

Letter of Findings Number: 09-0732
Use Tax
For Tax Years 2006-08

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ISSUES

I. Use Tax—Imposition.

Authority: IC § 6-2.5-3-2; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); [45 IAC 2.2-4-21](#); [45 IAC 2.2-4-22](#); [45 IAC 2.2-4-23](#).

Taxpayer protests the imposition of use tax on amounts paid to contractors.

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 corporation in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on certain improvements to its buildings. The Department determined that these were time and materials contracts and that sales tax should have been paid on the tangible personal property ("TPP") involved. The Department therefore issued proposed assessments for use tax, negligence penalties, and interest. Taxpayer protested the imposition of use tax on purchases from two contractors. Taxpayer also protests the imposition of negligence penalties. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Imposition.

DISCUSSION

Taxpayer protests the imposition of use tax on contracts it had for building improvements for the tax years 2006-08. Specifically, Taxpayer protests that two contractors operated either under lump sum contracts and paid sales tax at the time they purchased the materials which were used in the course of construction or under time and materials contracts and paid sales tax at the time it purchased the TPP. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the 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(a), which states:

(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.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Also of relevance is [45 IAC 2.2-4-21](#), 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 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](#)]).

(Emphasis added).

Also, [45 IAC 2.2-4-22](#) states:

(a) A contractor may purchase construction material exempt from the state gross retail tax only if he issues either an exemption certificate or a direct pay certificate to the seller at the time of purchase.

(b) A contractor, who purchases construction material exempt from the state gross retail tax or otherwise acquires construction material "tax-free", is accountable to the Department of Revenue for the state gross retail tax when he disposes of such property unless the ultimate recipient could have purchased it exempt (see 6-2.5-5 [[45 IAC 2.2-5](#)]).

(c) A contractor has the burden of proof to establish exempt sale or use when construction material, which was acquired "taxfree", is not subject to either the state gross retail tax or use tax upon disposition.

(d) Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

- (1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax); or
- (2) Construction material sold over-the-counter. Over the counter sales of construction materials will be treated as exempt from the state gross retail tax only if the contractor receives a valid exemption certificate issued by the person for whom the construction is being performed or by the customer who purchases over-the-counter, or a direct pay permit issued by the customer who purchases over-the-counter.
- (e) Disposition subject to the use tax. With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:
- (1) He converts the construction material into realty on land he owns and then sells the improved real estate;
- (2) He utilizes the construction material for his own benefit; or
- (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

A disposition under C. [subsection (e)(3) of this section] will be exempt from the use tax if the contractor received a valid exemption certificate from the ultimate purchaser (purchaser) or recipient of the construction material (as converted), provided such person could have initially purchased such property exempt from the state gross retail tax.

(Emphasis added).

Finally, [45 IAC 2.2-4-23](#) states:

A contractor has no further liability for either the state gross retail tax or use tax with respect to construction material acquired by the contractor in a taxable transaction, provided the contractor disposes of such property in the following manner:

- (1) He converts the construction materials into realty on land he owns and then sells the improved real estate;
- (2) He utilizes the construction material for his own benefit and does not resell or transfer such property to others; or
- (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

(Emphasis added).

Therefore, TPP supplied in the course of construction is taxable to either the contractor or the contractor's client if the contractor does not pay sales tax on the TPP and if the client is not exempt. A review of the documentation supplied in the protest process shows that one of the contractors did use lump sum contracts for the jobs in question and that the sales tax was paid by the contractor at the time of purchase. Taxpayer supplied documentation establishing that the other contractor operated under time and materials contracts, but also paid sales tax at the time it purchased the TPP. Since the contractors paid sales tax at the time they purchased the TPP, the amounts paid to the two protested contractors will be removed from the Department's use tax calculations.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years 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 affirmatively established that its failure to pay the remaining deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#). The negligence penalty will be waived.

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer's protest is sustained on Issue I regarding imposition of use tax on amounts paid to the two protested contractors. Taxpayer's protest is sustained on Issue II regarding imposition of negligence penalties.

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