

DEPARTMENT OF STATE REVENUE

04-20191420R.ODR
04-20191421R.ODR
04-20191422R.ODR

**Final Order Denying Refund:
04-20191420R; 04-20191421R; 04-20191422R
Gross Retail Tax
For the Years 2011 through 2014**

NOTICE: IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

HOLDING

Indiana Research Facilities failed to establish that the Department should reconsider its sales tax refund claim on the ground that Research Facilities' utilities were entirely exempt; in addition, the Department pointed out that there was no 100 percent "predominant use" research and development exemption provision.

ISSUE**I. Gross Retail Tax - Research and Development Exemption.**

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-5-40 (effective until January 1, 2016); IC § 6-2.5-5-40 (effective until June 30, 2013); IC § 6-2.5-5-40(b); IC § 6-2.5-5-40(d); *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 10 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-4-13\(e\)](#); [45 IAC 2.2-5-10\(a\)](#); Sales Tax Information Bulletin 55 (May 2012); Information Bulletin 55 (August 2011); Sales Tax Information Bulletin 75 (October 2008); Sales Tax Information Bulletin 75 (July 1, 2013).

Taxpayers argue that they are entitled to a refund of sales tax paid on the purchase of utilities because their electric, water, and natural gas utilities are predominantly consumed in the performance of qualifying research and development activities.

STATEMENT OF FACTS

Taxpayers are three related Indiana pharmaceutical research facilities (hereinafter "Taxpayer") each of which filed separate refund claims (GA-110L) seeking a total refund of approximately \$1,200,000 in sales tax. Taxpayer paid the tax on the purchase of utility services consumed during 2011 to 2014. According to Taxpayer's original claim, it "uses this electricity [gas and water] in their research [and] development functions."

The Indiana Department of Revenue ("Department") reviewed the refund claims after the Department's representatives toured the facilities accompanied by Taxpayer's representatives. The Department concluded that Taxpayer was entitled to a partial refund of the amount requested; at two of its facilities, the Department found that Taxpayer was entitled to a 74 percent exemption on the purchase of electricity, a 63 percent exemption on the purchase of natural gas, and an 86 percent exemption on the purchase of water. At a third facility, the Department found that Taxpayer was entitled to a 38 percent exemption on the purchase of electric utilities. In each case, the Department's report noted that the utilities were consumed "in research and development but that "the exempt percentage found is not a predominant use exemption."

Taxpayer disagreed with the Department's decision and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representatives explained the basis for the protest. This Final Order Denying Refund results.

I. Gross Retail Tax - Research and Development Exemption.**DISCUSSION**

The issue is whether Taxpayer has established that it is entitled to a refund of all sales tax paid on the purchase of water, natural gas, and electric utilities on the ground that these utilities were predominantly consumed in its Research and Development (R&D) activities.

A. Research and Development Exemption Statute and the Burden of Proof.

(1) Indiana's Sales and Use Tax.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

In general, purchases of tangible personal property are subject to sales tax. [45 IAC 2.2-5-10\(a\)](#). Tangible personal property means personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses. IC § 6-2.5-1-27. Tangible personal property also includes electricity, water, gas, steam, and prewritten computer software. *Id.*

Indiana also imposes a complementary excise tax called "the use tax" 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." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is functionally equivalent to the sales tax. See *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

(2) Research and Development Sales Tax Exemption.

IC § 6-2.5-5-40 (effective until January 1, 2016) provides a sales tax exemption for R&D property. IC § 6-2.5-5-40(d) explains that a taxpayer is entitled to purchase certain items of tangible personal property without paying the gross retail tax when the property is utilized in qualifying R&D activities. In full, the exemption is set out in IC § 6-2.5-5-40 as follows.

(a) As used in this section, "research and development activities" does not include any of the following:

- (1) Efficiency surveys.
- (2) Management studies.
- (3) Consumer surveys.
- (4) Economic surveys.
- (5) Advertising or promotions.
- (6) Research in connection with literary, historical, or similar projects.
- (7) Testing for purposes of quality control.

(b) As used in this section, "research and development *equipment*" means tangible personal property that:

- (1) consists of or is a combination of:
 - (A) laboratory equipment;
 - (B) computers;
 - (C) computer software;
 - (D) telecommunications equipment; or
 - (E) testing equipment;
- (2) has not previously been used in Indiana for any purpose; and
- (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:
 - (A) new products;
 - (B) new uses of existing products; or
 - (C) improving or testing existing products.

(c) As used in this section, "research and development property" means tangible personal property that:

- (1) has not previously been used in Indiana for any purpose; and
- (2) is acquired by the purchaser for the purpose of research and development activities devoted to experimental or laboratory research and development for:
 - (A) new products;

- (B) new uses of existing products; or
- (C) improving or testing existing products.

(d) A retail transaction:

- (1) involving research and development equipment; and
- (2) occurring after June 30, 2007, and before July 1, 2013;

is exempt from the state gross retail tax.

