

Letter of Findings Number: 09-0052
Use Tax
For Tax Years 2005-07

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ISSUES

I. Use Tax—Building Materials.

Authority: Indiana Dep't of State Revenue v. Trump Indiana, Inc., 814 N.E.2d 1017 (Ind. 2004); Morton Buildings, Inc. v. Indiana Dep't of State Revenue, 819 N.E.2d 913 (Ind. Tax Ct. 2005); 26 U.S.C.A § 501; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-25; IC § 6-8.1-5-1; [45 IAC 2.2-3-15](#).

Taxpayer protests the assessment of use tax on building materials which it had purchased without paying 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 ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a not-for-profit business in the healthcare industry. In years prior to the investigation period, Taxpayer began construction of a healthcare facility and utilized its status as a not-for-profit organization throughout the construction process to purchase building materials, also referred to as tangible personal property ("TPP"), exempt from sales tax. In 2005, the project's architect deemed the healthcare facility to be substantially completed and the healthcare facility opened in 2005. On the same day in 2005, Taxpayer conveyed the building to a related non-exempt Limited Liability Company ("Related"). The Indiana Department of Revenue ("Department") conducted an investigation for the years 2005-2007 and determined that the construction and sale of the healthcare facility to a for-profit entity was not related to Taxpayer's non-profit purpose, which rendered the purchase of materials non-exempt. The Department therefore issued assessments for use tax, penalties, and interest. The Department did not impose use tax on the labor involved in constructing the healthcare facility. Taxpayer protested these assessments, arguing that the purchase of materials did fall under its exempt purpose and was therefore exempt. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Building Materials.

DISCUSSION

Taxpayer protests the imposition of use tax on materials upon which it did not pay sales tax at the time of purchase and which were then incorporated into a building. Taxpayer is a tax-exempt organization as provided by I.R.C. § 501(c)(3). The Department determined that Taxpayer did not use the building for its exempt purpose and therefore that the materials which went into the building were not used for Taxpayer's exempt purpose. Taxpayer presents several points of protest to the Department's determination. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom a proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The use tax is imposed under IC § 6-2.5-3-2, which states in relevant parts:

(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.

...

(c) The use tax is imposed on the addition of tangible personal property to a structure or facility, if, after its addition, the property becomes part of the real estate on which the structure or facility is located. However, the use tax does not apply to additions of tangible personal property described in this subsection, if:

- (1) the state gross retail or use tax has been previously imposed on the sale or use of that property; or
- (2) the ultimate purchaser or recipient of that property would have been exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

(d) The use tax is imposed on a person who:

- (1) manufactures, fabricates, or assembles tangible personal property from materials either within or outside Indiana; and
- (2) uses, stores, distributes, or consumes tangible personal property in Indiana.

(e) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:

- (1) the property is delivered into Indiana by or for the purchaser of the property;
- (2) the property is delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and
- (3) the property is subsequently transported out of state for use solely outside Indiana.....

Also IC § 6-2.5-3-4 states:

- (a) The storage, use, and consumption of tangible personal property in Indiana is exempt from the use tax if:
 - (1) the property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property; or
 - (2) the property was acquired in a transaction that is wholly or partially exempt from the state gross retail tax under any part of [IC 6-2.5-5](#), except [IC 6-2.5-5-24\(b\)](#), and the property is being used, stored, or consumed for the purpose for which it was exempted.
- (b) If a person issues a state gross retail or use tax exemption certificate for the acquisition of tangible personal property and subsequently uses, stores, or consumes that property for a nonexempt purpose, then the person shall pay the use tax.

Also relevant is IC § 6-2.5-5-25, which states:

- (a) Transactions involving tangible personal property or service are exempt from the state gross retail tax, if the person acquiring the property or service:
 - (1) is an organization described in section 21(b)(1) of this chapter;
 - (2) primarily uses the property or service to carry on or to raise money to carry on its not-for-profit purpose; and
 - (3) is not an organization operated predominantly for social purposes.
- (b) Transactions occurring after December 31, 1976, and involving tangible personal property or service are exempt from the state gross retail tax, if the person acquiring the property or service:
 - (1) is a fraternity, sorority, or student cooperative housing organization described in section 21(b)(1)(A) of this chapter; and
 - (2) uses the property or service to carry on its ordinary and usual activities and operations as a fraternity, sorority, or student cooperative housing organization.

Next, [45 IAC 2.2-3-15](#) states:

If any person who issues an exemption certificate in respect to the state gross retail tax or use tax and thereafter makes any use of the tangible personal property covered by such certificate, or in any way consumes, stores, or sells such tangible personal property, where such use, consumption, storage or sale is in a manner which is not permitted by such exemption, such use, consumption, or storage shall become subject to the use tax (or such sale shall become subject to the gross retail tax), and such person shall become liable for the tax or gross retail tax due thereon.

Finally, I.R.C. § 501(c)(3), as provided by 26 U.S.C.A § 501, states:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Taxpayer's first point of protest is that the Department, in its audit report, referred to Related as a for-profit entity. Taxpayer states that Related is a wholly-owned, pass-through entity and is not a for-profit entity. Also, Taxpayer states that Related's activities are in furtherance of Taxpayer's tax exempt purposes. Taxpayer believes that these circumstances comply with the requirement that the TPP which it purchased be used, stored, or consumed for the purposes for which it was exempted, as provided by IC § 6-2.5-3-4(a)(2).

