DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 08-0515
Sales and Use Tax
For 2004, 2005 and 2006

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ISSUES

I. Sales and Use Tax on Materials Incorporated Into Realty: Agreements Characterized as Lump Sum Contracts.

Authority: IC § 6-2.5-3-2; IC 6-8.1-5-1(c); 45 IAC 2.2-4-22(e); 45 IAC 2.2-4-26(a); Sales Tax Information Bulletin 60 (July 2006).

Taxpayer protests the Department's assessment of use tax on materials provided by an Indiana contractor as part of improvement to realty contracts. Taxpayer contends that the improvements were made under lump sum contracts, and thus, not subject to use tax.

II. Sales and Use Tax on Software License Agreement: Multiple Points of Use.

Authority: IC § 6-2.5-13-2 (repealed effective Jan. 1, 2008); IC § 6-2.5-3-2; IC § 6-2.5-1-27; IC § 6-2.5-4-10; 45 IAC 2.2-5-8(j).

Taxpayer protests the Department's assessment of use tax on software incorporated in Taxpayer's business operations. Taxpayer contends that the multiple points of use exemption applies.

III. Tax Administration: Penalty

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the proposed assessment of a ten (10) percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a manufacturer of recreational vehicles, with corporate headquarters and manufacturing facilities in Indiana. At various times, Taxpayer and a contractor entered into agreements for the improvement of the property and buildings at Taxpayer's manufacturing facilities. Before entering into each of four improvement contracts, the contractor provided an estimate of costs associated with materials, parts, and labor. The Department's audit of Taxpayer for the subject tax years determined that Taxpayer should have paid use tax on materials associated with these improvements to Taxpayer's facilities.

Taxpayer uses computer software to manage its electronic parts catalog, pricing, sales promotions, product recalls, and other items and aspects of its business. Taxpayer entered into a software license agreement that allowed Taxpayer to purchase a license for, and gain access for, use of pre-programmed software in Taxpayer's facilities. The license agreement entitles Taxpayer to new software releases, updates, and upgrades to licensed applications software. The Department's audit deemed the provision of this software as a single site license per entity and assessed use tax on the purchase of the software and license.

Taxpayer disagreed with the Department's assessment with respect to these items and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Sales and Use Tax on Materials Incorporated Into Realty: Agreements Characterized as Lump Sum Contracts.

Taxpayer contends that the subject agreements, entered into between itself and its contractor, constituted lump sum contracts for the improvement to realty. Therefore, Taxpayer asserts that these transactions are not subject to use tax. Taxpayer described its process for securing the subject improvements as a three-step process, found in many transactions of this type. First, the contractor inspected the facility and the specific area in need of improvement. That inspection led the contractor to make an estimate of costs based upon materials and labor. Secondly, Taxpayer issued a "purchase order" which Taxpayer alleges constitutes the initial and primary agreement between Taxpayer and contractor. Taxpayer alleges that the purchase order includes a single price specification that is intended as the unit price for the project and is intended to represent both the contractor's labor and material costs. And finally, once the contractor completes the work, the contractor issues an invoice. Taxpayer pays the contractor the amount shown on the invoice.

In the hearing, Taxpayer presented copies of documents corresponding to the above description. However, the Department notes that only one of the purchase orders fits Taxpayer's description; three of the purchase orders include separate amounts corresponding to materials, and to labor. In the hearing, Taxpayer also provided a copy of a communication from the contractor stating that all of the invoices that do not show sales tax were assumed quoted jobs. In that communication, the contractor also asserts that it "would have paid the tax owed on materials as a use tax."

Indiana imposes use tax on the addition of tangible personal property to a structure or facility, if, after the addition, the property becomes part of the real estate on which the structure or facility is located. IC § 6-2.5-3-2(c). However, the use tax does not apply in such a scenario if the sales or use tax had been previously imposed on the sale or use of that property. Id.

Under 45 IAC 2.2-4-22(e), "[w]ith respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when [the contractor] disposes of such property in the following manner: (1) [the contractor] converts the construction material into realty on land [the contractor] owns and then sells the improved real estate; (2) [the contractor] utilizes the construction material for [the contractor's] own benefit; or (3) lump sum contract. [The contractor] converts the construction material into realty on land [the contractor] does not own pursuant to a contract that includes all elements of cost in the total contract price." (Emphasis added). Accordingly, the contractor will either pay the gross retail tax when it initially purchases the construction materials or it will pay the gross retail tax in the form of use taxes when the materials are incorporated into the construction project. In lump sum contracts between the taxpayer and its contractor, the contractor bears responsibility for paying the tax on the construction materials. 45 IAC 2.2-4-26(a) provides that "[a] person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of the all material so used." See also Sales Tax Information Bulletin 60 (July 2006).

