DEPARTMENT OF STATE REVENUE

04-20130348.LOF

Letter of Findings: 04-20130348
Gross Retail Tax
For the Years 2007 through 2010

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ISSUES

I. Industrial Processor – Gross Retail Tax.

Authority: IC § 6-2.5-5 et seq.; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-2(a); IC § 6-2.5-4-2(c); IC § 6-2.5-5-3; IC § 6-2.5-5-3(b); IC § 6-2.5-3-4; IC § 6-2.5-4-2; 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); Rotation Products Corp. v. Indiana Dep't of State Revenue, 690 N.E.2d 795 (Ind. Tax Ct. 1998); Mechanics Laundry & Supply, Inc., v. Indiana Dept. of State Revenue, 650 N.E.2d 1223 (Ind. Tax Ct. 1995); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); 45 IAC 2.2-5-8(b).

Taxpayer argues that the tools and equipment used to refurbish used stadium seating are exempt from tax.

II. Gaylord Bins and Forklift – Gross Retail Tax.

Authority: IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(c); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); 45 IAC 2.2-5-8(b).

Taxpayer maintains it was not required to pay sales/use tax on the purchase of Gaylord Bins and a forklift on the ground that the bins and forklift are directly used in the refurbishment of used stadium seating.

III. Plywood Bracing – Gross Retail Tax.

Authority: IC § 6-2.5-5-6; IC § 6-8.1-5-1(c); 45 IAC 2.2-5-14; 45 IAC 2.2-5-14(a).

Taxpayer states that it was not required to pay sales/use tax when it purchased plywood used to reinforce stadium seat legs because the plywood is incorporated into the refurbished stadium seating.

IV. Negligence Penalty – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(2); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer argues that the Department of Revenue should exercise its authority to abate the ten-percent "negligence" penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana business which acquires, refurbishes, and markets used sports stadium seating. Taxpayer acquires the seating from various stadiums throughout the United States.

The seats are disassembled on-site and shipped back to Taxpayer's location. Taxpayer removes paint from the metal parts. If the metal parts contain lead paint, the lead paint is "abated" pursuant to various environmental regulations. The metal and plastic parts are repainted, reassembled, boxed, and shipped to the person who purchased the seat.

The sales take place in two stages. In the first stage – even though the refurbished seats are held by Taxpayer – the seating remains the property of the stadium owner or team. Interested customers interact with the stadium (or team) placing orders and paying the stadium or team for that order. When the order is placed, Taxpayer is directed by the stadium owner or team to ship the refurbished seating to the stadium's or team's customers. The customer pays the stadium/team and the stadium/team keeps the money it earns.

After a set period of time, any remaining seats become the Taxpayer's property. Taxpayer continues to sell the refurbished seats, but now the customer deals directly with what are now Taxpayer's customers. Customers acquire the seating from Taxpayer, customers pay Taxpayer for the seating, and Taxpayer keeps the money it earns from selling the seating directly to its customers.

The Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and tax returns. The audit resulted in the assessment of additional sales/use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Industrial Processor – Gross Retail Tax.

DISCUSSION

Taxpayer argues that when it refurbishes used stadium seating on behalf of the stadium owner or the team, the equipment and supplies used to refurbish the seating are exempt pursuant to the manufacturing exemption under IC § 6-2.5-5-3. As explained by Taxpayer:

The first customer is the stadium who wants to have their seats (seats owned by the stadium) remanufactured into a product they can sell and help raise funds to pay for new seats or a new stadium. The

stadiums do not have this ability, so they contract with [Taxpayer] who will drop ship the remanufactured seats to the stadiums' customers at the stadiums' directions.

The audit report recognized that Taxpayer sold the seating by means of two different business models.

In the analysis of the [T]axpayer's operations, there are two components. The [T]axpayer refurbishes seats owned by the stadiums and also refurbishes seats owned and sold by the [T]axpayer. In the case of the seats owned by the stadiums, the [T]axpayer is not refurbishing the seats as a normal part of the life cycle of the seats. The stadium is not a manufacturer so the [T]axpayer cannot be acting as an industrial processor. When the seats were installed in the stadiums, recycling them and reselling them was not part of the normal life cycle. In this case, the [T]axpayer is acting as a service provider for the stadiums performing extraction and refurbishing of the seats much like a furniture refinisher.

