DEPARTMENT OF STATE REVENUE

04-20080467.LOF

Letter of Findings: 08-0467
Sales Tax
For the Years 2005, 2006, 2007

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ISSUES

I. Sales Tax – Imposition – Installation Charges.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-8.1-5-1; 45 IAC 2.2-4-1; 45 IAC 2.2-4-2; Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Frame Station, Inc. vs. Indiana Dep't of Revenue, 771 N.E.2d 129 (Ind. Tax Ct. 2002).

II. Sales Tax – Imposition – Exemption Certificate.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-2-1; IC § 6-2.5-8-8; Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007)

III. Tax Administration – Imposition of Negligence Penalty.

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

The Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer fabricates and installs granite countertops, bathroom vanities, furniture pieces, and fireplace surrounds for both residential and commercial projects. Taxpayer has a showroom where customers make their granite selections. Taxpayer places orders for its customers' selections and once the orders arrive at Taxpayer's premises they are custom cut to the exact lengths and widths required for each particular customer. At this time cutouts for cook tops, sinks, electrical outlets, etc. are also made as necessary. All orders are custom made. Once altered to the exact measurements, the granite product is delivered to the customer's location installation-ready.

The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for the years 2005, 2006, and 2007. The Department's audit assessed additional sales tax against Taxpayer. Taxpayer protested the assessments. A hearing was held on Taxpayer's protest and this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales Tax – Imposition – Installation Charges.

DISCUSSION

The Department's audit assessed additional sales tax on labor provided by Taxpayer prior to the transfer and installation of the granite at its customers.

Taxpayer appears to make several arguments in protest of the assessment of sales tax on its pre-installation labor charges. First, in its July 14, 2008, protest letter, Taxpayer argues that its pre-installation labor charges are actually part of the installation process because the customer has already pre-paid for the product, the payments being non-refundable, and therefore the labor is not subject to sales tax:

> It should be noted that the purchaser assumes the burden of either taking accurate measurements for the Taxpayer's company to perform the custom cuts, or scheduling a representative from the Taxpayer's company to come to the job site to take the measurements. If for some reason those measurements change or are incorrect at the time of installation, the purchaser is liable for all costs. If for some reason the business is at fault for any incorrect measurements, it will not charge the purchaser any additional fees. As such, the Taxpayer argues that all modifications to the counter-tops are actually part of the installation process, and as such any labor done to the counter-tops is also part of installation.

Second, in the same letter, Taxpayer concludes, with little explanation, that it is not a retail merchant:

> Taxpayer submits that no sales tax should be made for 2005, 2006, or 2007 under 45 IAC 2.2-4-1. The business is not a retailer, and is not subject to its labor being taxed for the preparation of counter-tops.

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).

Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a). The person who acquires property in a retail transaction is liable for the tax on the transaction and, unless exempt, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. IC § 6-2.5-2-1(b) The retail merchant shall collect the tax as agent for the state. Id.

Based on the above, in order for sales tax to apply, there must be a retail transaction of tangible personal property.

IC § 6-2.5-1-2(a) defines a "retail transaction" to mean:

"Retail transaction" means a transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-1, that constitutes making a wholesale sale as described in IC 6-2.5-4-2, or that is described in any other section of IC 6-2.5-4.

IC § 6-2.5-4-1 describes what constitutes being a "retail merchant" and "selling at retail:"

(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.

(d) Notwithstanding subsection (b), a person is not selling at retail if he is making a wholesale sale as described in section 2 of this chapter.

45 IAC 2.2-4-1, the regulation Taxpayer cites, further describes "selling at retail:"

(a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant".

(b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:

(1) The price arrived at between purchaser and seller.

(2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.

(3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to transfer of such property at retail.

45 IAC 2.2-4-2:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail **unless**:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

(Emphasis added).

Based on the above, Taxpayer is a retail merchant transferring tangible personal property for consideration. Taxpayer is not in an occupation that primarily furnishes and sells services as distinguished from tangible personal property; the granite products are the primary product of Taxpayer's business. 45 IAC 2.2-4-2(a)(1). The granite that Taxpayer purchases is not simply used as a necessary incident to the service; quite the contrary, the service is a necessary incident of the acquisition of the granite product. 45 IAC 2.2-4-2(a)(2). Lastly, based on the sample invoices provided by Taxpayer, the price charged for the granite is not inconsequential (ten percent or less) as compared to the service charges; according to the invoices, the granite is at least 20 percent of the total cost.

The question, then, is what income received in Taxpayer's retail transactions are taxable?

IC § 6-2.5.4-1 further states in part the extent to which income received in a retail transaction is taxable:

(e) The gross retail income received from selling at retail is only taxable under this article to the extent that

the income represents:

(1) the price of the property transferred, without the rendition of any service; **and**

(2) except as provided in subsection (g**), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.**

For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.