Sales Tax Information Bulletin 60 (July 2006), further provides that the fact that the seller subsequently furnishes information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material.

Taxpayer has failed to meet its burden of demonstrating that the subject contracts are lump sum contracts. Under 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." In regard to the four subject purchase orders, Taxpayer has set forth a bare assertion, unsupported by documentary evidence of the original agreements, that the purchase orders are lump sum contracts. Taxpayer has submitted secondary evidence, the subsequent communication dated almost two years after the purchase order dates, which purportedly gives evidence of the parties' intent to consummate lump sum agreements. However, that secondary evidence, standing alone, is insufficient to establish the nature of the original purchase order and is insufficient to rebut the presumption afforded under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

II. Sales and Use Tax on Software License Agreement: Multiple Points of Use.

Taxpayer allows both in-state and out-of-state customers to use its licensed software. Taxpayer argues that it should receive the benefit of the multiple points of use allocation exemption provided in IC § 6-2.5-13-2 (repealed effective Jan. 1, 2008) because it only has physical locations in Indiana. Taxpayer asserts that the ownership of the out-of-state locations or the relationship between the out-of-state customer and Taxpayer is not relevant to determine Taxpayer's eligibility for the multiple points of use exemption. Taxpayer thinks the application of the exemption reduces Taxpayer's use tax liability for the purchase of the software.

Indiana imposes a 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. IC § 6-2.5-3-2(a). Prewritten computer software falls within Indiana's definition of "tangible personal property." IC § 6-2.5-1-27. Combining the effect of both statutes, the Department believes that a license or lease agreement of computer software is tantamount to the renting or leasing of tangible personal property: each represents a taxable event. IC § 6-2.5-4-10(a).

45 IAC 2.2-5-8(j) provides that equipment "used in managerial sales, research and development... [is] subject to [use] tax." The provision applies to use of tangible personal property in "management and administration [and] selling and marketing[.]" Id.

The software license agreement provided by Taxpayer limits use of the applications software to Taxpayer's designated system. That designated system is located at Taxpayer's facility in Indiana. During the course of the protest, Taxpayer presented documentation listing the users of the software, as well as their respective locations. Those locations fall both within and outside of the State's borders. IC § 6-2.5-13-2 articulated the requirements necessary for taxpayers to realize a use tax exemption based upon multiple users of certain tangible personal property. Under IC § 6-2.5-13-2(a), a "business purchaser" which does not hold a direct pay permit with the State must present a "MPU exemption form" to a seller "in conjunction with its purchase." In fact, IC § 6-2.5-13-2(c) expanded on sourcing provisions pertaining to the Streamlined Sales Tax project, specifically applied to "[a] purchaser delivering the MPU exemption form" to the seller at the time of purchase.

However, during the course of the protest, Taxpayer, which does not, and did not hold, a direct payment permit, did not produce copies of any MPU exemption forms submitted to the seller at the time of Taxpayer's purchase of the software. Moreover, Taxpayer failed to present any evidence that, at the time of purchase,

showed Taxpayer disclosed its written intention to the seller to use the software at specific multiple locations. In response to the Department's request, Taxpayer did not provide documentation showing that any use tax was paid to other jurisdictions based upon use that was disclosed during the hearing.

Because Taxpayer did not present any MPU exemption forms to the seller at the time of Taxpayer's purchase of the software, nor present any evidence of written intent for multiple use at the time of purchase, Taxpayer cannot claim an exemption under IC § 6-2.5-13-2.

FINDING

Taxpayer's protest is respectfully denied.

III. Tax Administration: Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and ten (10) percent negligence penalties for the tax years in question. Taxpayer protests the imposition of the penalties. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

The Department refers to 45 IAC 15-11-2(b), which states:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), as follows:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. 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 this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
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> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has provided sufficient information to establish that its failure to pay the sales and use tax deficiencies was not due to Taxpayer's negligence, but was due to reasonable cause as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest to the imposition of the penalty is sustained.

CONCLUSION

Taxpayer failed to present sufficient evidence that its agreements with a contractor for improvements to its facilities were lump sum contracts affording a reduction in use tax liabilities. Taxpayer also could not provide documentation showing proper application of the multiple points of use exemption to overcome the Department's assessment of use tax in relation to its purchase of pre-written computer software. In summary, Taxpayer's protests of Issues I and II are denied, and Taxpayer's protest of Issue III is sustained.

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