DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 03-0004; 99-0640
Gross Retail Tax
For the Years 1995 through 1997 and 1998 through 2001

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ISSUES

I. Abatement of the Ten-Percent Negligence Penalty.

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

Taxpayer asks that the Department of Revenue exercise its discretion to abate the ten-percent negligence on the ground that taxpayer had no direct obligation to remit use tax on the purchase of certain items.

II. Food Purchases – Gross Retail Tax.

Authority: IC 6-2.5-1-1 et seq.; IC 6-2.5-3-2; IC 6-2.5-5-20(a); IC 6-2.5-5-20(c)(8); Hyatt Corp. v. Dept. of State Revenue, 695 N.E.2d 1051 (Ind. Tax Ct. 1998); 45 IAC 2.2-5-38.

Taxpayer argues that the money it received for serving prepared meals was not subject to the gross retail tax.

STATEMENT OF FACTS

Taxpayer owns and operates a "guest pavilion," parking lots, dock, restaurants, and berthing slips. These facilities serve two riverboat casinos. The two adjacent riverboats are licensed to conduct separate, but coordinated gaming operations.

The riverboats' parent companies formed taxpayer as a joint venture in 1995. The two riverboat parent companies each have a 50 percent ownership interest in taxpayer. The intent of the two parent companies was to share the initial cost and ongoing expense of the land-based, support facilities – parking lots, food service, etc. – necessary for successful operation of the riverboats' gambling business.

During 1999, the Department of Revenue (Department) conducted an audit review of taxpayer's business records and tax returns. The Department reviewed records and returns for 1995, 1996, and 1997. This first audit resulted in the issuance of proposed assessments of additional gross retail tax. Taxpayer disagreed and submitted a protest to that effect. Thereafter, taxpayer and the Department reviewed invoices and related documentation to resolve the issues raised in this first protest. According to taxpayer, taxpayer and the Department reached an "initial agreement" dated August 8, 2002, which made specific adjustments to the 1995, 1996, 1997 assessments.

According to taxpayer, it paid the unresolved gross retail tax assessments in full. Taxpayer believes that the only unresolved issue stemming from this first set of assessments is the ten-percent negligence penalty.

During 2002, the Department conducted a second audit review of taxpayer's business records and tax returns for 1998, 1999, 2000, and 2001. The Department concluded that taxpayer owed additional use tax on the complimentary meals taxpayer served to the riverboats' employees and the riverboats' preferred customers. Accordingly, the Department issued notices of "Proposed Assessment." Taxpayer disagreed with the proposed assessment and submitted a second protest to that effect.

The Department and taxpayer decided that the two protests – although addressing separate issues stemming from separate audits – should be treated and resolved as one protest. An administrative hearing was conducted during which taxpayer's representative explained taxpayer's position on the two remaining, disputed issues. This Letter of Findings results.

DISCUSSION

I. Abatement of the Ten-Percent Negligence Penalty.

The ten-percent negligence penalty stems from the first audit and the consequent assessment of additional use tax. The first audit found that taxpayer should have paid use tax on the materials integrated into realty under a lump sum contract and a time and materials contract. In addition, the first audit found that taxpayer should have paid use tax on the purchase of certain communications equipment, office equipment, kitchen equipment, and other personal property.

After taxpayer submitted the first protest, the Department and taxpayer's representatives conducted a review of the initial 1995, 1996, and 1997 assessments. The two parties agreed that certain purchases were not subject to use tax because sales tax was paid on the original invoice. The parties agreed that purchases of certain kitchen equipment were exempt from sales tax. The parties agreed that taxpayer had paid sales tax on a portion of the cost of a non-exempt item. The parties agreed that certain other charges should be eliminated (without written explanation) from the use tax assessment. The parties apparently compromised on the use tax assessments attributable to the lump sum contracts for the improvement to realty. As stated in the August 8, 2002, agreement, "for the remaining purchases claimed in the protest related to lump sum contracts, it was agreed that taxing 60% of these purchases fairly reflects the true taxability."

The unresolved issue is whether the ten-percent negligence penalty related to the first set of use tax assessments should be abated in its entirety.

