

Letter of Findings Number: 08-0593
Sales and Use Tax
For Tax Years 2004-2006

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ISSUES

I. Sales Tax—Imposition.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-2-1; IC § 6-2.5-3-5; IC § 6-2.5-4-1; IC § 6-2.5-13-1; IC § 6-8.1-5-1; IC § 6-2.5-9-3; [45 IAC 2.2-1-1](#); [45 IAC 2.2-3-7](#); [45 IAC 2.2-4-21](#); [45 IAC 2.2-4-22](#); [45 IAC 2.2-4-23](#); [45 IAC 2.2-4-26](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Sales Tax Information Bulletin 60 (July 2006); Sales Tax Information Bulletin 60 (April 2004).

Taxpayer protests the assessment of sales tax.

II. Tax Administration—Negligence Penalty.

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

Taxpayer protests the imposition of a negligence penalty.

STATEMENT OF FACTS

Taxpayer is an out-of-state entity operating a security business. Taxpayer sells, delivers, and/or installs home and business surveillance equipment, burglar and fire alarm systems, card access systems, and security monitoring and surveillance systems (hereafter, collectively "security equipment") to customers in Indiana on a regular basis. Taxpayer's sale and installation of this security equipment for the security, surveillance, and access systems includes the sale of closed circuit televisions, DVRs, VCRs, computers, computer software, video cameras, and motion detectors. Taxpayer also sells security equipment accessories—i.e., access cards, card holders, card clips, and camera batteries—and performs repair services for the security equipment and systems. The security equipment and accessories are delivered to the customers' Indiana locations with installation services usually being provided by Taxpayer.

Taxpayer was selected for audit by the Indiana Department of Revenue ("Department"). At the time of the audit, Taxpayer was not registered as an Indiana retail merchant. After an audit, the Department determined that Taxpayer owed sales tax and assessed negligence penalties for the tax years 2004, 2005, and 2006. The Department's audit recognized that Taxpayer acted as a "contractor" making "lump sum improvements to realty" in some instances, and did not assess *[sic]* sales tax on those transactions. However, the Department's audit also found, and assessed sales tax on, several transactions where Taxpayer was selling security equipment and accessories to Indiana customers in retail transactions that are subject to Indiana sales tax. In addition, the Department's audit found, and assessed sales tax, on transactions where the Taxpayer sold and delivered tangible personal property to Indiana customers as a "time and materials" contractor. Taxpayer protested this imposition of the tax and penalties. An administrative hearing was held, and this Letter of Finding results.

I. Sales Tax—Imposition.

DISCUSSION

The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made. IC § 6-8.1-5-1(b), (c); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

The Department found that when Taxpayer sells security equipment and accessories to Indiana customers and delivers and/or installs the equipment for them in Indiana, Taxpayer is a "retail merchant" selling tangible personal property in a "retail transaction" that is subject to Indiana sales tax.

IC § 6-2.5-4-1(a)-(c) defines a "retail merchant" involved in "retail transactions," as follows:

- (a) A person is a retail merchant making a retail transaction when he engages in selling at retail.
- (b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:
 - (1) acquires tangible personal property for the purpose of resale; and
 - (2) transfers that property to another person for consideration.
- (c) For purposes of determining what constitutes selling at retail, it does not matter whether:
 - (1) the property is transferred in the same form as when it was acquired;
 - (2) the property is transferred alone or in conjunction with other property or services; or
 - (3) the property is transferred conditionally or otherwise.

Accordingly, a retail merchant performing retail transactions is a person who obtains and sells tangible personal property. Pursuant to IC § 6-2.5-2-1(a), retail transactions that are made in Indiana are subject to the state gross retail tax ("sales tax"). Moreover, "the retail merchant is required to collect the tax [due on the retail

transaction] as [an] agent for the state." IC § 6-2.5-2-1(b). Furthermore, the retail merchant "has a duty to remit Indiana [sales] or use taxes... to the department, [to] hold those taxes in trust for the state, and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state." IC § 6-2.5-9-3(2).

