § 6-8.1-5-1(c).

Stretch Wrap Machine

Taxpayer asserts that its "Stretch Wrap Machine" is exempt because it is used in its "integrated production process to ensure the finished goods are properly packaged, clean and sanitary (because they are used in the food industry) and not damaged" The Audit Report found that the stretch wrap machine was used "after the product has been packaged. The drink carriers and egg cartons are placed into stacks as they come off the dryer. These stacks are packaged by applying shrink wrap around the stack." The Audit Report states that the "stretch wrap machine . . . [is] used in this area to apply shrink wrap around the completed shrink wrapped packages that are on the pallet."

For sales and use tax purposes, a manufacturer's process can be characterized as having the following division: processes that occur prior to production (i.e., pre-production); the production process itself; and what occurs after

production (post-production). Taxpayer, argues that the stretch wrap machine is part of its production process, whereas the Audit Report found that it is post-production. After the hearing, Taxpayer provided the Department's Legal Division with a video of the shrink wrap machine in use. The video shows a bundle of cartons (the size of a large box that a person can lift)—that have already been shrink wrapped as part of the production process—moving along on a conveyor belt. The conveyor takes this shrink wrapped bundle of cartons to a robotic arm that lifts this shrink wrapped bundle and stacks the bundles onto another conveyor. The stack appears to be comprised of over thirty shrink wrapped bundles. The next stage is this pallet/stack being further wrapped by the stretch wrap machine.

The Department notes the Indiana Tax Court case *North Central Industries, Inc. v. Indiana Dept. of State Revenue*, 790 N.E.2d 198 (Ind. Tax Ct. 2003). *North Central* involved a shrink wrap machine:

North Central contends that its shrink-wrap machine is exempt from use tax because it was acquired for direct use in the direct production of its "fireworks assortments." The Department, on the other hand, argues that North Central is not entitled to the exemption because it does not produce other tangible personal property, but rather provides a packaging service.

Id. at 200 (Internal footnote omitted). The Indiana Tax Court further stated:

Although "[t]here are innumerable ways to produce other tangible personal property, [Indiana Code Section 6-2.5-5-3] cannot be expected to give a precise answer to each factual situation that arises." *Rotation Prod.*, 690 N.E.2d at 798. Nevertheless, the Department's rules make clear that production must entail a "substantial" change or transformation that "places tangible personal property in a form, composition, or character different from that in which it was acquired." Ind. Admin. Code tit. 45, r. 2.2-5-8(k) (2001). Moreover, production must increase the number of "scarce economic goods," i.e., it must create a new, marketable product. *Harlan Sprague Dawley, Inc. v. Indiana Dep't of State Revenue*, 605 N.E.2d 1222, 1226 (Ind. Tax Ct.1992) (quoting *Borden Co. v. Borella*, 325 U.S. 679, 65 S.Ct. 1223, 89 L.Ed. 1865 (1945)).

North Central at 200. The Indiana Tax Court held that, "North Central does not create a new, marketable product; it merely packages existing fireworks into boxes, then labels and shrink-wraps them. This is not the sort of substantial change or transformation that places the fireworks 'in a form, composition, or character different from that in which [they were] acquired.'" *Id.* at 201.

Taxpayer asserted at hearing that "SQF" certification is a requirement of some of its customers. Subsequently, Taxpayer provided the Department with a scanned copy of the SQF Code. That SQF Code is over two hundred pages; Taxpayer did not specify where, within the SQF Code, a second level of shrink wrapping is listed as a requirement for SQF purposes. When the Department sent Taxpayer a follow-up question regarding this, Taxpayer stated in relevant part:

The SQF Code does not specifically address shrink wrapping the pallet/stacks. Based on our internal processes and the requirements of our customers, we create our own SQF Program to ensure we comply with the SQF Code. This is stated in Module 2, section 2.3.5.1 that states "Finished product specifications shall be . . . approved by the supplier and their customer". Module 2 is a requirement of Module 13, the Module that applies to our facility. An external third party then comes in to audit us to ensure what we are doing actually meets the requirements of the SQF Code.

Taxpayer further states that, "The shrink wrapping of the product prevents cross contamination, prevents damage, maintains product integrity and prevents foreign matter contamination." Even if, *arguendo*, a customer requirement could be considered relevant in the determination of when a production process ends, Taxpayer did not provide the Department with any documents (e.g., contracts) establishing that its customers require the bundles be stacked and then collectively shrink wrapped. Given this, the Department finds that the additional stacking of the bundles and second level shrink wrapping of the pallet/stack is post-production. The second level of shrink wrapping is not substantially changing or transforming the *already* shrink wrapped bundle(s). Taxpayer's protest is denied.

Manuals

Taxpayer states that it "disagree[s]" with the assessment of tax on "manuals" that "are required . . . to properly operate the production equipment and to assist us in correcting any problems we may have with the operation of the production equipment." Taxpayer cites to no law for its contention that the manuals are exempt. The Department notes that [45 IAC 2.2-5-8\(b\)](#) states:

The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be *directly used* by the purchaser *in the direct production*, manufacture, fabrication, assembly, or finishing of tangible personal property.

The manuals do not meet the double direct test—they are not directly used in direct production. Taxpayer's protest is denied.

Capital Assets

The Audit Report addresses the category of "Capital Assets," stating:

The taxpayer purchased a conveyor belt and a gripper for the palletizer. The product comes out of the dryer, is stacked and then is shrink wrapped. This completes the packaging of the product. The product is then moved by the conveyor into the pallet area or what the taxpayer refers to as "the cage." The packaged [] cartons or drink carriers are then removed from the conveyor by the gripper. The gripper then places these packages onto the pallet. There are several rows of these packages on each pallet. The items on the pallet are then shrink wrapped together so that they can be shipped.

Regarding which capital assets Taxpayer is protesting, Taxpayer states the following: gripper for palletizing; heavy duty plastic belt conveyor; change order; zipline conveyor; freight; vinyl robosuit, controller; pallet tool, pallet pro V8, handling pro v8 PC. In its written protest, Taxpayer also states that "software" is at issue. As to the specifics of its protest, Taxpayer does not engage in any detailed and particularized argument for the protested capital assets. Instead, Taxpayer refers to them collectively as "Capital Assets" and cites once again to the whiskey example in [45 IAC 2.2-5-10](#). Taxpayer concludes:

The Capital Assets . . . are a required part of our integrated production process, they are not used after the integrated production process is complete as the Auditor implies.

Taxpayer has not demonstrated how each of the Capital Assets is used by Taxpayer. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dept. of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dept. of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Taxpayer has not met its burden of proof; Taxpayer's protest is denied.

FINDING

Taxpayer's protest for all protested items is denied.

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