

Final Order Denying Refund Number: 04-20210051
Sales Tax
For the Tax Year 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 final determination.

HOLDING

Indiana Business was not entitled to the \$137.74 refund because it failed to demonstrate that it was entitled to the manufacturing exemptions under [IC 6-2.5-5](#).

ISSUE

I. Sales Tax - Refund.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; *Rhoade v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Indiana Dep't. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520 (Ind. 1983); *General Motors Corp. v. Indiana Dep't. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); *Indiana Dep't. of Revenue v. Interstate Warehousing, Inc.*, 783 N.E.2d 248 (Ind. 2003); *White River Env'tl. P'ship v. Indiana Dep't of State Revenue*, 694 N.E.2d 1248 (Ind. Tax Ct. 1998); *Indianapolis Fruit Co. v. Indiana Dep't of State Revenue*, 691 N.E.2d 1379 (Ind. Tax Ct. 1998); *Mechanics Laundry & Supply, Inc. v. Indiana Dep't of State Revenue*, 650 N.E.2d 1223 (Ind. Tax Ct. 1995); *Mumma Bros. Drilling Co. v. Indiana Dep't. of State Revenue*, 411 N.E.2d 676 (Ind. Ct. App. 1980); [45 IAC 2.2-5-3](#); [45 IAC 2.2-5-6](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-9](#); [45 IAC 2.2-5-10](#); [45 IAC 2.2-5-12](#); [45 IAC 2.2-3-4](#); [45 IAC 2.2-3-14](#); *Black's Law Dictionary* (8th ed. 2004).

Taxpayer protests the refund denial of sales tax paid concerning its purchases of tangible personal property.

STATEMENT OF FACTS

Taxpayer is an Indiana business who filed a refund claim, requesting a \$137.74 refund of sales tax paid on items it purchased during 2020.

The Indiana Department of Revenue ("Department") reviewed the refund request and denied the refund. In its March 10, 2021 letter, in relevant part, the Department stated the following:

A review of the taxpayer's financials and documentation provided with the refund claim [shows that the] taxpayer is not a manufacturer and is registered with the department as providing engineering services. As a service provider all purchasers would be subject to the retail sales tax. A review of the invoices shows mainly shipping labels, scotch tape, printer ink, some small screws, and bolts. With the information provided, it is unknown what the taxpayer is "manufacturing."

Taxpayer protested the refund denial and requested that the Department make "Final determination without a hearing." This final determination results. Further facts will be provided, as necessary.

I. Sales Tax - Refund.

DISCUSSION

Upon initial review, the Department denied Taxpayer's refund claim, finding that Taxpayer registered as a service provider and was not entitled to manufacturing exemptions.

Taxpayer disagreed. According to Taxpayer, it requested the refund of sales tax paid "on materials purchased

which were consumed in the manufacture of products" which it then sold online. In relevant part, Taxpayer stated the following:

I sold three different products in 2020 which were (and two of which still are) available for sale on Amazon.com. I have attached a spreadsheet which details order IDs, SKUs, descriptions, and other information concerning the items sold. . . . [T]wo SKUs [] utilized the materials for which I am requesting a refund of the sales tax I paid.

In 2020, I sold 179 units of [Item One] in 167 separate transactions and 3486 units of [Item 2] in 2541 separate transactions. In case there is any question, Amazon collects and remits all sales taxes for the jurisdictions containing the addresses to which the purchased items are shipped - no sales of any of these items were conducted via any other sales platform in 2020.

Each unit of [Item One] consists of about 80g of polylactic acid (PLA) which I purchased and utilized in 3-D printers to form into the final product. Also included are four, #8-32 oval top screws (which the customer uses in installing the product), two different plastic bags (one for the screws and one for the PLA piece), a reverse-tuck chipboard box, Scotch tape (used to secure the box), and a shipping label with a product bar code and description utilized in identification of the contents.

Each unit of [Item Two] consists of about 40g of PLA which I utilize in 3-D printers to form three pieces of the final product. Also included are two each of screws and nuts used to assemble the product (sizes varied throughout the year), two hollow wall anchors, two different plastic bags (one for the hardware and one for the PLA pieces), a reverse-tuck chipboard box, Scotch tape (used to secure the box), and a shipping label with a product bar code and description utilized in identification of the contents. Some earlier sales also included small hex wrenches used for assembly.

