

Letter of Findings: 04-20120337
Gross Retail Tax
For the Years 2006, 2007, and 2008

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ISSUE

I. Chemical Cleaner – Gross Retail Tax.

Authority: [IC 6-2.5-2-1](#); [IC 6-2.5-3-2](#); [IC 6-2.5-3-2\(a\)](#); [IC 6-8.1-5-1\(c\)](#); [IC 6-2.5-5-5.1\(b\)](#); [45 IAC 2.2-5-10\(g\)](#); [45 IAC 2.2-5-12\(d\)](#); [45 IAC 2.2-5-12\(d\)\(1\)](#); [45 IAC 2.2-5-12\(f\)](#); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Guardian Automotive Trim, Inc. v. Indiana Dept. of State Revenue, 811 N.E.2d 979 (Ind. Tax Ct. 2004); 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 Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Letter of Findings 05-0321 (December 28, 2006).

Taxpayer argues that it was not required to pay sales tax when it purchased a chemical cleaner consumed during Taxpayer's printing process.

STATEMENT OF FACTS

Taxpayer is a business which has one Indiana location and which manufactures plastic containers and accessories. Taxpayer makes plastic containers primarily for the food industry. Taxpayer provides design, engineering, prototyping, packaging, and printing services.

The Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and determined that Taxpayer owed additional sales/use tax. Taxpayer disagreed with a portion of the assessment. Taxpayer filed a protest to that effect and this Letter of Findings results.

I. Chemical Cleaner – Gross Retail Tax.

DISCUSSION

Taxpayer prints both designs and text on its plastic containers. Taxpayer prints the designs and words by means of an offset printing process in which the inked design is transferred from a printing plate to a "rubber blanket" and then to the printed surface. According to Taxpayer's representative, the "rubber blanket" is used because it most effectively prints irregular, plastic surfaces.

The Department's audit report explains further:

If the [rubber] blankets are not cleaned regularly the print on the container is not clear. The [T]axpayer stops the printer, removes the printing blanket then manually cleans the blanket with a pad or bush and acetone then places the blanket back into printer. This cleaning activity takes place on the line and production is stopped while they clean the blanket. The [T]axpayer states it takes about 5 minutes to clean a printing blanket on line and return to the machine for production. The [T]axpayer believes that the acetone, pads, and brushes to clean the blankets along with the gloves to handle the acetone are exempt. This acetone was purchased from Sherwin-Williams and sales tax was paid at the time of purchase, no credit was given in the [audit] sample for the sales tax paid to [] this vendor.

It is appropriate to point out that Taxpayer disputes the audit's determination that the acetone was subject to sales tax. Further the Taxpayer only argues that acetone used to clean the rubber printing blankets is exempt. Taxpayer is not disputing any determination concerning the rubber printing blankets, the pads, or the brushes.

The Department's audit concluded that the use of acetone was "not conducted 'during production' but rather in between production runs." The audit report cited [45 IAC 2.2-5-12\(d\)](#):

Pre-production and post-production activities.

(1) Direct consumption 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 process has altered the item to its completed form, including packaging, if required.

The audit report stated that "the cleaning solutions are used to clean the blankets or molds while production is stopped. Additionally, the cleaning is not an automated continuous process." The audit report concluded that the acetone used to clean the printing blankets is equivalent to normal maintenance activities which occur when manufacturing machinery is stopped and that cleaning the printing blankets "is ultimately secondary to production of plastic containers" and that cleaning activity is best described in [45 IAC 2.2-5-12\(f\)](#).

Other taxable transactions. Purchases of materials consumed in manufacturing, processing, refining, or mining activities beyond the scope of those described in subsection B above [subsection (e) of this section] are taxable. Such activities include postproduction activities; storage step [sic.]; maintenance, testing and

inspection (except where in direct production); (except where essential and integral to the process system); management and administration; sales; research and development; exhibition of products; safety or fire prevention; space heating; ventilation and cooling equipment for general temperature control; illumination; shipping and loading.

Taxpayer believes that the acetone cleaning solution is exempt pursuant to [IC 6-2.5-5-5.1](#)(b) which states: 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.

As a threshold issue, it is the 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." *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012).

Pursuant to [IC 6-2.5-2-1](#), a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. [IC 6-2.5-3-2](#)(a). A complementary 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. [IC 6-2.5-3-2](#).

[IC 6-2.5-5-5.1](#)(b) 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 Dept. of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). 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).

As Taxpayer notes, the printing process stops while the print blankets are cleaned. The audit report concluded that the acetone was not used during the production of Taxpayer's plastic items and that "[T]axpayer's cleaning activities are similar to those routine maintenance activities that are required for all types of production equipment; and such use is never exempt from taxation." (Emphasis added). The audit admitted that cleaning of the print blankets was necessary for production to continue, the acetone was "ultimately secondary to production of plastic containers."

Taxpayer disagrees arguing that the Tax Court's decision in *Guardian Automotive Trim, Inc. v. Indiana Dept. of State Revenue*, 811 N.E.2d 979 (Ind. Tax Ct. 2004) squarely addresses the issue.

In that case, the petitioner used acetone to periodically clean its paint masks. *Id.* at 980. The petitioner rotated a set of masks some of which were actively involved in the production process and some of which were alternatively taken out of the production process and were being cleaned and readied for use. *Id.* at 981. As the court noted, "To sustain continuous production of its parts, [petitioner] processed the masks in synchronization with the manufacturing process." *Id.* The court agreed that the petitioner's mask processing equipment qualified for the equipment exemption because the equipment was "essential and integral to the overall production of [petitioner's] automotive trim products...." *Id.* at 985.

The issue is whether the acetone consumed in cleaning Taxpayer's printing blankets "has an immediate effect on the article produced" and if the acetone "is an essential and integral part of an integrated process which produces tangible personal property." [45 IAC 2.2-5-12](#)(d)(1). In arriving at a decision, it should be noted that [45 IAC 2.2-5-10](#)(g) states in part:

The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not, of itself, mean that the property "acts upon and has an immediate effect on the tangible personal property being processed or refined". Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

The Department agrees that use of the acetone to clean the printing blankets is "essential to the conduct of the manufacturing," but whether or not the acetone is "necessary" does not resolve the issue of whether or not the acetone is subject to tax. As stated in [45 IAC 2.2-5-10](#)(g), in order to determine that the acetone is exempt "the property must also be an integral part of an integrated process which produces tangible personal property."

Taxpayer argues that its use of the acetone in its printing process is identical to the use of the acetone in *Guardian Automotive*. In that case, the petitioner processed the paint masks "in synchronization with the manufacturing process. *Guardian*, 811 N.E.2d at 981. Taxpayer explains that "[d]uring the printing process it is necessary to clean the printing blankets from time to time depending on several process factors."

Starting with the premise that all tax exemption provisions, is strictly construed against exemption from the

tax, Tri-States, 706 N.E.2d at 283, but that an exemption must "not be construed so narrowly that it does not give effect to legislative intent," General Motors, 578 N.E.2d at 404, the Department is prepared to agree that Taxpayer has sufficiently established that the acetone is an "integral part of an integrated process which produces tangible personal property." [45 IAC 2.2-5-10\(g\)](#). See also Letter of Findings 05-0321 (December 28, 2006). In Taxpayer's case, the use of the acetone is sufficiently distinguished from the routine use of cleaning supplies commonly found and used during various manufacturing processes to permit a conclusion that the acetone falls under the exemption set out at [IC 6-2.5-5-5.1\(b\)](#); the acetone is acquired and directly consumed in the direct production of Taxpayer's plastic products.

FINDING

Taxpayer's protest is sustained.

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