DEPARTMENT OF STATE REVENUE

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Memorandum of Decision: 04-20210063; 04-20210064
Gross Retail Tax
For the Years 2017 through 2020

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 Memorandum of Decision.

HOLDING

Restaurant Company produced documentation and further explanation establishing that its rethermalyzers consumed electricity in an exempt fashion; thereafter, Restaurant Company was required to document the extent to which the rethermalyzers consumed electricity in exempt fashion; however, Restaurant Company failed to establish that its additional restaurants were entitled to the 100 percent, "predominate use," exemption.

ISSUE

I. Gross Retail Tax - Utilities Consumed in Preparing Food.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-5-5.1; *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); *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 2.2-5-8.

Taxpayer argues that the Department erred in determining the extent to which its restaurants were entitled to a sales tax exemption on the purchase of utilities directly used in the preparation of its food offerings.

STATEMENT OF FACTS

Taxpayer is an out-of-state company which operates Indiana restaurants. Taxpayer submitted a request for a refund of sales tax paid on the purchase of electricity consumed in the production of its restaurants' food products. The Indiana Department of Revenue ("Department") reviewed the information submitted by Taxpayer.

The Department's review resulted in a determination that certain of the restaurants were entitled to a 100 percent exemption on the purchase of electricity. In other instances, the Department found that the restaurants were entitled to a partial - less than 100 percent - exemption.

The Department's decision resulted in a partial refund and a partial denial of the amount of sales tax originally requested. Taxpayer disagreed with the Department's decision arguing that the Department erred in concluding that certain items of its restaurant equipment were not directly used in producing its food products. Taxpayer submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest, maintained it was entitled to an additional refund, and submitted additional documentation intended to support its argument. This Memorandum of Decision results.

I. Gross Retail Tax - Utilities Consumed in Preparing Food.

DISCUSSION

The issue is whether Taxpayer has submitted information sufficient to establish that it is eligible for an additional refund of sales tax because its restaurants' food preparation equipment consumed utilities in an exempt fashion.

Indiana sales tax is imposed pursuant to IC § 6-2.5-2-1, which states in relevant part:

(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 in part:

> (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.
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> (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.
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> (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.
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> (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.
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> (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 decision denying a portion of the requested refund, 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).

The Indiana Tax Court addressed the application of the exemption provision in *Aztec Partners.* In that case, the Indiana Tax Court addressed the extent to which a restaurant's use of food preparation equipment was exempt on the ground that Aztec's food warmers and coolers were integral to the production of the restaurant's food entrees. *Id.* at 322. Aztec had purchased the warmers and coolers to hold "salsa, chicken, chorizo, eggs, rice, lettuce, and tortilla chips that were combined into the entrees served at [Aztec's] restaurants." *Id*.

The court concluded that the warmers and coolers "changed the individual food items into new, marketable products that [had] a character and form different from the food items first acquired." *Id*. After Aztec made use of the warmers and coolers, Taxpayer combined those constituent items into the final food items eventually sold its customers. *Id.* at 234.

Taxpayer argues that the Department failed to classify two items of its food equipment - utilized in its restaurant locations - as directly used in direct production of its food products.

- Taxpayer states that it can provide documentary evidence establishing that its "food rethermalyzers/steam tables" consume electricity in an exempt fashion.

- Taxpayer argues that it can provide documentary evidence establishing that its "Carthco lemonade machines" consume electricity in an exempt fashion.

A. "Food Rethermalyzers/Steam Tables."

Taxpayer operates "rethermalyzers" at its restaurant locations. The devices consume electricity. Taxpayer states that these appliances consume electricity in a manner which qualifies for the exemption. Taxpayer states that it uses the rethermalyzers "to bring soups, cheeses, baked potato toppings, and some proteins to the temperature." Taxpayer explains that all these food items are pre-cooked and delivered to each restaurant location "flash-frozen." Taxpayer concludes that it believes the rethermalyzers are exempt because the food items "are not ready to serve until they are dropped into the rethermalyzer and allowed to cook for 1.5 to 3 hours."