The Department does not agree that selling the completed healthcare facility to a non-exempt entity satisfies IC § 6-2.5-3-4(a)(2). The TPP was purchased exempt from sales tax since Taxpayer itself is an exempt entity. The exempt purpose was for Taxpayer itself to provide healthcare services and facilities to the community. The exempt purpose was not for Taxpayer to provide healthcare facilities for sale to a non-exempt entity. Whether or not Related was a for-profit entity is not relevant. What is relevant is whether or not Related could have purchased the TPP exempt itself. Related was a non-exempt entity which could not have purchased the TPP to construct the healthcare facility without paying sales tax.

Taxpayer's next point of protest is that the sale of the completed healthcare facility raised money for it to carry on its exempt purpose. Taxpayer believes that the funds it realized from the sale of the healthcare facility aided its own operations and therefore qualify as an exempt purpose under IC § 6-2.5-5-25(a)(2). The Department does not agree with this position. As explained by IC § 6-2.5-5-25(a)(2), transactions involving TPP or service are exempt from the state gross retail tax, if the person acquiring the property or service primarily uses the

property or service to carry on or to raise money to carry on its not-for-profit purpose. In this case, Taxpayer's not-for-profit purpose is to provide healthcare services and facilities to the community, not to sell healthcare facilities to non-exempt entities. A review of the documentation shows that the fee Taxpayer collected was approximately fifty percent higher than the use tax at issue in this protest.

While the Department understands that Taxpayer created Related to operate the healthcare facility and that Taxpayer's exempt purpose is to provide healthcare services and facilities to the community, the Department cannot agree that IC § 6-2.5-5-25(a)(2) is satisfied by Taxpayer's collection of the fee on the sale of the healthcare facility. Again, the fee Taxpayer collected is approximately fifty percent higher than the use tax at issue in this protest. The audit period did not cover all years of construction. The fee is inconsequential when compared to the cost of building the healthcare facility. Clearly, the sale was not completed to raise money for Taxpayer's exempt purpose.

Taxpayer's next point of protest is that, at the time of the sale, the TPP upon which the Department is proposing use tax was no longer tangible personal property. Taxpayer states that the TPP had been converted into real property and that this conversion converted the TPP from its original character and gave it a new character, namely that of real property. Taxpayer refers to *Morton Buildings, Inc. v. Indiana Dep't of State Revenue*, 819 N.E.2d 913 (Ind. Tax Ct. 2004) in support of its position. In that case, the Indiana Tax Court determined that tangible personal property did have a different character when it underwent a construction process. Taxpayer states that it purchased TPP and, as in *Morton Buildings*, converted it into real property which gave the TPP a different character.

The Department finds no support for Taxpayer's position in *Morton Buildings*. That case has nothing to do with exemption certificates, exempt status, or exempt use of TPP. It is simply a use tax case in which the court determined that TPP could be transformed into something other than TPP and then addressed the use tax consequences of such a transformation. Of much more relevance is the Indiana Supreme Court's decision in *Indiana Dep't of State Revenue v. Trump Indiana, Inc.*, 814 N.E.2d 1017 (Ind. 2004), in which the court established that one piece of property may at one point in time be tangible personal property and at another point in time may be real property. The court also explained that both taxing methods may be valid and may both be imposed. In the instant case, the Department did not impose use tax on the transfer of the building. The Department imposed use tax on the purchase of the materials Taxpayer used to build the healthcare facility for a non-exempt purpose.

The only relevance of the transfer is that it resulted in Taxpayer building and selling a healthcare facility to Related rather than building and operating a healthcare facility itself. If Taxpayer had purchased the TPP exempt, built the healthcare facility and then operated the healthcare facility, that would have satisfied the exempt purpose language of IC § 6-2.5-5-25(a)(2). Taxpayer did not do so. As discussed above, Taxpayer's sale of a healthcare facility to an entity which would not have been able to purchase the TPP exempt does not satisfy the requirements of IC § 6-2.5-5-25(a)(2). Neither does Taxpayer's conversion of the TPP into real property satisfy those requirements.

Next, Taxpayer protests that there is no statute, regulation, or court case which establishes how long an exempt purchaser must use the TPP for an exempt purpose prior to a potential transfer in order to satisfy the requirements of IC § 6-2.5-3-4(a)(2). The Department acknowledges that specific guidelines on such timelines are not to be found. However, the Department notes that any requirement regarding time of use in an exempt manner must logically be more than "none", which is the length of time in which Taxpayer used the TPP in an exempt manner. Therefore, this point of protest is moot.

In conclusion, Taxpayer did not use the tangible personal property for its exempt purpose. Taxpayer built and sold a healthcare facility to Related. Related is not an exempt entity. Taxpayer did not operate the healthcare facility. Therefore, Taxpayer did not provide healthcare services and facilities to the community, which was its I.R.C. § 501(c)(3) exempt purpose. The Department did not base its use tax assessments on the sale of the healthcare facility, but rather based the assessments on the purchase of tangible personal property which Taxpayer did not use for an exempt purpose. As provided by [45 IAC 2.2-3-15](#), this subjects the purchases to use tax. Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax year in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) 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.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

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.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer is denied on Issue I regarding imposition of use tax. Taxpayer is denied on Issue II regarding imposition of negligence penalty.

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