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. 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.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." 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 . . . ."

In the August 8 agreement, the parties agreed to compromise or otherwise resolve the contested use tax issues. As stated in that agreement, "The complexity of the paperwork, the inability to obtain every source document, and the inferences and conclusions that could be drawn from the information that was provided[,] all lead to the conclusion, that in fairness to the state as well as the taxpayer, this compromise was warranted."

Given the parties' willingness to compromise on the original use tax assessment, that both parties agreed that a substantial portion of the original assessment should be abated, and that the use tax questions were difficult to resolve because of the "complexity of the paperwork," it cannot be said that the original use tax assessments were attributable to the absence of reasonable care on the part of taxpayer or that taxpayer failed – under the circumstances – to exercise ordinary business care and prudence.

Therefore, the ten-percent negligence penalty imposed following audit review of taxpayer's 1995, 1996, and 1997 records should be entirely abated.

FINDING

Taxpayer's protest is sustained.

II. Food Purchases – Gross Retail Tax.

Taxpayer is owned by two riverboat casinos. Taxpayer supplies the ancillary, land-based services necessary for the operation of the riverboats. Each riverboat owns 50 percent of taxpayer.

Taxpayer operates a cafeteria which serves free meals to the riverboats' employees. In addition, taxpayer serves free meals to the riverboats' preferred customers. The preferred customers are those who have received a complimentary meal voucher.

Taxpayer keeps records of the meals it serves to its own employees, the meals it serves to the riverboats' employees, and the meals it serves to the riverboats' preferred customers.

Every month, taxpayer sends a bill to each of the two riverboats for the cost of the meals served to the riverboats' employees and the riverboats' customers. The two riverboats reimburse taxpayer for the cost of the meals served to these employees and customers.

The second audit review (1998 through 2001) found that taxpayer should have collected sales tax on the reimbursements received from the riverboats. As stated in the explanation of adjustments, "An adjustment was made in the audit to assess the taxpayer for sales tax that should have been charged to [the two riverboats] on the cost of these meals." However, the audit did not assess use tax on the food used to provide free meals to taxpayer's *own* employees because, as stated in the explanation of adjustments, "the food is never sold. The food was purchased free of sales tax in accordance with 45 IAC 2.2-5-39 as the purchase of food for human consumption."

Taxpayer argues that the meals served to the riverboats' employees and the riverboats' customers were exempt from sales tax under IC 6-2.5-5-20(a) which states that, "Sales of food for human

consumption are exempt from the state retail tax." According to taxpayer, it "purchased only unprepared food which it prepared and provided to employees and patrons of [the two riverboats]. All of these purchases were exempt from Indiana sales and use tax under the food for human consumption exemption."

Taxpayer points to the decision set out in Hyatt Corp. v. Dept. of State Revenue, 695 N.E.2d 1051 (Ind. Tax Ct. 1998) as support for its position that the cost of the meals served to the riverboats' employees and customers was not subject to sales or use tax. In Hyatt, the petitioner-taxpayer argued that it was not subject to use tax on the food it purchased and served as complimentary meals to its own guests and employees. Id. at 1052. Petitioner-taxpayer claimed that, under IC 6-2.5-5-20(a), its food purchases were exempt because the items purchased were "food for human consumption" and that the food items were not "food furnished, prepared, or served for consumption at a location, or on equipment provided by the retail merchant." Id. at 1054. *See* IC 6-2.5-5-20(c)(8). The court agreed with petitioner-taxpayer's position. Petitioner-taxpayer was buying food for human consumption and giving away meals prepared with that food. Id. at 1056-57. The Tax Court found that, "the fact that the food [petitioner-taxpayer] purchased was not resold is irrelevant to the question of whether [petitioner-taxpayer's] food purchases qualify for an exemption under section 6-2.5-5-20." Id. at 1057.

Indiana imposes a sales tax on retail transactions and a complimentary use tax on tangible personal property that is stored, used, or consumed in the state. IC 6-2.5-1-1 et seq. 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, regardless of the location of that transaction or of the retail merchant making that transaction." IC 6-2.5-3-2.

