

Letter of Findings: 09-0626
Sales and Use Tax
For the Years 2006, 2007, 2008

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ISSUES

I. Use Tax – Imposition.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-3-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; [45 IAC 2.2-3-9](#); Sales and Use Tax Information Bulletin 60 (July 2006); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of use tax on some items.

II. Tax Administration – Negligence Penalty.

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

Taxpayer protests the assessment of negligence penalty.

STATEMENT OF FACTS

Taxpayer, an Indiana S corporation in business since 2005, is predominantly a mechanical contractor that performs plumbing and HVAC work. Taxpayer performs all types of construction work from manufacturing equipment relocation to pipe installation to concrete work. In some instances, Taxpayer acts as a general contractor and subcontracts out some of the work. Taxpayer performs both lump sum and time and materials jobs.

Pursuant to a sales and tax audit of the years 2006, 2007, and 2008, the Indiana Department of Revenue ("Department") assessed additional sales and use tax, as well as penalty and interest. Taxpayer protested the assessment of use tax relating to one particular job at a car manufacturer's Indiana plant. A hearing was held on Taxpayer's protest and this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Use Tax – Imposition.

DISCUSSION

The Department's audit found that certain materials Taxpayer purchased were used in lump sum jobs and no sales tax was paid at the time of the purchase, nor use tax upon use of the materials. Taxpayer protests the assessment of use tax relating to one job in particular (with partial designation in the audit summary as "Job 07-477"). In 2007, Taxpayer performed a lump sum job for a manufacturer that entailed building loading docks, heaters and doors at the manufacturer's plant in Indiana.

Taxpayer explained that purchase orders for the project were issued by the general contractor, an engineering firm, that then billed the manufacturer on a lump sum basis for the project. Taxpayer performed the project on a tax-exempt basis in accordance with the bid specifications and documents issued by the engineering firm. At the time of the audit, Taxpayer did not have exemption certificates from either the engineering firm nor from the manufacturer. After the audit concluded, Taxpayer obtained what it described as "job specific" ST-105s from the engineering firm (dated June 2, 2009), as well as, a copy of the manufacturer's direct pay permit. Taxpayer argues that this should suffice to show that it was not under an obligation to remit sales/use tax on these materials.

The Department notes that all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. 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).

In accordance with IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on Indiana retail transactions unless a valid exemption is applicable. IC § 6-2.5-4-1 provides that a retail transaction involves the transfer of tangible personal property. Indiana imposes a use tax on tangible personal property stored, used, or consumed in Indiana when no sales tax was paid at the time of purchase. IC § 6-2.5-3-2.

Taxpayer first argues that it performed this project based on the contractual terms it had with the engineering firm which stipulated tax-free purchases of materials. Taxpayer has not referred to any statute, regulation, or court case which would allow it to contract away a statutory obligation to pay or collect tax.

[45 IAC 2.2-3-9](#) states procedure when tax is not paid on construction materials when purchased by a contractor:

(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.

- (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 materials 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 materials 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.
- (f) A disposition under C. [subsection (e)(3) of this section] will be exempt from the use tax only if the contractor received a valid exemption certificate, not a direct pay permit, from the ultimate 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).

Accordingly, based on the above, Taxpayer will either pay the supplier gross retail tax "up-front" when he initially purchases the construction materials or he will self-assess the gross retail tax in the form of use tax when the materials are incorporated into the construction project. Either up-front or at the point where the materials are incorporated into realty, in lump sum contracts between the supplier and its contractors, it is Taxpayer, the contractor, who is ultimately responsible for paying the tax on the construction materials, unless Taxpayer can show that he either acquired or disposed of the property subject to exemption as evidenced by an exemption certificate. The 2009 date of the exemption certificate in this case is problematic since the work on the project at issue was done in 2007. Therefore, at the time of the project, Taxpayer did not have a valid exemption certificate.

There is also the issue of an exemption certificate stating as a reason for exemption another entity's direct pay permit, as is the case here. Sales and Use Tax Information Bulletin 60 (July 2006) states that a lump sum contractor must issue its own exemption certificates (p. 4). It also states that a construction contractor may not accept a direct pay permit in lieu of an exemption certificate (p. 4). This would suggest that an exemption certificate cannot state that the direct pay permit is the reason for exemption. This conclusion is also supported by [45 IAC 2.2-3-9\(f\)](#) which also distinguishes between an "exemption certificate" and a "direct pay permit" and along with [45 IAC 2.2-3-9\(e\)](#), precludes a lump sum contractor from relying on a "direct pay exemption certificate" to avoid paying use tax on the materials used in the project.

Taxpayer also provided a letter from the manufacturer, dated February 10, 2010, stating that it, the manufacturer, had a direct pay permit from the Department and that the manufacturer "believed this Direct Pay Permit was given to the General Contractor, [the engineering firm], on this project. Any services you [Taxpayer] performed for them as subcontractor should have been handled between [Taxpayer] and [engineering firm]. Since [manufacturer] is the end user, we would have asked for the labor and materials to be separately stated on the bid and invoice so that we only accrued and paid sales tax on the materials of the project." This letter, however, does not establish anything other than the manufacturer's usual procedure. For the purpose of this protest, however, it does not specify payment of use tax on the very materials at issue.

As a subcontractor on this project, Taxpayer was in a difficult position, however, the application of the law as stated above clearly shows that absent a valid exemption certificate from either the engineering firm or the manufacturer, Taxpayer was obligated to either pay sales tax upon purchase of the materials, or remit use tax upon use of the materials. The Department's audit correctly adjusted for use tax on this project.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – 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.

Taxpayer has affirmatively established, as required by [45 IAC 15-11-2\(c\)](#), that its failure to pay sales tax or use tax on its purchases was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest is respectfully denied.

CONCLUSION

Taxpayer protest of the adjustment for use tax on "Job 07-477" is denied.

Taxpayer's protest of the negligence penalty is sustained.

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