Accordingly, the issue is whether Taxpayer demonstrated that it is a manufacturer and its purchases qualified for the manufacturing exemptions under [IC 6-2.5-5](#).

IC § 6-2.5-2-1(a) imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-4-1 provides that a retail transaction occurs when a seller "acquires tangible personal property for the purpose of resale; and . . . transfers that property to another for consideration." IC § 6-2.5-4-1(b). In addition, the Indiana 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, 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). The use tax is generally functionally equivalent to the sales tax. See *Rhoades v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

Accordingly, all purchases of tangible personal property are taxable unless specifically exempted under Indiana law. [45 IAC 2.2-5-3\(b\)](#); [45 IAC 2.2-5-6\(a\)](#); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-9\(a\)](#); [45 IAC 2.2-5-10\(a\)](#). An exemption from the use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4 and [45 IAC 2.2-3-4](#). There are various tax exemptions available outlined in [IC 6-2.5-5](#) which are applicable to both sales tax and use tax. [45 IAC 2.2-3-14\(2\)](#). A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such 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." *Id.* at 101 (internal citations omitted). In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). Thus, in order for Taxpayer to prevail on the issue it raised in its claim for a refund of sales or use tax, Taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

IC § 6-2.5-5-3(b), in relevant part, states:

[T]ransactions involving manufacturing machinery, tools, and equipment, including material handling equipment purchased for the purpose of transporting materials into activities described in this subsection from an onsite location, are exempt from the state gross retail tax if the person acquiring that property acquires it for **direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. (Emphasis added).**

IC § 6-2.5-5.1(b) provides:

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. **(Emphasis added).**

The Legislature granted Indiana manufacturers a sales tax exemption when a manufacturer "acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in [its] business of manufacturing" In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. The tangible personal property "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* Accordingly, the sales tax exemption is applicable to tangible personal property which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. *General Motors Corp. v. Indiana Dep't. of State Revenue*, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991). The application of Indiana's double-direct manufacturing exemptions often varies based on a determination of when a taxpayer's manufacturing process is considered to have begun and ended.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment are directly used in the direct production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. *Id.* An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#), example 1.

Similarly, "[d]irect 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." [45 IAC 2.2-5-12\(d\)\(1\)](#).

[45 IAC 2.2-5-8\(g\)](#) further states:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. **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 itself mean that the property "has an immediate effect upon the article being produced"**. 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. **(Emphasis added).**

[45 IAC 2.2-5-8\(k\)](#) describes direct production as the performance of an "integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. **The change in form, composition, or character must be a substantial change, and it must result in a transformation of property into a different product having a distinctive name, character, and use.** Operations such as compounding, fabricating, or assembling are illustrative of the types of operations which may qualify under this definition." **(Emphasis added).**

"Manufacture" is defined as "[a] thing that is made or built by human being, as distinguished from something that is a product of nature; esp. any material form produced by a machine from an unshaped composition of matter." *Black's Law Dictionary* 984 (8th ed. 2004). While statutes are silent on what constitutes "manufacture," courts, on several occasions, have attempted to answer this question through statutory construction.

In *Mechanics Laundry & Supply, Inc. v. Indiana Dep't of State Revenue*, 650 N.E.2d 1223 (Ind. Tax Ct. 1995), the taxpayer, who operated a commercial laundry, claimed it was entitled to the statutory exemptions, such as exemption of environmental quality compliance, under [IC 6-2.5-5](#) for sales/use taxes concerning cleaning

supplies, water, gas, electricity, and other products consumed during the laundering of soiled textiles. *Id.* at 1226-27. Referring to the statutory and regulatory requirements, the Tax Court stated that the taxpayer failed to demonstrate that its "end product" was "substantially different from the component materials used." The Tax Court found that the taxpayer did not "place tangible personal property in a form, composition, or character substantially different from that in which it was acquired." *Id.* at 1229. The Tax Court thus concluded that the laundering of soiled textiles did not constitute "production," and, therefore, the taxpayer was not engaged "in an overall process directed to the production of textiles;" rather, the taxpayer was "perpetuat[ing] textiles that were produced by others." *Id.* at 1229-30.

