

Letter of Findings: 09-0145
Sales and Use Tax
For the Years 2005, 2006, and 2007

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ISSUES

I. Sales & Use Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-8.1-5-1(c); [45 IAC 2.2-3-7](#); [45 IAC 2.2-3-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Sales Tax Information Bulletin 28S (February 2008); Sales Tax Information Bulletin 60 (July 2006).

Taxpayer protests the assessment of use tax on tangible personal property.

II. Tax Administration – Penalty.

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

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana mechanical construction contractor. Taxpayer charges its customers on either "lump sum" or "time and materials" basis. Pursuant to an audit, the Indiana Department of Revenue ("Department") concluded that Taxpayer should have self assessed and remitted use tax on consumable supplies, including tools, safety glasses, and gloves, and equipment, such as booms, cranes, and loaders, Taxpayer used to complete the construction projects. The Department assessed Taxpayer use tax, interest, and penalty. Taxpayer protests the assessments. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales & Use Tax – Imposition.

DISCUSSION

As a construction contractor, Taxpayer purchases certain items such as tools, safety glasses, and gloves, and rents equipment, such as booms, cranes, and loaders that it consumes or uses in the process of providing its services. The Department's audit noted that Taxpayer collected sales tax from its customers on the items. The Department's audit also noted that because Taxpayer consumed or used these items rather than transfer items to its customers, Taxpayer should have either paid sales tax when it acquired the consumables and rented the equipment, or self assessed and remitted use tax. Thus, the Department's audit assessed Taxpayer use tax, interest, and penalty on the items because Taxpayer did not pay sales tax when it acquired the items, nor did it self assess and remit the use tax.

Taxpayer stated that it had established a direct payment account with the Department, so Taxpayer did not pay sales tax when it purchased tangible personal property, such as consumables, or when it rented equipment to perform the construction projects. Instead, Taxpayer self assessed and remitted use tax on these purchases to the Department. Taxpayer stated that, for "time and materials" contracts, it was required to provide its customers invoices that stated the cost of labor and materials separately. Taxpayer explained that its customers put the invoices through an approval process before paying Taxpayer. To show that Taxpayer's charges truthfully reflected the cost of the materials, Taxpayer enclosed its suppliers' billing statements for the materials with the invoices it sent to its customers. Taxpayer explained that it needed to reflect the use tax it had paid on the invoices it sent to its customers in order to recoup the total cost of materials. Taxpayer stated:

When use tax is put on the [] invoice [the] customer sees [Taxpayer's] vendor invoice at a different amount than what is on the actual billing invoice from [Taxpayer] which makes [the] customer believe [Taxpayer is not] billing the correct amount (many customers do not understand the difference between sales and use tax and many do not understand use tax at all). For example, [Taxpayer's] vendor invoice is \$100 but [Taxpayer] put use tax on it of \$7, [Taxpayer's] billing invoice would show an invoice amount of \$107 but [the] customer sees a vendor invoice [Taxpayer] supplied as backup for only \$100. In order to show [the customers] in a more 'visual' way that [Taxpayer is] billing the \$100 invoice (and not trying to bill more than the vendor invoiced [Taxpayer]) [the customers] see the invoice listed at the vendor invoiced amount and then [Taxpayer] put a line for sales tax (the words 'sales tax' they understand) and [they] no longer have an issue.

Taxpayer further argued that, in any case, the Department received the tax as a result regardless of who paid for the items and the types of tax.

All tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal

property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq.

IC § 6-2.5-2-1 provides:

(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 § 6-2.5-3-2 provides:

(a) An excise tax, known as 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.

Accordingly, all sales of tangible personal property are taxable. An exemption from use tax is granted for transaction where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

[45 IAC 2.2-3-7](#)(c) states, "[m]achinery, tools, equipment and supplies used by a contractor to perform a construction contract are not construction materials." [45 IAC 2.2-3-12](#)(c) further states that "[u]tilities, machinery, tools, forms, supplies, equipment, or any other items used or consumed by the contractor and which do not become a part of the improvement to real estate are not exempt regardless of the exempt status of the person for whom the contract is performed."

Information Bulletin 60 for Sales Tax illustrates the construction contractors' tax responsibility. However, it does not address issues concerning consumable supplies. While Information Bulletin 28S for Sales Tax focuses on sales of motor vehicles and trailers, it does provide a useful guide to handle issues of consumable supplies. Information Bulletin 28S for Sales Tax, in pertinent part, provides:

IV. SHOP SUPPLIES CONSUMED BY A DEALER

Consumable supplies used by a [car] dealer, such as masking paper and tape, oil dry, sandpaper, buffing pads, rags and cleaning supplies, used to repair and service motor vehicles are not exempt purchases by the dealer. The dealer should pay sales tax upon these type purchases or remit use tax on the cost of these purchases on their sales tax returns. The purchaser (dealer) becomes the final consumer of such items because its customer does not become the owner of such consumable supplies. Although the dealer may charge the customer a fee for the dealer's consumption of these materials, such items are not being sold to the customer in a retail transaction and sales tax is not to be collected from the customer.

Sales Tax Information Bulletin 28S (February 2008).

Here, Taxpayer's documentation showed that Taxpayer first marked up the cost of the items (mark-ups), and then added sales tax on the total mark-ups to calculate the total amount Taxpayer should charge its customers for the materials used to complete the projects. According to Taxpayer's documentation, Taxpayer seemed to act as a retail merchant selling the items to its customers and the customers clearly paid the sales tax for the items which Taxpayer used or consumed to perform the jobs. While Taxpayer is certainly entitled to recoup whatever overhead cost it incurred to complete its construction projects, there has been no retail transaction for the items discussed above and, therefore, Taxpayer cannot collect sales tax on the consumables and rented equipment from the customers. Taxpayer, like the car dealer, cannot transfer its cost of these items to the customers in the form of sales tax or use tax because it is Taxpayer who purchased and consumed them, not the customers.

In conclusion, the consumable supplies and equipments were used by Taxpayer, and were not sold to the customers. The sales and/or use tax liability for materials consumed by Taxpayer cannot be transferred to the customers.

FINDING

Taxpayer's protest on the assessment of use tax is respectfully denied.

II. Tax Administration – Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a tax return;
- (2) fails to pay the full amount of tax shown on the tax return;
- (3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
- (4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

[45 IAC 15-11-2](#)(b) further 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\(c\)](#), in part, 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.

Taxpayer has provided sufficient documentation establishing that its failure to timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of negligence penalty is sustained.

SUMMARY

For the reasons discussed above, Taxpayer's protest on the imposition of use tax is respectfully denied. However, Taxpayer's protest on negligence penalty is sustained.

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