Therefore, Taxpayer, as a retail merchant, has a duty to collect and remit sales tax on its sales of tangible personal property. When Taxpayer fails to collect and hold the taxes in trust for the state, Taxpayer is personally liable for the sales tax, interest, and penalties due to the state for those sales. Since Taxpayer failed to collect the sales tax from its customers, the Department assessed sales tax liabilities on the Taxpayer.

Taxpayer asserts all of its sales transactions are lump sum contracts for the construction of an improvement to realty that are not subject to Indiana sales tax, but are subject to Indiana use tax. Taxpayer also maintains that since it paid Kentucky sales tax on all the materials at the time of purchase a use tax assessment would not be due to Indiana. Taxpayer cites to Sales Tax Information Bulletin 60 (July 2006) reference to "alarms," [45 IAC 2.2-4-23](#), and [45 IAC 2.2-4-26](#) to support its assertions.

A. Improvements to Realty.

The first issue to be determined is whether the transactions involving the security equipment are a retail merchant's sales of tangible personal property or a "contractor's" conversions of "construction materials" that are permanently affixed to real property as an improvement to realty. The Department has defined "construction materials" and "contractors" in its regulations at [45 IAC 2.2-3-7](#), which states, in relevant part:

(a) Contractors. For purposes of this regulation [[45 IAC 2.2](#)] "contractor" means any person engaged in converting construction material into realty. The term "contractor" refers to general or prime contractors, subcontractors, and specialty contractors, including but not limited to persons engaged in building, cement work, carpentry, plumbing, heating, electrical work, roofing, wrecking, excavating, plastering, tile and road construction.

(b) Construction material. For purposes of this regulation [[45 IAC 2.2](#)], "construction material" means any tangible personal property to be used for incorporation in or improvement of a facility or structure constituting or becoming part of the land on which such facility or structure is situated.

Since April of 2004, Sales Tax Information Bulletin 60 (April 2004) has included some guidance to taxpayers by stating a definition of construction materials and examples of improvements to real estate. In the April 2004 version, the definition of construction materials and the examples of improvements to real estate were in two separate sections. In 2006, Sales Tax Information Bulletin 60 (July 2006), was updated, and while the language of the definition of construction materials and the examples of improvements to real estate remained the same, they were put under the same section heading stating, as follows:

"Construction materials" means any tangible personal property intended for incorporation in or improvement to real property. Improvements include both new installations and repairs to existing improvements to real property.

Examples of improvements or repairs to real property are: doors, garage doors, garage door openers, windows, cabinets, garbage disposals, water heaters, water softeners, alarms, furnaces, central air conditioning units, gutters, carpeting and fencing.

Examples of items which are not improvements or repairs to real property are: personal computers, home stereos, televisions, refrigerators, stoves, dishwashers, garbage compactors, clothes washers and dryers and window air conditioning units.

However, the Department's audit did not assess sales or use tax stemming from Taxpayer's sale and installation of alarms as Taxpayer asserts. The Department's audit assessed sales tax on Taxpayer's sale and installation of security equipment and accessories. The security equipment, in question, includes Taxpayer's sale of closed circuit televisions, DVRs, VCRs, computers, computer software, video cameras, and motion detectors. The security accessories, in question, include Taxpayer's sale of access cards, card holders, card clips, and camera batteries. Other than the fact that the installation services provided for the security equipment, in certain instances, might be somewhat more complicated, the transactions in question are little different than the sale and installation of a stereo, washing machine, clothes dryer, or kitchen stove.

While the installation of the security equipment might include Taxpayer's use of materials, such as wiring, which could be classified as "improvements to realty," the tax issue raised in that instance does not relate to Taxpayer's obligation as a retail merchant to collect and remit sales tax from its Indiana customers on the sale of the security equipment and accessories, which do not themselves become improvements to realty. That tax issue relates to Taxpayer's own obligation, as a purchaser of tangible personal property (electrical wiring, etc.) it uses during installation. IC § 6-2.5-3-2. As a purchaser of materials, pursuant to [45 IAC 2.2-4-23](#), Taxpayer must pay sales tax to the retailer from whom it purchases the materials, or, if the sales tax was not paid at that point, then, pursuant to [45 IAC 2.2-4-22](#), Taxpayer must pay use tax to the state where these materials were consumed. The Department, however, did not assess sales or use tax relating to that activity. The Department assessed sales tax on Taxpayer's failure to collect and remit the sales tax on its sales of tangible personal property (security equipment and accessories) made in Indiana.

