DEPARTMENT OF STATE REVENUE

04-20191548R.ODR

Final Order Denying Refund: 04-20191548R
Gross Retail Tax
For the Years 2015 through 2018

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 Facility failed to establish that the Department should reconsider its sales tax refund claim on the ground that Research Facility's 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 January 1, 2016); IC § 6-2.5-5-40(b); IC § 6-2.5-5-40(d); IC § 6-2.5-5-40(g); *Rhoade 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.,* 310 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 (April 2017); Sales Tax Information Bulletin 75 (July 1, 2013); Sales Tax Information Bulletin 75 (October 2008).

Taxpayer argues that it is entitled to a refund of sales tax paid on the purchase of utilities because its electric utilities are predominantly consumed in the performance of qualifying research and development activities.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of providing services to pharmaceutical and biotechnology companies. Taxpayer submitted a refund claim (GA-110L) seeking the return of approximately $32,000 in sales tax. Taxpayer paid the tax on the purchase of utility services during 2015 through 2018. According to Taxpayer's original claim, the "[u]tilities [were] used in Research & Development and Manufacturing."

The Indiana Department of Revenue ("Department") reviewed the refund claim and determined that Taxpayer was entitled to a portion of the refund. The Department determined that the utilities measured by a particular meter qualified for a 1.54 percent research and development exemption. As such, the Department granted a refund of approximately $500 and denied the remaining $31,500. 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 electric utilities on the ground that the utilities were 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 *Rhoade 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 January 1, 2016) provides a sales tax exemption for research and development property. The current 2016 version of IC § 6-2.5-5-40 provides that certain activities are not considered research and development activities and clarifies that certain activities are considered incidental to research and development activities. Sales Tax Information Bulletin 75 (April 2017), 20170726 Ind. Reg. 045170335NRA.

Indiana law, IC § 6-2.5-5-40(g) 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 research and development 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" includes design, refinement, and testing of prototypes of new or improved commercial products before sales have begun for the purpose of determining facts, theories, or principles, or for the purpose of increasing scientific knowledge that may lead to new or enhanced products. The term 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 nontechnical activities, including literary, historical, social sciences, economics, humanities, psychology, or similar projects.
(7) Testing for purposes of quality control.
(8) Market and sales research.
(9) Product market testing, including product testing by product consumers or through consumer surveys for evaluation of consumer product performance or consumer product usability.
(10) The acquisition, investigation, or evaluation of another's patent, model, process, or product for the purpose of investigating or evaluating the value of a potential investment.
(11) The providing of sales services or any other service, whether technical or nontechnical in nature.

(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) For purposes of subsection (c)(2), a research and development activity is devoted to experimental or laboratory research and development if the activity is considered essential and integral to experimental or laboratory research and development. The term does not include activities incidental to experimental or laboratory research and development.

(e) For purposes of subsection (c)(2), an activity is not considered to be devoted to experimental or laboratory research and development if the activity involves:
(1) heating, cooling, or illumination of office buildings;
(2) capital improvements to real property;
(3) janitorial services;
(4) personnel services or accommodations;
(5) inventory control functions;
(6) management or supervisory functions;
(7) marketing;
(8) training;
(9) accounting or similar administrative functions; or
(10) any other function that is incidental to experimental or laboratory research and development.

(f) 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.

(g) A retail transaction:
(1) involving research and development property; and
(2) occurring after June 30, 2013;
is exempt from the state gross retail tax.

(h) The exemption provided by subsection (g) applies regardless of whether the person that acquires the research and development property is a manufacturer or seller of the new or existing products specified in subsection (c)(2).

(i) 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*).

In Taxpayer's case, it is pointed out that IC § 6-2.5-5-40(d) was specifically added in 2015 to exclude items which are "incidental" to otherwise qualified research and development projects. In part, the statutory clarification states:

> [Research and Development] does not include activities incidental to experimental or laboratory research and development [and] . . . any other function that is incidental to experimental or laboratory research and development.

(3) Qualifying for the Research and Development Exemption.

IC § 6-2.5-5-40 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). 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). (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 site and reviewed both the GA-110L refund request and Taxpayer's utility study. The Department's report stated:

> Several items listed under the exemption of research development have been determined to be possibly used within a lab setting and used during research and development activities. These items were identified through a thorough review of the [T]axpayer's list of equipment as listed on the Utility Sales Tax Survey that was completed by [consulting company]. The [onsite] review process merely looked to see which pieces of equipment and their descriptions would allowed an exemption for the use of electricity in an R&D setting. The equipment that was allowed was generally equipment that would be used in performing R&D activities. The equipment that was not allowed included equipment used in performing cold storage activities, in providing overhead lighting and general illumination, general HVAC equipment, an aseptic machine that was used to fill vials (used to provide a service to clients; not to manufacture anything) and other equipment that was not used in direct R&D activities.

The Department found that Taxpayer was not entitled to a full-scale, comprehensive exemption ST-109 certificate that Taxpayer could provide to Taxpayer's utility provider. Instead, the Department concluded that "the amount that was determined to be exempt, from this review was 1.54[percent] and that "no predominant usage of the [T]axpayer's electric meter existed."

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. To that end, Taxpayer explains that it is involved in the creation and formulation of "a wide range of molecules," that it is in the business of providing "complex drug development" regimens, that it provides its customer labeling, kitting, and packaging services, and that it manages a wide range of toxic, flammable, and hazardous materials on behalf of its clients.

In arriving at its decision that it is entitled to a 100 percent refund of the sales tax paid on utilities, Taxpayer relies on its utility study which - according to Taxpayer - establishes that the majority of its utilities are consumed in R&D activities. Taxpayer disagrees with the Department's conclusion that 1.54 percent of the electricity measured at a particular meter is entitled to the exemption.

At the outset, the Department agrees with Taxpayer that utilities - statutorily categorized as "tangible personal property" - may 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), 2011098 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 fifty 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 combined 55 percent exemption and not a 100 percent predominantly used exemption.

Taxpayer provided a copy of its utility study listing items purportedly used in qualifying R&D activities. For example, Taxpayer states that a "Lunaire stability chamber" qualifies because the device is "used in accelerated shelf-life studies for drugs and research and testing . . . ." Taxpayer also points to its "Darwin stability chamber" as qualifying for the R&D exemption because the device "measure[s] stability under various temperatures of drug[s] used in testing, analysis of clinical trial . . . ." As yet another example, Taxpayer indicates that its "Thermo Electron Precision Incubators" qualify for the exemption because the device "provides uniform heating, precise temperature and incubation for testing analysis of clinical trials." In each case, Taxpayer lists the "amps" and "volts" consumed by the devices.

Based on what Taxpayer has provided, the three items listed above appear to directly fall within the category of IC § 6-2.5-5-40(b) "laboratory equipment." However, there is nothing to establish that these items were overlooked in the Department's original review of the utility study or that the Department's 1.54 percent allowance was mathematically incorrect.

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

FINDING

Taxpayer's protest is respectfully denied.

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