(e) A retail transaction:

- (1) involving research and development property; and
- (2) occurring after June 30, 2013;

is exempt from the state gross retail tax.

(f) The exemption provided by subsection (e) applies regardless of whether the person that acquires the R&D property is a manufacturer or seller of the new or existing products specified in subsection (c)(2).

(g) For purposes of this section, a retail transaction shall be considered as having occurred after June 30, 2013, to the extent that delivery of the property constituting selling at retail is made after that date to the purchaser or to the place of delivery designated by the purchaser. However, a transaction shall be considered as having occurred before July 1, 2013, to the extent that the agreement of the parties to the transaction is entered into before July 1, 2013, and payment for the property furnished in the transaction is made before July 1, 2013, notwithstanding the delivery of the property after June 30, 2013. This subsection expires January 1, 2017.

(*Emphasis added*).

The version of IC § 6-2.5-5-40 (effective to June 30, 2013) refers to exempt "equipment" which the Department determined "does not include . . . property with a useful life of less than one year." Sales Tax Information Bulletin 75 (October 2008), 20081029 Ind. Reg. 045080815NRA. The "more than one year" requirement was deleted in IC § 6-2.5-5-40 (effective July 1, 2013 to December 31, 2015). As explained in Sales Tax Information Bulletin 75 (July 1, 2013), 20131127 Ind. Reg. 045130524NRA.

With regard to the new exemption available for research and development property purchased after June 30, 2013, there is no requirement that the property have a useful life of one year or more, nor are consumables or hand-powered tools excluded from the definition. (*Emphasis added*).

(3) Qualifying for the Research and Development Exemption.

IC § 6-2.5-5-40 like all tax exemption provisions, is strictly construed against the taxpayer. *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). Indiana law has long held that "[W]here [] 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." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974). 1 (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

Nevertheless, the Department is also 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. The Department's Original Review of Taxpayer's Refund Claim.

In considering Taxpayer's original request, the Department's representatives visited Taxpayer's facilities and reviewed the GA-110L refund requests. The Department's report concluded that Taxpayer was entitled to a portion of the refunds originally requested on the ground that the "exempt percentages found are related to utilities consumed in research and development. The exempt percentages found are the percentages to be granted in a refund."

C. Taxpayer's Arguments.

Taxpayer argues that it is entitled to a refund of all sales tax paid on the purchase of utilities because its utilities

are predominantly consumed in conducting R&D purposes. As Taxpayer explains, "[W]e respectfully request one hundred (100) percent of the denied utilities under appeal used predominantly, directly in manufacturing and research and development activities The utilities serve as an essential and integral conduit to the development and production processes"

In arriving at its decision that it is entitled to a 100 percent refund of the sales tax paid on utilities, Taxpayer notes that the Department determined that two of its separate facilities were entitled to a 74 percent exemption on the purchase of electricity, a 63 percent exemption on the purchase of natural gas, and an 86 percent exemption on the purchase of water. At the third facility, the Department found that Taxpayer was entitled to a lesser percentage.

At the outset, the Department agrees with Taxpayer that utilities - statutorily categorized as "tangible personal property" - fit squarely within Indiana's R&D exemption found at IC § 6-2.5-5-40(b).

However, Taxpayer suggests that it is entitled to a refund of 100 percent of the tax because its utilities are "predominantly used" for R&D purposes. Utility transactions are exempt from sales and use tax when the sales "are (1) by public utilities or power subsidiaries; (2) used in manufacturing, production, etc.; and (3) either separately metered or predominantly used in an excluded manner." Sales Tax Information Bulletin 55 (May 2012), 20120530 Ind. Reg. 045120251NRA. See also Information Bulletin 55 (August 2011), 20110928 Ind. Reg. 045110518NRA.

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." [45 IAC 2.2-4-13\(e\)](#).

Generally, to qualify for predominant use, a purchaser of a utility must show that more than 50 percent of the utility is used "as an essential and integral part of an integrated part of an *integrated production process*." Sales Tax Information Bulletin 55 (May 2012) (*Emphasis added*).

In this case, Taxpayer errs in its interpretation and application of the "predominant use" standard because the R&D provision applies to utilities consumed in "an integrated production process." There is no parallel provision for the exemption provided at IC § 6-2.5-5-40. Utilities consumed in R&D activities are entitled a straight-forward, dollar-for-dollar sales tax exemption. In addition, the Department points out that there is no provision allowing taxpayers conducting both production and R&D activities to "stack" the two exemptions in order to meet the predominant use standard. In other words, taxpayers consuming 30 percent of utilities in production and 25 percent in R&D activities are entitled to a 55 percent exemption and not a 100 percent predominantly used exemption.

The Department disagrees with Taxpayer's claim that it is presumptively entitled to a R&D predominant use provision for utilities consumed in R&D activities or that the Department's original conclusions were incorrect.

FINDING

Taxpayer's protest is respectfully denied.

March 6, 2020

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