

**Final Order Denying Refund 04-20231228 and 04-20231229
Indiana Gross Retail Tax
For the Year 2021 and 2022**

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 Company was not entitled to the original sales tax refund amount on the grounds that Research Company's purchases of utilities were entirely exempt; Department pointed out that there was no 100 percent "predominant use" research and development exemption provision under Indiana law.

ISSUE

I. Gross Retail and Use Tax - Utilities Consumed in Conducting Research and Development.

Authority: [IC 6-2.5-1-27](#); [IC 6-2.5-2-1](#); [IC 6-2.5-3-1](#); [IC 6-2.5-3-2](#); [IC 6-2.5-5-40](#); *Conklin v. Town of Cambridge City*, 58 Ind. 130 (1877); *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *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); *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](#); [45 IAC 2.2-5-10](#); Sales Tax Information Bulletin 75 (January 2023); Sales Tax Information Bulletin 75 (April 2017); Sales Tax Information Bulletin 55 (May 2012); Sales Tax Information Bulletin 55 (August 2011).

Taxpayer is a company in the business of conducting medical research. Taxpayer operates multiple locations including a location in Indiana.

Taxpayer submitted two GA-110Ls (Claim for Refund) seeking a refund of sales tax it paid on the purchase of electric and gas utilities. Taxpayer explained that it had erroneously paid approximately \$31,000 in sales tax for utilities consumed in its "research and development process." In the second GA-110L, Taxpayer explained that it also paid \$16,000 on the purchase of utilities also consumed in Taxpayer's research activities.

In letters dated August 2022 and September 2022, the Indiana Department of Revenue ("Department") agreed that - in total - Taxpayer was entitled to an approximately \$42,000 sales tax refund but denied the \$5,000 remaining amount. In the August 2022 letter, the Department explained as follows:

A previous utility exemption case was conducted for meter [number] at 87.95[percent] exemption. Then a case for meter [number] with 82.75[percent]. The approved exemption rates were applied for the requested amounts for this case. The exemption for this company does not qualify for the predominate usage because the exempt usage is for research and development.

In the September 2022 letter, the Department explained again:

A previous utility exemption case was conducted for meter [number] at 83.68[percent] exemption. Then a case for meter [number] with 90.11[percent]. The approved exemption rates were applied for the requested amounts for this case. The exemption for this company does not qualify for the predominate usage because the exempt usage is for research and development.

Taxpayer disagreed with the Department's decision denying portions of the original refund and submitted protests to that effect. In its protest, Taxpayer challenged the Department's denial of the approximately \$5,000 in sales tax. In both protests, Taxpayer explained that "[T]axpayer meets the criteria [] to fully exempt electric, gas, and water utilities from the Indiana sales tax"

An administrative hearing was scheduled to allow Taxpayer and its representatives an opportunity to explain the

factual and statutory grounds for its protests. However, neither Taxpayer nor its representatives chose to participate. This Final Order Denying Refund addresses both protests and is based on the Taxpayer's written explanation and on the documents available to the Department.

I. Gross Retail and Use Tax - Utilities Consumed in Conducting Research and Development.

DISCUSSION

The issue is whether Taxpayer has met its burden of establishing that it is entitled to a refund of all sales tax paid on its purchase of water, gas, and electricity on the ground that these utilities are "predominantly used" in its research and manufacturing 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 generally equivalent to the sales tax. See *Rhoades 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 R&D property. The current version of [IC 6-2.5-5-40](#) provides that certain activities are not considered R&D activities and clarifies that certain activities are considered incidental to R&D activities. Sales Tax Information Bulletin 75 (January 2023), 20230125 Ind. Reg. 045230020NRA, See *also* 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 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" 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).

(Emphasis added).

(3) Qualifying for the Research and Development Sales Tax 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 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. Taxpayer's Predominate Use Argument.

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 (and/or manufacturing) purposes. To that end, Taxpayer explains that [45 IAC 2.2-4-13](#)(e) supports its interpretation.

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.

In arriving at its decision that it is entitled to a 100 percent refund of the sales tax paid on utilities, Taxpayer maintains that it has established that the majority of its utilities are consumed in R&D activities. Taxpayer disagrees with the Department's conclusion that it was entitled to only a percentage of the sales tax paid on the purchase of electricity and natural gas measured at the meters reviewed.

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" (more than 50 percent) 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). The excepted uses listed under [45 IAC 2.2-4-13](#) do not include research and/or development.

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 2022) Sales Tax Information Bulletin 55 (May 2012).

In this case, Taxpayer errs in its interpretation and application of the "predominant use" standard because the "predominately used" 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 qualifying R&D activities are entitled a straight-forward, dollar-for-dollar sales tax exemption. Indiana law does not provide a taxpayer a route to claim a 100 percent exemption solely by means of the R&D exemption.

In addition, the Department takes this opportunity to point 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. In the last example here, the taxpayer would only be entitled to the 100 percent exemption if the *production* percentage exceeded 50 percent *or* if the combined production and R&D percentages equaled or exceeded 100 percent.

FINDING

Taxpayer's protest is respectfully denied.

May 8, 2023

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