In *Indianapolis Fruit Co. v. Indiana Dep't of State Revenue*, 691 N.E.2d 1379 (Ind. Tax Ct. 1998), the taxpayer, Indianapolis Fruit Co., claimed that it was entitled to agricultural and manufacturing exemptions for the tangible personal property it had purchased for ripening bananas and tomatoes. The Tax Court stated that:

In the context of the exemption provisions at issue, production is "defined broadly" and "focuses on the creation of a marketable good." The exemption provisions were enacted to deal with a host of different activities and factual situations. As a result, mathematical precision in the application of these exemptions cannot be expected, and any evaluation of whether production is occurring depends on the factual circumstances of the case. However, there is one iron-clad rule: without production there can be no exemption. *Id.* at 1383-84 (internal citation and quotation marks omitted).

The court, in *Indianapolis Fruit*, found that the bananas had undergone substantial change and had transformed from "green, hard, inedible, and unmarketable bananas" to yellow, edible, and sellable bananas after the bananas were placed in air and temperature controlled banana ripening booths and the taxpayer applied ethylene gas to the bananas. *Id.* at 1385. The court, however, declined to find the same result for the taxpayer's tomatoes. The court determined that "production" occurred as the taxpayer created the sellable bananas, but the taxpayer did not actively perform the same or similar activities to produce the sellable tomatoes. As a result, the court, in *Indiana Fruit*, concluded that the taxpayer was entitled to the exemptions for its purchases of tangible personal property to be used or consumed in the bananas' production process, but not the tomatoes' production process.

Similarly, in *White River Env'tl. P'ship v. Indiana Dep't of State Revenue*, 694 N.E.2d 1248 (Ind. Tax Ct. 1998), the taxpayer, White River Environmental Partnership (WREP), which operated a wastewater treatment facility, claimed that it was entitled to statutory exemptions for the equipment which it purchased to be used in its wastewater treatment process. The Indiana Tax Court first followed the well-established case law stating that a taxpayer must "engage in production before receiving an exemption." *Id.* at 1250.

The Tax Court in *White River* explains:

In [*Mechanics Laundry & Supply, Inc. v. Indiana Dep't of State Revenue*, 650 N.E.2d 1223 (Ind. Tax Ct. 1995)], **the terms listed in the exemption provisions, i.e., processing, manufacturing, etc., have meaning only to the extent that there is production. If there is no production of goods, the exemption provisions at issue do not apply.** Therefore, WREP's entitlement to a sales and use tax exemption rests not on whether wastewater treatment can be called processing, but rather whether WREP is engaged in the production of goods.

...

[T]he fact that WREP substantially changes the wastewater does not *ispo facto* lead to the conclusion that production for purposes of the exemption provisions is taking place. **Production, within the context of the exemption provisions at issue, is "defined broadly" and "focuses on the creation of a marketable good." In this case, the "products" of the wastewater treatment process (clean water, ash, and sludge) are not sold to others.** The clean water is discharged into the White River, and the ash and sludge are disposed of in a landfill.

Id. at 1250-51. (Internal citation and quotation marks omitted) **(emphasis added)**.

The Tax Court, in *White River*, further referred to *Mumma Bros.*, where the Indiana Court of Appeals determined that the taxpayer, who drilled water wells and installed pumps and plumbing for residences, farms, and commercial entities in order to provide water for animal and human consumption, was not entitled to exemptions because the taxpayer did not produce a marketable good. Following the same analysis in *Mumma Bros.*, the Tax Court in *White River* illustrated:

The legislature enacted the sales and use tax exemption in order to prevent tax pyramiding, i.e., a situation where a tax is levied upon a tax. In *Mumma Bros.*, a situation where the "**product**," i.e., the extracted water, **was not resold, there was no tax pyramiding to prevent**. Accordingly, the purposes of the exemption were not served. In light of this and the fact that a tax exemption is strictly construed, the court found that the exemption was not meant to apply to the extraction of water for personal use.

Id. at 1252. (Internal citation and quotation marks omitted) (**emphasis added**).

