

**Letter of Findings Number: 09-0430**  
**Sales and Use Tax**  
**For Tax Years 2006-2007**

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**ISSUES**

**I. Sales and Use Tax—Imposition.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-8; IC § 6-2.5-6-13; IC § 6-8.1-5-1; [45 IAC 2.2-3-7](#); [45 IAC 2.2-3-8](#); [45 IAC 2.2-3-12](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Brambles Industries, Inc. vs. Indiana Dep't of State Revenue, 892 N.E.2d 1287 (Ind. Tax Ct. 2008).

Taxpayer protests the assessment of use 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.

**III. Tax Administration – Interest.**

**Authority:** IC § 6-8.1-10-1.

Taxpayer protests the imposition of interest.

**STATEMENT OF FACTS**

Taxpayer is carpet and tile flooring contractor. Taxpayer sells the flooring both uninstalled and with installation services. Taxpayer uses subcontractors to complete installations and bills the customers for the flooring and installation. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional use tax and assessed tax, interest, and negligence penalties for the 2006 and 2007 tax years. The Department found that Taxpayer had purchased a variety of materials without either paying sales tax at the time of purchase or remitting use tax to the Department. The Department determined that the items purchased were consumed by Taxpayer during the installation of the carpet and tile flooring and were subject to use tax. Taxpayer protested this imposition of the tax, interest, and penalties. An administrative hearing was held, and this Letter of Finding results.

**I. Sales and Use Tax—Imposition.**

**DISCUSSION**

The Department found that Taxpayer had purchased a variety of materials without either paying sales tax at the time of purchase or remitting use tax to the Department. The Department determined that the items purchased were consumed by Taxpayer during the installation of the carpet and tile flooring and were subject to use tax.

Taxpayer agrees that certain of the items in the assessment are "consumable items," such as masking tape and utility blades, that are used during the installation process and are subject to use tax. However, Taxpayer asserts that the Department also assessed use tax on certain items that are not "consumable items," but are "construction materials" that are incorporated into the realty—i.e., tile glues, carpet glues, adhesives, and tile grout—and are purchased for resale to its customers. Taxpayer maintains that it purchased these materials for resale and as such the materials are not subject to use tax under IC § 6-2.5-5-8 ("the resale exemption"). Taxpayer claims that the "construction materials" were either separately stated on the sales invoice or were included in the amount that Taxpayer charged per tile or per square foot of carpet on the sales invoices. Taxpayer asserts that since it collected and remitted sales tax on these "construction materials" upon which the Department assessed use tax, the Department is attempting to collect the tax twice.

As a threshold issue, it is the taxpayer's responsibility to establish that the existing tax assessment is incorrect. 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(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-3-2(a). A complementary 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. IC § 6-2.5-3-2. An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

IC § 6-2.5-3-2(c)(1) provides, as follows:

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 the state gross retail or use tax has been previously imposed on the sale or use of that property.

The Department refers to [45 IAC 2.2-3-8](#), which states:

(a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.

(b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt (see 6-2.5-5 [[45 IAC 2.2-5](#)]).

The Department also refers to [45 IAC 2.2-3-7](#)(b), which states that "'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." [45 IAC 2.2-3-7](#)(c) further states, "Machinery, tools, equipment and supplies used by a contractor to perform a construction contract are not construction materials."

Accordingly, when a contractor purchases "construction materials" exempt the contractor must either charge sales tax to the customer in a retail transaction for the "construction materials" or remit use tax on the "construction materials" at the time of disposition of the materials. Thus, if the "construction materials" are neither sold to the customers in a retail transaction nor sales tax is collected, the contractor must remit use tax on the items. Additionally, for materials that are used or consumed in the provision of a construction service—i.e., "consumable items," the contractor must remit use tax on the items as the contractor is the final user of the materials and the items cannot be resold. A contractor must remit the use tax on these items even if the contractor invoices sales tax to its customers on the "consumable items," as this is done in error. Those customers would have the right to claim a refund of the sales taxes improperly paid. IC § 6-2.5-6-13.

As stated previously, Taxpayer maintains that the "construction materials" that are incorporated into the realty—i.e., tile glues, carpet glues, adhesives, and tile grout—are purchased for resale to its customers and are not subject to use tax. Taxpayer maintains that the "construction materials" were sold in retail transactions to its customers either as separately stated items on its sales invoice or in the amount invoiced per tile or per square foot of carpet on the sales invoices. During the hearing process, Taxpayer presented a number of invoices to demonstrate these materials were sold in retail transaction in which sales tax was collected and remitted.