(f) Notwithstanding subsection (e):

(1) in the case of retail sales of gasoline (as defined in IC 6-6-1.1-103) and special fuel (as defined in IC 6-6-2.5-22), the gross retail income received from selling at retail is the total sales price of the gasoline or special fuel minus the part of that price attributable to tax imposed under IC 6-6-1.1, IC 6-6-2.5, or Section 4041(a) or Section 4081 of the Internal Revenue Code; and

(2) in the case of retail sales of cigarettes (as defined in IC 6-7-1-2), the gross retail income received from selling at retail is the total sales price of the cigarettes including the tax imposed under IC 6-7-1.

(g) Gross retail income does not include income that represents charges for serving or delivering food and food ingredients furnished, prepared, or served for consumption at a location, or on equipment, provided by the retail merchant. However, the exclusion under this subsection only applies if the charges for the serving or delivery are stated separately from the price of the food and food ingredients when the purchaser pays the charges.

(Emphasis added).

Further, 45 IAC 2.2-4-1(b)(3) provides the amount of the retail transaction that is subject to tax includes the amounts collected for "services performed or work done on behalf of the seller prior to transfer of such property at retail." (Emphasis added).

In Frame Station, Inc. vs. Indiana Dep't of Revenue, 771 N.E.2d 129 (Ind. Tax Ct. 2002), the court held that when customers were charged separate amounts for labor and materials for custom framing services the labor charges were subject to sales tax. Id. at 131. In arriving at that decision, the court reasoned that the focus of analysis should be "whether [Taxpayers'] services were performed before or after it transferred property to its customers." Id. The court found that services that are performed prior to the transfer of the property are taxable, and services that are performed after the transfer of the property are taxable to the extent that the services represent a "unitary transaction" and are "inextricable and indivisible" from the property being transferred. Id.

For the sake of clarification of the above referenced case law, 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." IC § 6-2.5-1-1(a). Unitary sales, however, are not an issue in this protest, simply the court's emphasis that services performed prior to the transfer of tangible personal property are taxable.

In summary, when services are performed or work is done to tangible personal property before the tangible personal property is transferred to the purchaser, then the amount of charges for the services or work done is subject to sales tax. It does not matter whether these charges are separately stated or part of the unitary price of the transaction; though, clearly, if the pre-transfer services are separately stated they are subject to sales tax. This is the case according to the sample invoices Taxpayer provided. Services provided after the transfer of the tangible personal property are not subject to Indiana sales tax if such services are separately stated; i.e., not part a unitary contract. Indeed, the Department's audit did not subject Taxpayer's post-delivery installation services to sales tax.

The Department's audit correctly assessed sales tax on the pre-installation labor charges listed on Taxpayer's invoices.

FINDING

Taxpayer's protest is respectfully denied.

II. Sales Tax – Imposition – Exemption Certificate.

DISCUSSION

The Department assessed sales tax on sales to a particular unrelated retail merchant ("Unrelated"). Taxpayer protested that those sales were for resale by Unrelated and, at the time of the audit, provided Unrelated's retail merchant certificate.

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).

IC § 6-2.5-2-1 states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-8-8 states:

(a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

(b) The following are the only persons authorized to issue exemption certificates:

(1) retail merchants, wholesalers, and manufacturers, who are registered with the department under this chapter;

(2) organizations which are exempt from the state gross retail tax under IC 6-2.5-5-21, IC 6-2.5-5-25, or IC 6-2.5-5-26 and which are registered with the department under this chapter; and

(3) other persons who are exempt from the state gross retail tax with respect to any part of their purchases.

(Emphasis added).

After the hearing, Taxpayer provided an exemption certificate for Unrelated. Taxpayer has met its burden of proof to show that sales tax should not be assessed on its sales to Unrelated.

FINDING

Taxpayer's protest is sustained.

III. Tax Administration – Imposition of Negligence Penalty.

DISCUSSION

The Taxpayer also protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

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 standard for waiving the negligence penalty is given at 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:

(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.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

The Department conducted income tax, withholding tax, and sales and use tax audits of Taxpayer for the years in question. Taxpayer was found to be substantially in compliance with its tax reporting and remittance requirements. Taxpayer has reasonably shown that its non-payment of tax on its pre-installation labor charges was not due to negligence.

FINDING

Taxpayer's protest of the assessment of the negligence penalty is sustained.

CONCLUSION

Taxpayer's pre-installment labor charges are subject to sales tax – Issue I.

Taxpayer's sales to a particular unrelated third party are exempt – Issue II.

Taxpayer is not subject to the negligence penalty – Issue III.

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