

Memorandum of Decision: 04-20210116; 04-20210117
Sales Tax
For the Years 2017 through 2020

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HOLDING

Although the Department agreed it was entitled to an additional refund amount, Indiana Research Facility was not entitled to the original sales tax refund amount 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 under Indiana law.

ISSUES

I. Gross Retail Tax - Research and Development Exemption.

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 (effective January 1, 2016); *Conklin v. Town of Cambridge City*, 58 Ind. 130 (1877); *Rhoads 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](#); [45 IAC 2.2-5-10](#); 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); *The American Heritage Dictionary of the English Language*. Boston: Houghton Mifflin, 1996; *Webster's II* (1st ed. 1994).

Taxpayer argues that it is entitled to a refund of sales tax paid on the purchase of utilities because the electricity and natural gas it buys are predominantly consumed performing qualifying research and development activities.

II. Gross Retail Tax - Exempt R&D Equipment.

Authority: IC § 1-1-4-1; IC § 6-2.5-5-40; Sales Tax Information Bulletin 75 (April 2017); *The American Heritage Dictionary of the English Language*. Boston: Houghton Mifflin, 1996; *Webster's II* (1st ed. 1994).

Taxpayer maintains that the Department erred when it determined that certain items of its equipment were not entitled to the R&D exemption.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of conducting medical research. Taxpayer submitted a refund claim (Form GA-110L) seeking the return of approximately \$9,000 in sales tax. Taxpayer originally paid the tax on the purchase of natural gas during 2017 through 2020. According to Taxpayer's original claim, the "natural gas [was] 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 natural gas measured by two particular meters qualified for a 73.62 and 83.78 percent research and development ("R&D") exemption. As such, the Department granted a refund of approximately \$5,000 and denied the remaining \$4,000.

Taxpayer simultaneously submitted a second refund claim (Form GA-110L) seeking the return of approximately \$71,000 in sales tax. Taxpayer paid the tax on the purchase of utility services also during 2017 through 2020. According to Taxpayer's original claim, the "electricity [was] used in research and development/manufacturing."

The Department reviewed this second claim and - again - determined that Taxpayer was entitled to a portion of

the refund. The Department determined that electricity measured by four particular meters qualified for an 82.61, 82.61, 73.02 and 45.39 percent R&D exemption along with the manufacturing exemption. As such, the Department granted a refund of approximately \$46,000 and denied the remaining \$24,000.

Taxpayer disagreed with the Department's decisions on the two claims because the Department did not exempt the gas and utility sales tax at 100 percent. Taxpayer submitted a protest to that effect. An administrative hearing was conducted by video conference during which Taxpayer's representatives explained the basis for the protest. This Memorandum of Decision 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 electricity and natural gas on the ground that these utilities were consumed in its R&D activities and, based on the predominant use standard, were therefore fully exempt.

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 generally 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 Rhoads 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 2016 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 (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).
- (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 R&D 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 allow 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.

C. 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:

Tangible personal property (electricity and gas) qualifies for the sales tax exemption if it is considered research and development process. Therefore, the utilities consumed in the research and development and should be fully exempt from sales tax.

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\(e\)](#).

Generally, to qualify for predominant use, a purchaser of a utility must show that more than 50 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).

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.

II. Gross Retail Tax - Exempt R&D Equipment.

DISCUSSION

Taxpayer questions the Department's determination that certain items of its equipment did not qualify for the exemption.

Taxpayer provided a copy of its utility study listing items purportedly used in qualifying R&D activities. Taxpayer states that the items listed are used in research development and that any utilities consumed are entitled to the exemption. Taxpayer states that the Department erred in excluding certain items listed on that study.

For example, Taxpayer states that a "Printer, HP LaserJet" fixture qualifies because the printer is used to print the results of mass spectrometry testing.

Taxpayer also points to "lighting, inspection mirror LED" as qualifying for the R&D exemption because the device is used to "inspect parts used in catheter brain probe parts." As yet another example, Taxpayer indicates that its fluorescent lighting fixtures qualify for the exemption because they "illuminate" various areas of the laborites.

Taxpayer asks that it receive an additional refund because these - and numerous other - items were not properly considered during the Department's original review.

The Department agrees with Taxpayer in part. Many of the items on Taxpayer's study are clearly precluded under IC § 6-2.5-5-40. The statute excludes "heating, cooling, or illumination" and other "activities incidental to experimental or laboratory research and development." Printers, florescent lights, label makers, and task lights are likely necessary or useful, but they are not "devoted directly to experimental or laboratory research and development."

The statute is clear when it states items of laboratory or experimental equipment which qualifies for the exemption. IC § 6-2.5-5-40(b) provides that qualifying "research and development equipment" means "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."

In making these distinctions here, the Department will assume that the Indiana legislature meant what it wrote and wrote what it meant. IC § 1-1-4-1 requires that the statutes of this state be interpreted according to their "plain meaning." The "plain meaning" of IC § 6-2.5-5-40 is that exempt R&D tangible property is "essential and integral" to R&D activities but excludes property which is "incidental" to those same activities. As a guide to "plain meaning," the Department notes dictionary defines "essential" as "necessary or indispensable," and "integral" as "necessary for completeness." *The American Heritage Dictionary of the English Language*. Boston: Houghton Mifflin, 1996. In contrast, "incidental" is defined as "minor, casual, or subordinate." *Webster's II* (1st ed. 1994).

However, the Department does agree that certain devices contained in the study do apparently qualify for the exemption because they are rationally "considered essential and integral to experimental or laboratory research and development." Sales Tax Information Bulletin 75 (April 2017). Those items include:

- Motor, Sanyo -80 Celsius freezer used to freeze samples of blood from animals for testing for toxicity;
- Motor, Helmer -80 Celsius freezer used to freeze test samples at required temperatures to maintain the integrity of the sample for drug testing;
- Motor, Fisher Sci Isotemp Plus refrigeration used to maintain 3.80 Celsius of test articles to maintain integrity for drug testing;
- Incubator, Precision 6LM convection used to incubate sample for researching and developing drug;
- Motor, Sanyo -20 Celsius Biomedical freezer; freeze drug sample to -860C to maintain integrity for testing the stability of drug in the stability chamber.

Based on what Taxpayer has provided, the five items listed fairly represent approximately 20 items which can be rationally defined as falling within the category of IC § 6-2.5-5-40(b) "laboratory equipment" which is "integral" to Taxpayer's laboratory regime. The remaining items will be enumerated in a spreadsheet which will be forwarded to Taxpayer and the Department's audit division.

Based on the conclusions above, Taxpayer is entitled to an increase of the amount of refund originally received. However, the Department emphatically disagrees with Taxpayer's claim that it is presumptively entitled to a R&D predominant sales/use tax exemption for R&D equipment.

FINDING

Pending the Department's supplemental audit review, Taxpayer's protest is sustained in part and denied in part.

SUMMARY

Taxpayer's protest is denied in part and sustained in part. Taxpayer is not entitled to claim the predominate use exemption under the R&D sales tax regime, but it was correct in arguing that certain individual equipment items were exempt.

November 17, 2021

Posted: 03/02/2022 by Legislative Services Agency
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