Thus, the Tax Court in *White River* determined that WREP, like the taxpayer in *Mumma Bros.*, was not entitled to statutory exemptions because WREP failed to demonstrate that it produced a marketable good. The Tax Court concluded that "[w]here something is made, but not sold, the danger of tax pyramiding does not exist." *Id.*

Furthermore, in *Interstate Warehousing*, the taxpayer, Interstate Warehousing, Inc. ("Interstate"), claimed that it was entitled to an exemption under IC § 6-2.5-5-5.1 on its consumption of the electricity used to convert the ammonia from gas form to a liquid. *Indiana Dep't of Revenue v. Interstate Warehousing, Inc.*, 783 N.E.2d 248, 249. The Tax Court ruled in favor of the taxpayer. The Indiana Supreme Court, in reversing the Tax Court's determination, found that the taxpayer, Interstate Warehousing, Inc., was not qualified for the exemption in two respects: the court found that (1) the taxpayer was not engaged in the "production of other tangible personal property" (namely, the "distinct marketable good" requirement); and (2) the taxpayer was not in the business of "manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture" (namely, the "transformation" requirement). *Id.* at 250. The court, in pertinent part, explained that:

Interstate uses electricity to cool gaseous ammonia to liquid form and then circulates the liquid through its warehouse facilities to cool the air. When the temperature of the ammonia begins to rise, it is again chilled. The ammonia stays in the refrigeration system, which was referred to as "closed loop." While it is certainly true that there is some transformation of the ammonia from gas to liquid form as a consequence of the consumption of electricity, such transformation alone is not sufficient to constitute "production of other tangible personal property" under the statute. **By "production of other tangible personal property," the Legislature meant that the taxpayer must use the electricity to transform the ammonia into a distinct marketable good. That does not occur here; the liquid ammonia is never marketed.**

...

Interstate [does not] perform an integrated series of operations resulting in a transformed end product to Interstate's customer. . . . The cool air merely maintains the customer's previously manufactured goods. There is no substantial change in 'form, composition, or character' to those goods. **The cold air is only incidental to the service of storing previously manufactured goods.**

Id. at 250-52. (**Emphasis added**).

Accordingly, to meet the production requirement, a taxpayer must engage in the business of production and its production must result in a marketable good.

In this instance, Taxpayer submitted purchase invoices and an Excel spreadsheet to support its \$137.74 refund claim. Taxpayer contended that it paid sales tax on its purchase of tangible personal property - including polylactic acid (PLA), oval top screws, different plastic bags, a reverse-tuck chipboard box, Scotch tape, shipping labels, and hex wrenches - to be used to manufacture Item One and Item Two for sale. In particular, according to Taxpayer, (1) it purchased polylactic acid (PLA), which was "utilized in 3-D printers to form into the final product" and (2) its products, Item One and Item Two, were sold online. As such, Taxpayer asserted that it was entitled to the refund of tax paid pursuant to the manufacturing exemptions.

Upon review, however, the Department is not able to agree that Taxpayer is in the business of manufacturing because Taxpayer did not provide any supporting documentation to substantiate its manufacturing production process, including the beginning and the end of its production process. Also, publicly verifiable information demonstrates that Taxpayer primarily offers engineering services to small businesses and it is not a company manufacturing product for sale.

Even if, for the purposes of argument, assuming that Taxpayer could establish that it is in the business of manufacturing Item One and Item Two for sale, Taxpayer's documentation in this instance failed to establish that it directly consumed tangible personal property, such as oval top screws, different plastic bags, a reverse-tuck chipboard box, Scotch tape, shipping labels, and hex wrenches, in its direct manufacturing production. Taxpayer's statement failed to establish that its use of the tangible personal property in question - namely, oval top screws, different plastic bags, a reverse-tuck chipboard box, Scotch tape, shipping labels, and hex wrenches - met the

"double direct" requirement and would have been non-production or post-production.

As mentioned above, 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 itself mean that the property "has an immediate effect upon the article being produced." In short, the Department is not able to agree that Taxpayer demonstrated that it was entitled to the refund.

FINDING

Taxpayer's protest is respectfully denied.

June 15, 2021

Posted: 08/25/2021 by Legislative Services Agency

An [html](#) version of this document.