As noted above, "Sales of food for human consumption are exempt from the state gross retail tax." IC 6-2.5-5-20(a). However, the phrase "food for human consumption" does not include "food furnished, prepared, or served for consumption at a location or on equipment provided by the retail merchant." IC 6-2.5-5-20(c)(8). The Department's regulation restates the rule: "The gross retail tax exempts food for human consumption. Primarily the exemption is limited to sales by grocery stores, supermarkets, and similar type businesses of items which are commonly known as grocery food." 45 IAC 2.2-5-38.

Taxpayer is reimbursed for the cost of the meals served to the riverboats' employees and the riverboats' customers. The Department agreed that taxpayer was not subject to use on the value of the food to taxpayer's *own* employees. What is at issue is whether taxpayer should have charged the two riverboats sales tax for the cost of the meals served to the *riverboats'* employees and the *riverboats'* customers. Taxpayer argues that it was simply acting as an agent for the two riverboats. According to taxpayer, it "had no prospects for earning a profit. Its sole purpose was to act as [the riverboats'] agent for the purpose of providing food to their employees and club members." Taxpayer concludes that, "All acts performed by [taxpayer] in its agency capacity, including the purchase, preparation and delivery of food to [the riverboats'] employees and patrons, are therefore treated as though such acts were performed by [the riverboats]."

Taxpayer indicates that it has acted as the riverboats' agent since its inception and that the arrangement was formally memorialized six years afterward. Taxpayer maintains that – because of the agency/principal relationship it has with the riverboats – it stands in the same shoes as the petitioner-taxpayer in Hyatt; because the riverboats could presumably have purchased food and served that food free-of-charge to the riverboats' own employees and the riverboats' own

preferred customers, taxpayer stands in the stead of the two riverboats and can purchase and serve meals to the riverboats' employees and guests without collecting sales tax.

However, it should be noted that taxpayer wants something more than the petitioner-taxpayer in Hyatt. In that case, the petitioner-taxpayer wanted to buy unprepared food without paying sales tax. Hyatt, 695 N.E.2d at 1054-55. Taxpayer wants to receive tax-free payment from the riverboats for the cost of the cooked and prepared meals along with the cost of procuring, preparing, and delivering the food to riverboat employees and guests. As set out in the parties' Limited Agency Agreement, "In consideration of the [taxpayer's] performance of its duties under this Agreement, [the riverboats] shall reimburse [taxpayer] monthly for the actual cost of food purchased and other costs and expenses incurred in connection with the provision of food to [the riverboats'] employees and club members." Essentially, taxpayer wants to operate a restaurant/catering business without having to charge sales tax when it receives payment for serving meals.

The Department must respectfully disagree with taxpayer's argument because it does not conclude that the rules governing the interplay between the gross income tax and agency/principal standards are relevant in determining whether a retail transaction occurs when the riverboats pay taxpayer for the cost of meals served to other than the taxpayer's own employees. As recognized in the parties' own "Limited Agency Agreement," "[A]s part of [taxpayer's] *Business*, [taxpayer] maintains and operates in the pavilion a cafeteria for the purpose of producing, preparing and delivering food to [taxpayer's] employees and to the [the riverboats'] employees." (*Emphasis added*). Elsewhere in the same document, the parties recognize "also as a part of [taxpayer's] *Business*, [taxpayer] maintains and operates certain other facilities for the purpose of procuring, preparing and delivering food to the [the riverboats'] club members . . . . [Taxpayer] operates the Club Member Food Facilities and provides such food free-of-charge to club members who bear compensation certificates . . . ." (*Emphasis added*).

The agency/principal arrangement is an irrelevancy in determining whether taxpayer should have collected sales tax on the money it received for serving meals to other than its own employees. Taxpayer is in the "business" of running a restaurant/cafeteria service. It buys and prepares food which it serves to persons other than its own employees. Taxpayer receives payments based upon the number of meals served to persons other that its own employees. These transactions are subject to the gross retail tax, and taxpayer should have collected sales tax each time it received a payment.

FINDING

Taxpayer's protest is respectfully denied.

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