As to Taxpayer's argument about the price of these materials being included in the price of the tile or carpet it sold, the Indiana Tax Court has addressed similar situations. In *Brambles Industries, Inc. vs. Indiana Dep't of State Revenue*, 892 N.E.2d 1287 (Ind. Tax Ct. 2008), where a manufacturer that was seeking the "resale exemption" under IC § 6-2.5-5-8 for pallets by maintaining that "the price of pallet was incorporated into the price of their products" was denied the exemption, the Tax Court explained, as follows:

Indiana Code § 6-2.5-5-8 exempts from tax "[t]ransactions involving tangible personal property... if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business [.]" Ind. Code Ann. § 6-2.5-5-8(b) (West 2001) (amended 2003). See also 45 Ind. Admin. Code 2.2-5-15(a) (2001). This Court has previously explained that in order to show entitlement to the sale for resale exemption, the taxpayer must demonstrate that it received itemized consideration for the item. See *Miles, Inc. v. Indiana Dep't of State Revenue*, 659 N.E.2d 1158, 1165 (Ind. Tax Ct.1995) (discount coupons inserted in boxes were not resold because customers did not pay itemized amount for them); *Indiana Bell Tel. Co. v. Indiana Dep't of State Revenue*, 627 N.E.2d 1386, 1389 (Ind. Tax Ct.1994) (telephone directories, the cost of which was built into customers' monthly bills, were not resold for purposes of the exemption because their cost was not itemized in the bills); *USAir, Inc. v. Indiana Dep't of State Revenue*, 542 N.E.2d 1033, 1035-36 (Ind. Tax Ct.1989) (holding that meals provided on airline's flights were not resold because there was nothing in the price of the ticket to reflect the price of the food). "Moreover, separate bargaining must occur between the customer and the taxpayer for the exchange of that particular item." *Miles*, 659 N.E.2d at 1165. See also *Greensburg Motel Assocs. v. Indiana Dep't of State Revenue*, 629 N.E.2d 1302, 1305-06 (Ind. Tax Ct.1994) (holding that consumable and non-consumable items provided in hotel guest rooms were not resold because the hotel's customers did not bargain for those items).

Id. at 1289-90.

Accordingly, for items to be sold in a retail transaction, the items must be listed separately on the invoices—i.e., the grout separate from the tile and the glue separate from the carpet. Therefore, to the extent that the documentation Taxpayer provided demonstrates that only one price was charged for tile or carpet, Taxpayer's protest is denied.

On the other hand, several of the sales invoices Taxpayer provided do show detail of grout, glues, and adhesives that were separately stated from the carpet and tile sold. As discussed above items such as glue, adhesive, and grout, which become part of the structure/realty, are "construction materials." Taxpayer's purchases of these "construction materials" would not be subject to use tax to the extent that Taxpayer's invoices reflect that sales tax was collected and remitted on the separately stated "construction materials" that were sold in

retail transactions. Therefore, Taxpayer's protest to the imposition of use tax is sustained in part to the extent that the invoices provided by Taxpayer demonstrate that use tax has been assessed on items that were sold in retail transactions in which sales tax was collected and remitted. Thus, the audit division is requested to review the invoices and make whatever adjustments it deems appropriate.

**FINDING**

Taxpayer's protest to the imposition of use tax is denied in part and sustained in part to the extent that the Audit Division's review determines that Taxpayer's invoices demonstrate that Taxpayer resold "construction materials" in retail transactions in which sales tax was collected and remitted.

**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.

**III. Tax Administration – Interest.**

**DISCUSSION**

The Department assessed interest on the tax liabilities. Taxpayer protests the imposition of interest.

IC § 6-8.1-10-1(a) provides, as follows:

If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on the person's return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

Pursuant to IC § 6-8.1-10-1(e), the Department does not have the authority to waive the interest. Therefore, Taxpayer's protest is denied.

**FINDING**

Taxpayer's protest to the imposition of interest is respectfully denied.

**CONCLUSION**

Taxpayer's protest to the imposition of tax is denied in part and sustained in part subject to the results of a review by the audit division as discussed in Issue I. Taxpayer's protest to the imposition of penalty is sustained as discussed in Issue II. Taxpayer's protest to the imposition of interest is denied as discussed in Issue III.

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