

Letter of Findings: 06-0237
Indiana Sales/Use Tax
For Tax Periods 2003-2005

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ISSUES

I. Sales/Use Tax—Resale Exemption

Authority: IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5; IC § 6-2.5-5-8; IC § 6-2.5-5-24

Taxpayer disputes the Department's conclusion that a truck chassis was not purchased for resale, and further disputes the amount upon which the Department assessed tax.

II. Tax Administration—Negligence Penalty

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#)

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer is a company that sells motorcoaches and sleeper cabins for trucks. During the audit period, Taxpayer purchased a truck chassis for conversion into a motorcoach.

However, the chassis had mechanical problems. The seller of the chassis sold the chassis with the understanding that Taxpayer would not resell the chassis for two years. The two-year delay ensured that the seller would not be subject to liability under a warranty on the chassis. Taxpayer converted the chassis into a motorcoach. The motorcoach remained on Taxpayer's sales lot for customer viewing even though it was not advertised for sale. Taxpayer treated the truck as a capital asset and depreciated the truck during the period that Taxpayer held the truck. The Department's audit determined that Taxpayer did not purchase the motorcoach for resale, and assessed use tax on the full capitalized value of the motorcoach.

During the audit period, Taxpayer purchased another company. Some of the assets of the company were pieces of furniture which Taxpayer capitalized for income tax purposes. The Department's audit assessed use tax on the purchase price of the company that Taxpayer allocated to the furniture. Without further discussion, this portion of the assessment has been resolved in Taxpayer's favor.

The Department's audit also projected non-capital purchases upon which Taxpayer did not remit use tax. As part of the projection, the Department included a computer drive tape as a non-capital purchase, while Taxpayer maintained that the computer drive tape was a capital purchase and should not be included in the Department's projection. Instead, Taxpayer argues that the tape should be taxed as an item separate from the projection. Without further discussion, the removal of the computer drive tape from the Department's projection also has been resolved in Taxpayer's favor.

Finally, the Department assessed a penalty with respect to the entire assessment (including items not previously listed and which are uncontested). Taxpayer protested the items listed above, including penalty.

DISCUSSION

I. Sales/Use Tax—Resale Exemption

Taxpayer asserts that it purchased a particular truck chassis to be converted into and sold as a motorcoach. The seller indicated to Taxpayer that the chassis had mechanical troubles. The chassis was covered by a warranty that did not expire until two years after the sale to Taxpayer. Under the warranty, the seller was liable for repair and replacement due to mechanical troubles. Because of the seller's potential warranty liability, the seller and Taxpayer agreed that Taxpayer would not sell the chassis until the expiration of the warranty. Taxpayer modified the chassis into a motorcoach. Taxpayer sold the motorcoach at the end of the two-year period agreed to by Taxpayer and the seller.

During the period between Taxpayer's purchase of the chassis and Taxpayer's sale of the motorcoach, Taxpayer placed the motorcoach in Taxpayer's sales lot for viewing and inspection by customers, but did not list the motorcoach for sale.

Taxpayer maintains that the chassis was purchased for resale. Due to Taxpayer's internal accounting procedures, Taxpayer treated the motorcoach as a capitalized asset and took depreciation deductions for the motorcoach on Taxpayer's income tax returns. Taxpayer further capitalized other expenses, including labor, in the value of the motorcoach. Upon audit, the Department determined that the motorcoach was not used by Taxpayer for resale in the ordinary course of Taxpayer's business, and assessed use tax on the full value of the motorcoach (i.e., the purchase price of the chassis and any parts or labor added to the chassis in the conversion of the chassis into a motorcoach). The issue is whether a resale exemption applies to the chassis/motorcoach.

Taxpayer's contention is that the chassis was purchased for resale. Taxpayer maintains that Taxpayer's intent was to sell the chassis/motorcoach to its customers, even though Taxpayer agreed to wait two years to sell

the motorcoach. The issue is whether Taxpayer used the motorcoach for use other than for resale.

