

**OSCEOLA FOODS, LLC (TRU) (2017)****Topic Codes: M011 Machinery & Equipment; R071 Real Property vs. Tangible Personal Property  
Document Reference: 17300001**

January 13, 2017

Kelly Butler  
Ryan, LLC  
2800 Post Oak Blvd., Suite 4200  
Houston, TX 77056

RE: Osceola Foods, LLC  
Docket No. 2015-320-1-0331  
Consumer Use Tax Protest

Dear Ms. Butler:

The Review Unit of the Iowa Department of Revenue (Department) has considered the proposed offer you have presented regarding the protest referenced above. This letter states the Review Unit's position in this matter.

**Machinery, Equipment and Replacement Parts**

According to your most recent correspondence, the total amount of machinery, equipment and replacement parts under protest is \$38,837.71. In an attempt to resolve the protest, you propose the Department allow \$34,619.54 of that amount. You state that the proposed calculation is based on percentages developed through correspondence with plant personnel which you claim is also verified by the company's Hormel AM10 system. You claim that the proposed calculation represents the dollar amount of items that actually qualify as machinery, equipment and replacement parts.

The information provided with the protest indicates that the total amount of machinery, equipment and replacement parts under protest is \$36,383.20. The Department does not concur that all of the items claimed are considered machinery, equipment or replacement parts. These items include doors, labor to repair doors, oils, lubricants and any item under the \$200.00 threshold (as mutually agreed upon in the audit procedure agreement for replacement parts). Consequently, the Department proposes a refund in the amount of \$29,097.06 plus applicable interest.

**Equipment Sanitizers**

With regard to the equipment sanitizers, which are being claimed to be exempt under Iowa Code section 423.3(51) as chemicals, the Department must reject your offer to settle this issue for 50 percent of the \$62,497.40 originally requested. The statute applicable to the chemical exemption you are seeking is section 423.3(51) which states, in part, that:

51. The sales price of tangible personal property sold for processing. Tangible personal property is sold for processing within the meaning of this subsection only when it is intended that the property will, by means of fabrication, compounding, manufacturing, or germination, become an integral part of other tangible personal property intended to be sold ultimately at retail; or for generating electric current; or the property is a chemical, solvent, sorbent, or reagent, which is directly used and is consumed, dissipated, or depleted, in processing tangible personal property which is intended to be sold ultimately at retail or consumed in the maintenance or repair of fabric or clothing , and which may not become a component or integral part of the finished product. . . .

(Emphasis added).

Rule 701—230.4 interprets section 423.3(51) and requires that all of the following conditions be met before a chemical is exempt as being sold for processing, by stating that:

To qualify for this exemption, all of the following conditions must be met:

1. The item must be a chemical, solvent, sorbent, or reagent.
2. The chemical, solvent, sorbent, or reagent must be directly used and consumed, dissipated, or depleted during processing as defined in reference rule 701-18.29(422,423).
3. The processing must be performed on tangible personal property intended to be sold ultimately at retail.
4. The chemical, solvent, sorbent, or reagent need not become an integral or component part of the processed tangible personal property.

(Emphasis added).

The code section you are citing from comes out of section 423.3(47), the machinery and equipment exemption, which contains its own definition of processing apart from section 423.3(51). The exemption in section 423.3(47) pertains to machinery and equipment being used under that section's definition of processing and does not apply to chemicals that are being used in a processing operation. The chemicals being claimed for exemption here are not being used during the processing activity. Instead, the chemicals are acting as a sanitizer for machines and equipment that are being used in processing, but are not part of the actual process itself. Since the chemicals at issue are not being directly used and consumed or dissipated on the food being processed, they do not qualify for the processing exemption under section 423.3(51). *See Mississippi Valley Milk Producers v. Iowa Dept. of Rev.*, 387 N.W.2d 611 (Iowa Ct. App. 1986). *See also Pioneer Hi-Bred International, Inc.*, Proposed Order, Granting Department of Revenue Motion for Summary Judgment, April 5, 2016 (copy enclosed). Based on the above, the Department denies this portion of your claim in total.

In order to resolve this matter, the Department is willing to refund \$29,097.06 in tax plus applicable interest through January 31, 2017. This amounts to \$35,614.80. If this is agreeable, please notify me in writing by January 31, 2017.

If you disagree with the Review Unit's position in this matter, then the Review Unit requests that you identify those areas of disagreement and provide documentation to support your position. Upon receipt of your letter, the Review Unit may file an Answer, which will initiate the process for an administrative hearing on your protest. A department attorney will be assigned to your protest at that time.

If no response is received by January 31, 2017, then the Review Unit will construe this inaction as failure to pursue the protest and will request dismissal of the protest pursuant to department rule 701 IAC 7.11(2).

If you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

Holly Cretsinger, Technical Tax Specialist  
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Audit Services Section  
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Enclosure