The audit did agree that Taxpayer was acting as a "manufacturer" when it sold refurbished seats for which it had acquired ownership, which were sold to Taxpayer's own customers, and where Taxpayer earned the money from selling the refurbished seats. As stated in the audit report:

However, in the instances of the seats which are owned and sold by the [T]axpayer, the [T]axpayer is acting as a manufacturer that is remanufacturing the seats that are sold to end users and resellers. Therefore, the [T]axpayer was allowed a percentage of the manufacturing exemption to the extent of the seats owned by the [T]axpayer that were refurbished.

Pursuant to IC § 6-2.5-2-1, a sales tax, known as the 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.

An exemption from 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. There are additional exemptions from sales and use tax. IC § 6-2.5-5 et seq. Specifically, IC § 6-2.5-5-3 provides an exemption for machinery, tools, and equipment directly used in the purchaser's direct production of tangible personal property. That exemption extends to "industrial processors." An "industrial processor" is defined under IC § 6-2.5-4-2(c) as one who: (1) acquires tangible personal property owned by another person; (2) provides industrial processing or servicing, including enameling or plating, on the property; and (3) transfers the property back to the owner to be sold by that owner either in the same form or as part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.

Taxpayer cites to IC § 6-2.5-5-3(b) as authority for its argument that the equipment and tools used to refurbish the used stadium seating – ownership of which is retained by the original stadium – is exempt.

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment 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.

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

In applying any tax exemption such as IC § 6-2.5-5-3(b), the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). 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.

The issue is whether Taxpayer is entitled to the "industrial processor" exemption when it refurbishes used stadium seats owned by the stadium or team.

Taxpayer cites to Rotation Products Corp. v. Indiana Dep't of State Revenue, 690 N.E.2d 795 (Ind. Tax Ct. 1998), which involved a taxpayer that claimed the equipment and consumption manufacturing exemptions. Taxpayer believes it meets the standard set out in that case.

According to Rotation Products, IC § 6-2.5-5-3(b) "cover[s] a host of different activities and factual situations. There are innumerable ways to produce other tangible personal property, and the exemption provisions cannot be expected to give a precise answer to each factual situation that arises." Rotation Products, 690 N.E.2d at 798. According to Rotation Products, a taxpayer is eligible for the exemption based on "whether the activity was directly involved in the creation of a product." Id. at 799. To make this decision, the Rotation Products court established a four-part test as follows:

1) The substantiality and complexity of the work done on the existing article and the physical changes to the

existing article, including the addition of new parts;

2) A comparison of the article's value before and after the work;

3) How favorably the performance of the remanufactured article compares with the performance of newly manufactured articles of its kind; and

4) Whether the work performed was contemplated as a normal part of the life cycle of the existing article. Id. at 802-03.

Taxpayer must satisfy all of the above to be considered a remanufacturer or "processor" of stadium seats.

Taxpayer meets the first test because Taxpayer's stadium seats undergo a substantial change. Not only are the parts disassembled, cleaned, and painted, Taxpayer adds replacement parts as necessary. The seats were originally mounted on the stadium's vertical concrete riser; in effect, the stadium seats, as removed from stadium, do not have "legs" and would not support themselves in an individual consumer setting. Therefore, Taxpayer must modify and add four legs to each seat.

Taxpayer meets the second test because the value of the seating, as removed from the stadium, is negligible. Discarded seats which are not remanufactured have little or no value; in some cases, these seats are disposed of in a landfill. Remanufactured seats are sold to individuals for whatever price can be obtained depending on the public's interest in the team or stadium.

Taxpayer meets the third test because, upon removal from the original stadium, the seats are not functional because the seats have no standard legs. The Taxpayer adds value to the recycled seats because it designs, fabricates, and attaches legs rendering the recycled seats usable for the consumer. Because certain of the seats contain lead paint, the seats are unmarketable in their original condition.

Taxpayer meets the fourth test because the seats undergo a transformation from a commercial product installed in large stadiums to an individual consumer item which is a process not within the normal or expected lifecycle of this particular product. The items were built as seating in sports stadiums; as refurbished, the seats are sold as fan souvenirs. See Mechanics Laundry & Supply, Inc., v. Indiana Dept. of State Revenue, 650 N.E.2d 1223, 1229 (Ind. Tax Ct. 1995) (holding that laundering shirts did not constitute production within the meaning of the sales tax exemption).