Taxpayer cites IC § 6-2.5-5-8 for the proposition that its purchase and conversion of the chassis was exempt from sales tax because the chassis was purchased for resale Under IC § 6-2.5-5-8 (effective January 1, 2004):

- (a) As used in this section, "new motor vehicle" has the meaning set forth in [IC 9-13-2-111](#).
- (b) Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.
- (c) The following transactions involving a new motor vehicle are exempt from the state gross retail tax:
 - (1) A transaction in which a person that has a franchise in effect at the time of the transaction for the vehicle trade name, trade or service mark, or related characteristics acquires a new motor vehicle for resale, rental, or leasing in the ordinary course of the person's business.
 - (2) A transaction in which a person that is a franchisee appointed by a manufacturer or converter manufacturer licensed under [IC 9-23](#) acquires a new motor vehicle that has at least one (1) trade name, service mark, or related characteristic as a result of modification or further manufacture by the manufacturer or converter manufacturer for resale, rental, or leasing in the ordinary course of the person's business.
 - (3) A transaction in which a person acquires a new motor vehicle for rental or leasing in the ordinary course of the person's business.
- (d) The rental or leasing of accommodations to a promoter by a political subdivision (including a capital improvement board) or the state fair commission is not exempt from the state gross retail tax, if the rental or leasing of the property by the promoter is exempt under [IC 6-2.5-4-4](#).

Under IC § 6-2.5-3-2, a use tax is imposed on the tangible personal property purchased in a retail transaction. IC § 6-2.5-3-4(a)(2) provides that the sales tax exemptions provided under IC § 6-2.5-5 (except IC § 6-2.5-5-24(b)) also apply to use tax. IC § 6-2.5-3-4(b) provides that property purchased for an exempt purpose that is subsequently used for a non-exempt purpose is subject to use tax when the property is used for the non-exempt purpose.

Taxpayer's capitalization of the chassis indicated that Taxpayer used the chassis as a capital asset rather than as inventory during its period of ownership, notwithstanding its subsequent sale of the chassis. By treating—and thus using—the chassis as a capital asset rather than as inventory in its accounting records, Taxpayer used the property for a purpose other than resale. Therefore, the exemption for property purchased for resale was not applicable to Taxpayer's use of the chassis.

If the chassis was not exempt from use tax, Taxpayer argues that only the value of the chassis and associated materials used to convert the chassis into a motorcoach should be subject to use tax. Taxpayer asserts that the capitalized value of the motorcoach included labor expenses that are not subject to use tax. The issue is the amount—the purchase price of the chassis and the materials incorporated into the motorcoach or the full capitalized value of the chassis—that is subject to use tax.

Under IC § 6-2.5-3-2, use tax is imposed on the value of tangible personal property purchased in a retail transaction. The value of the tangible personal property is the price that Taxpayer paid to purchase the chassis, as well as other personal property added to the motorcoach in order to convert the chassis into the motorcoach—no more and no less. To the extent that the value of the motorcoach included labor charges, Taxpayer's protest is sustained. However, the determination that the added labor charges is subject to audit review of the amount of labor charges added to the capitalized value of the motorcoach.

FINDING

Taxpayer's protest is denied with respect to the resale exemption for the chassis/motorcoach. Taxpayer's protest is sustained with respect to the labor charges that Taxpayer added to the capitalized value of the motorcoach, subject to audit verification.

II. Tax Administration—Negligence Penalty

The Department may impose a ten percent negligence penalty. IC § 6-8.1-10-2.1 and [45 IAC 15-11-2](#). Taxpayer's failure to timely file income tax returns, generally, will result in penalty assessment. IC § 6-8.1-10-2.1(a)(1). The Department, however, may waive this penalty if the taxpayer can establish that its failure to file "was due to reasonable cause and not due to negligence." [45 IAC 15-11-2\(c\)](#). A taxpayer may demonstrate reasonable cause by showing "that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. . . ." *Id.*

With respect to the penalty, Taxpayer has provided sufficient information to conclude that it acted with ordinary business care with respect to the issues in dispute in the current protest.

FINDING

Taxpayer's protest is sustained.