Therefore, Taxpayer's protest to the imposition of sales tax is denied.

B. Credit for Kentucky Sales Tax.

Alternatively, Taxpayer contends that it does not owe the Indiana sales tax because it paid Kentucky sales tax on the materials at the time of purchase. Taxpayer maintains that it deserves a credit for the Kentucky sales tax paid as provided in IC § 6-2.5-3-5.

IC § 6-2.5-3-5 provides for "a credit against the use tax imposed on the use, storage, or consumption of a particular item of tangible personal property equal to the amount, if any, of sales tax, purchase tax, or use tax paid to another state, territory, or possession of the United States for the acquisition of that property." (Emphasis added). However, IC § 6-2.5-3-5 does not apply to Taxpayer's situation. Taxpayer has not been assessed use tax on its use, but has been assessed sales tax.

Taxpayer sold tangible personal property and services to Indiana customers, which accepted delivery in Indiana. Pursuant to IC § 6-2.5-13-1(d)(2), Taxpayer's sales, which are accepted in Indiana, are completed here and are sourced to Indiana. Since the sales were completed here, the sales are Indiana retail transactions that are subject to the Indiana sales tax rather than the Kentucky sales tax. In this case, Taxpayer owes Indiana sales tax on its sales of the property on which it had improperly paid sales tax to Kentucky. Thus, Taxpayer does not receive a credit for the sales tax paid to Kentucky. Taxpayer remedies for the sales tax it improperly paid to Kentucky are with Kentucky.

Therefore, Taxpayer's protest of the Department's denial of use tax credits is denied.

C. Installation Services.

Taxpayer asserts that the Department assessed sales tax on a sales invoice charging for "installation only services" for the installation of a closed circuit television system, which the Indiana customer had previously purchased from another vendor. Taxpayer also maintains that it does not know how the Department arrived at the \$6,826.28 taxable sales charge. The line item in the audit details a taxable charge of \$6,826.28 out of the \$13,565.48 charged for the "system total." This segregated amount was provided to the Department by Taxpayer during the audit. As noted on page 8 of the audit report, Taxpayer supplied the Department with a breakdown of the amount of equipment that it sold to the customer with the installation services under the "system total," and the Department charged the sales tax on only the property. Therefore, the Department did not assess sales tax on the installation services.

However, the Department would like to note these total systems charges—where Taxpayer included the price of the equipment and the installation services under one price—constitute "a unitary transaction." Pursuant to IC § 6-2.5-1-1(a), a unitary transaction is a transaction that "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." Additionally, [45 IAC 2.2-1-1\(a\)](#) states:

For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

As explained by [45 IAC 2.2-1-1\(a\)](#), sales tax applies to the total combined charge in a unitary transaction irrespective of the fact that services which would not otherwise be taxable are included in the charge. Thus, the installation charges are excluded from "gross retail income" only when the charges are separately stated by the transferor of the tangible personal property. When the installation services are part of a unitary transaction, the charges are subject to Indiana sales tax. Consequently, Taxpayer is on notice that sales tax was due on the entire unitary transaction and, in the future, Taxpayer should charge sales tax accordingly.

Therefore, Taxpayer's protest to the imposition of sales tax is denied.

FINDING

In summary, Taxpayer's protests of subparts A, B, and C are denied.

II. Tax Administration—Negligence Penalty.**DISCUSSION**

The Department issued proposed assessments and ten 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, "[i]f a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

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.

Taxpayer has provided sufficient information to establish that its failure to pay the deficiency in this instance was not due to Taxpayer's negligence, but was due to reasonable cause as required by [45 IAC 15-11-2\(c\)](#). While Taxpayer's current circumstances show that Taxpayer acted with reasonable cause, Taxpayer should be on notice that should these circumstances arise again in the future penalty waiver would not be warranted.

FINDING

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

CONCLUSION

In summary, Taxpayer's protest to the imposition of tax is denied, but Taxpayer's protest to the imposition of penalty is sustained.

Posted: 05/27/2009 by Legislative Services Agency
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