Taxpayer has met its burden of demonstrating that refurbishing used stadium seating – ownership of which is retained by the original stadium or team – is exempt. Under IC § 6-2.5-4-2, Taxpayer qualifies as an "Industrial Processor" because Taxpayer acquires the seating from its owner, provides "industrial processing" of the seats, and transfers the seating back to the owner for sale to the owner's customers.

The audit division is requested to review the original audit to the extent warranted by this Letter of Findings. It should be noted, that the exemption does not apply to equipment and supplies used either before or after the actual and immediate refurbishment of the stadium seats.

FINDING

Taxpayer's protest is sustained.

II. Gaylord Bins and Forklift – Gross Retail Tax.

DISCUSSION

Taxpayer purchased "Gaylord Bins" which "are [] pallet-size box[]es used for storage and shipping of bulk quantities." Wikipedia: Bulk Box, http://en.wikipedia.org/wiki/Bulk_box . (last visited August 10, 2013).

Taxpayer purchased the bins to "bring the seats to [Taxpayer's location]. However, after bringing the seats to [Taxpayer], the bins, while, in Indiana were and are used to temporarily store and move hundreds of pieces of seats, parts, arms, etc. while work-in-process."

In addition, Taxpayer seeks an exemption for a forklift because "it is constantly moving the Gaylord bins full of work in process around the warehouse through the various stages of the production process.

As authority, Taxpayer cites to IC § 6-2.5-5-3(b) which states:

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment 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.

In addition, Taxpayer cites to 45 IAC 2.2-5-8 which states in part:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property. 45 IAC 2.2-5-8(b).

As noted in Part I. above, Taxpayer has the responsibility of establishing that the original assessment was wrong, IC § 6-8.1-5-1(c), and the exemption which Taxpayer seeks to attain is "strictly construed in favor of taxation and against the exemption." Kimball Int'l Inc., 520 N.E.2d at 456.

Taxpayer has failed to provide sufficient information necessary to establish that either the Gaylord boxes or the forklifts are "directly used in the production process" or that either have an "immediate effect on the article

being produced."

FINDING

Taxpayer's protest is respectfully denied.

III. Plywood Bracing – Gross Retail Tax.

DISCUSSION

Taxpayer's remanufactured stadium seats are typically sold in sets of two or three. As discussed above, Taxpayer adds legs to the seats in order for the seats to be used by the casual, ordinary, consumer of these seats. The legs are then permanently mounted on a sheet of plywood which is intended to add stability to the seats.

The Department's audit found that purchase of the plywood was subject to sales/use tax. Taxpayer disagrees stating the plywood is incorporated into the refurbished seats. Taxpayer cites to IC § 6-2.5-5-6 which states:

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

Taxpayer also cited to 45 IAC 2.2-5-14 which states in part:

> The state gross retail tax shall not apply to sales of any tangible personal property which is to be incorporated by the purchaser as a material or an integral part into tangible personal property produced for sale by such purchaser in the business of manufacturing, assembling, refining or processing. 45 IAC 2.2-5-14(a).

Taxpayer has provided information sufficient to meet its burden under IC § 6-8.1-5-1(c) of demonstrating that the plywood sheets – which are purchased, cut, and permanently attached to Taxpayer's refurbished stadium seats – become an integral part of the product being sold to its customers.

FINDING

Taxpayer's protest is sustained.

IV. Negligence Penalty – Gross Retail Tax.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty because "Taxpayer was a new business running all across the country, removing tens of thousands of seats." According to Taxpayer, it purchased items of equipment on an ad hoc basis in out-of-state locations where Taxpayer hired hundreds of temporary employees to remove the stadium seats in the extremely limited period of time permitted to remove the stadium seating.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

The Department believes that Taxpayer erred in determining its sales and use tax liability. However, there is insufficient information to establish that Taxpayer's position was so egregious as to constitute "willful neglect." Based on a "case-by-case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department agrees that the ten-percent negligence penalty should be abated.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer is not entitled to an exemption for the purchase of the Gaylord boxes and forklift. In all other respects, Taxpayer's protest is sustained.

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