DEPARTMENT OF STATE REVENUE

04-20171229.LOF

Letter of Finding Number: 04-20171229
Sales/Use Tax
For Tax Years 2010-2012

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 established that the sampling and testing of its own groundwater wells was a service with no tangible personal property transferred. Company also established that cooling towers were an exempt part of its manufacturing process. Company did not meet its burden of proof regarding its protest of three invoices from a vendor.

ISSUE

I. Sales/Use Tax - Various Use Tax Items.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-9; IC § 6-2.5-4-1; *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); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Rhoade v. Indiana Dept. of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); 45 IAC 2.2-3-4; 45 IAC 2.2-5-8.

Taxpayer protests the Department's assessment of use tax.

STATEMENT OF FACTS

At issue is a sales and use tax audit conducted by the Indiana Department of Revenue ("Department") for the years 2010 through 2012 of Taxpayer's Indiana manufacturing location. As a result of the Department's audit, proposed assessments were issued. Taxpayer filed a protest with the Department. As part of its protest, Taxpayer requested "audit review" of additional documentation "prior to proceeding with the protest." After audit completed its review, an administrative hearing was held on the remaining issues and this Letter of Findings results. Further facts will be supplied as required.

I. Sales/Use Tax - Various Use Tax Items.

DISCUSSION

As a threshold issue, it is 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.

Turning to the relevant law, Indiana 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.

Therefore, retail merchants are required to collect sales tax on retail transactions, unless the transaction is exempt from sales tax. Use tax, which is what is at issue in the present protest, 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.

Therefore, when sales tax is not paid at the time tangible personal property is purchased, use tax will be imposed unless the purchase is eligible for an exemption. The use tax is generally functionally equivalent to the sales tax. *See Rhoade v. Indiana Dept. of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). The Audit Report made "no adjustments" regarding the sales tax portion of the audit. The proposed assessments that resulted from the audit were regarding use tax.

Taxpayer, as noted, filed a protest regarding the Department's proposed assessments from the audit. However, in its protest Taxpayer requested "audit review prior to proceeding with the protest" on Taxpayer's protest submission form (State Form 56317) and provided additional documentation. Pursuant to that request, Taxpayer's additional documentation was reviewed by the Department's audit division. After audit completed its review the results were communicated to Taxpayer's Power of Attorney (POA). A hearing was later held for the three remaining issues that were not resolved by the (pre-hearing) audit review: (a) environmental monitoring; (b) cooling tower; and (c) fixed assets. Each of these remaining protest issues will be addressed, in turn, below.

Environmental Monitoring

Taxpayer protested environmental monitoring, specifically field sampling. Taxpayer states in e-mail correspondence to the Department:

> Sampling of groundwater wells. This charge is for the vendor to gather groundwater samples from wells. These samples will then be analyzed in a lab by the vendor. These are all part of a testing service only, no tangible personal property was transferred.

The invoice at issue states that "Field Sampling" of multiple groundwater wells was completed, that "Lab Analysis" of the sampled wells was conducted, and that "Final Report" was put together. The pertinent part of the invoice looks similar to this:

> Completed:
>
> Field Sampling
> Sampling of [] groundwater wells = $[]
>
> Lab Analysis
> Analysis of [] groundwater samples for [] and [. . .] = $[]
>
> Final Report
> [. . .]
> = $[]
>
> NET INVOICE: $[]

At the hearing Taxpayer argued that the groundwater belongs to the client and is thus not taxable because "no tangible personal property was transferred."

After reviewing the matter, the Department finds that no tangible personal property (TPP) was acquired in a retail transaction since it was Taxpayer's own water that was being tested. Thus Taxpayer's protest is sustained.

Cooling Towers

The auditor had denied the cooling towers in the audit. The auditor states that he asked Taxpayer if the cooling towers were an OSHA requirement, but did not get an answer. Taxpayer describes this portion of its protest thusly:

> The cooling tower is an integral part of the [] acid production process. [Taxpayer] needs to cool the [] acid (manufactured product) to keep the reaction controlled. The acid needs to be [] degrees to limit the corrosion rate to the internal equipment.