Taxpayer provided the rethermalyzer manufacturer's specifications and descriptions. Those manufacturer's specifications describe the device as a "vehicle to reheat pre-packaged soups . . . [and] reheating meats, steaming vegetables, warming gravies, and pasta." Elsewhere, the manufacturer explains that a rethermalyzer "heats food from a chilled or frozen form in 90 minutes or less" bringing prepared food "through the USDA 'Danger Zone,' which is between 40 degrees Fahrenheit and 140 degrees Fahrenheit to a safe holding temperature of 165 degrees Fahrenheit avoiding bacteria growth that may cause illness."

As with any of the "production" exemptions such as that provided under IC § 6-2.5-5-5.1, proper application of that exemption requires determining at what point "production" begins and at what point "production" ends. 45 IAC 2.2-5-8(d) states:

> Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The rethermalyzers perform two functions; the devices maintain prepared food at an appropriate temperature which is a "post-production" function which does not qualify for the sought-after exemption. To the extent which these appliances perform this post-production function, the electricity consumed in the operation of the appliances does not qualify for the sales tax exemption provided under 45 IAC 2.2-4-13.

However, the available information also establishes that the rethermalyzers prepare pre-packaged foods in a process which has a direct effect on those foods and which changes the form and nature of the food. To the

extent that the rethermalyzers are used to "alter [] the [food] to its completed form," the electricity consumed in the operation of the appliances qualifies for the sales tax exemption provided under 45 IAC 2.2-4-13. See *Aztec*, 35 N.E.3d at 324.

Taxpayer is sustained to the extent Taxpayer hereafter supplies additional information distinguishing the amount of electricity consumed in active "production" of the food and the amount of electricity consumed simply to maintain the prepared food in a state fit to be served to its customers.

B. "Carthco Lemonade Machines."

Taxpayer explains that its restaurants sell lemonade "by the glass and by the gallon" and that these machines are used to produce the beverage. The lemonade is "brewed fresh in-store throughout the day in five-gallon brewers using filtered water, dried lemon powder, and pure cane sugar."

Taxpayer further explains that these machines "continuously blend the ingredients so there's no settling."

Taxpayer also provided manufacturer specifications. The devices are described as "dispensers which employ an evaporator and high efficiency pump," "spray circulator," and "agitators." The devices can be used to dispense milk, juices, coffee, or tea.

In this case, the information provided is - at best - ambiguous because the machines function primarily, if not exclusively, as a dispensing device which maintains lemonade in form fit for customer consumption. There is little indication that the Carthco machines "alter the [food] to its completed form," as required under 45 IAC 2.2-4-13.

C. Predominate Use.

Nonetheless, Taxpayer suggests that the Department's decision in this matter allows its additional restaurants an across-the-board 100 percent predominate usage exemption.

The Department must respectfully decline Taxpayer's invitation to grant here the full predominant use, 100 percent exemption. As noted above, exemptions are "strictly construed against exemption from [] tax." *Tri-States Double Cola Bottling Co.*, 706 N.E.2d at 283. Simply stated, in determining the extent to which Taxpayer's restaurants are entitled to the exemption, the numbers are what the numbers are. The decision driving any decision to grant a refund or determining the extent to which a taxpayer is entitled to an exemption is driven strictly by the reliable, substantive, quantifiable information provided by that taxpayer.

Taxpayer's protest is sustained in part and denied in part. The Department's Enforcement Division is requested to review the supplemental information expected of Taxpayer delineating the electric consumption of the rethermalizers and to make whatever adjustment to the amount of electrical consumption as required. As to any additional predominate usage exemption, "the numbers are what the numbers are." In all other respects, Taxpayer's protest is denied.

FINDING

Subject to review by the Department's Enforcement Division, Taxpayer's protest is sustained in part and denied in part.

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