In follow-up correspondence, after the hearing, Taxpayer more thoroughly described this portion of the protest:

> The manufacturing process begins with reclaimed acid from refineries in liquid form as raw materials. The raw materials then go through the furnace and boiler stations to be cleaned by a WET Acid precipitator. Next, the materials go through the main blower and a series of additional production processing stations. During these stations, oxygen molecules are introduced into the process. This process causes a chemical reaction which causes the product heat to go up. To control the heat process, the acids must go through tube coolers throughout the production process. Tube coolers are tubes inside a direct contact water cooler. The cooling towers are used to control the temperature of the water which in turn, regulates the temperature of the acid being produced.

Taxpayer then cites to 45 IAC 2.2-5-8 for its contention that the cooling towers are used directly in its production process. The Department notes that 45 IAC 2.2-5-8(c), under "Examples," states the following:

> (3) **The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, 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.
> (A) Pumping and filtering equipment and related tanks and tubing used to supply lubricating and coolant fluids to exempt drilling and cutting machinery.
> **(B) Cooling towers and related pumps and piping used to cool, circulate, and supply water employed to control the temperature of exempt furnaces and exempt machines used in the foundry and machining areas.**
> (**Emphasis added**).

Taxpayer's protest is sustained.

Fixed Assets

The last item addressed at the hearing involved a vendor, referred to herein as "Vendor M." The auditor found the equipment rented to be taxable pursuant to 45 IAC 2.2-3-27. Taxpayer argues to the contrary that Vendor M "rents equipment which the vendor uses in the performance of time and materials contracts." Taxpayer in correspondence states that the invoices show that "these are time and material contracts for electrical work and the labor, materials, and equipment charges are separately stated." Further, Taxpayer states:

> During the performance of this time and material contract, [Vendor M] was acting as a retail merchant and was responsible for collecting tax on the resale of construction materials. On these transactions, the "equipment rental" charge does not constitute the resale of construction materials incorporated into the building. Rather, this charge is for equipment that [Vendor M] rented and used in the performance of the service. [Vendor M] was not selling or renting the equipment to [Taxpayer].

The auditor cites to 45 IAC 2.2-3-27, which was repealed in 2017; Taxpayer in turn relies upon IC § 6-2.5-4-9 and IC § 6-2.5-4-1, respectively in its argument. Regarding the two statutes Taxpayer cites, IC § 6-2.5-4-9 states:

> (a) A person is a retail merchant making a retail transaction when the person sells tangible personal property which:
> (1) is to be added to a structure or facility by the purchaser; and
> (2) after its addition to the structure or facility, would become a part of the real estate on which the structure

or facility is located.
(b) A contractor is a retail merchant making a retail transaction when the contractor:
(1) disposes of tangible personal property; or
(2) converts tangible personal property into real property;
under a time and material contract. As such a retail merchant, a contractor described in this subsection shall collect, as an agent of the state, the state gross retail tax on the resale of the construction material and remit the state gross retail tax as provided in this article.
(c) Notwithstanding subsections (a) and (b), a transaction described in subsection (a) or (b) is not a retail transaction, if the ultimate purchaser or recipient of the property to be added to a structure or facility would be exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

And IC § 6-2.5-4-1 states in relevant part:

(a) A person is a retail merchant making a retail transaction when he engages in selling at retail.
(b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:
(1) acquires tangible personal property for the purpose of resale; and
(2) transfers that property to another person for consideration.
(c) For purposes of determining what constitutes selling at retail, it does not matter whether:
(1) the property is transferred in the same form as when it was acquired;
(2) the property is transferred alone or in conjunction with other property or services; or
(3) the property is transferred conditionally or otherwise.
[. . .]

Taxpayer argues that "the 'equipment charge' does not meet the definition of a retail sale . . . ." Taxpayer reaches this conclusion without any substantive argument. Although Taxpayer provided invoices for Vendor M, Taxpayer was unable to provide the contracts, stating "due to the age of these invoices" that Taxpayer was "unable to obtain the contracts." Without the contracts Taxpayer has not met is burden of proof as required under IC § 6-8.1-5-1(c). Taxpayer states that it "was not renting or leasing the equipment and the costs associated with the operation and/or storage of the equipment," but without the contracts Taxpayer's contention has not been established. Taxpayer's protest regarding Vendor M is denied.

FINDING

Taxpayer's protest is sustained regarding environmental monitoring and cooling towers. Taxpayer's protest of Vendor M is denied. The other portions of Taxpayer's initial protest were resolved pursuant to audit review.

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An html version of this document.