

Letter of Findings: 10-0096
Gross Retail Tax
For the Years 2007 and 2008

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ISSUES

I. Gross Retail Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-8.1-5-1; [45 IAC 2.2-4-1](#); [45 IAC 2.2-4-2](#); Frame Station, Inc. v. Indiana Dep't of State Revenue, 771 N.E.2d 129 (Ind. Tax Ct. 2002); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of the Gross Retail (sales) Tax on design and labor charges which it performed in creating a mascot or costume.

II. Tax Administration – Negligence 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, an Indiana company, designs and makes custom mascots and costumes for sport teams, corporations, special events, fundraisers, and parades. Pursuant to an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer failed to collect sales tax on design and labor charges which it performed in creating a mascot or costume ("design and labor charges"). The Department's audit also determined that Taxpayer failed to collect sales tax on "shipping and handling charges" as well as on "rentals of the costumes." As a result, the Department's audit assessed Taxpayer additional sales tax, interest, and penalty.

In addition to penalty, Taxpayer protests the imposition of sales tax on design and labor charges. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Gross Retail Tax – Imposition.

DISCUSSION

The Department's audit determined that Taxpayer failed to collect sales tax on design and labor charges. Taxpayer, to the contrary, asserted that the design and labor charges were charges for non-taxable services.

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.

[45 IAC 2.2-4-1](#) further explains:

- (a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant".
- (b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:
 - (1) The price arrived at between purchaser and seller.
 - (2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.
 - (3) **No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to transfer of such property at retail. (Emphasis added).**

[45 IAC 2.2-4-2](#), in relevant part, states:

- (a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge; and
- (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

In this instance, referring to [45 IAC 2.2-4-2\(a\)](#), Taxpayer maintained that the design and labor charges were for services which it rendered on creating the custom mascots and costumes. Additionally, Taxpayer provided two sample invoices and claimed that the materials which it charged were inconsequential (less than ten percent) compared with the design and labor charges.

Upon reviewing Taxpayer's sample invoices, however, one of Taxpayer's sample invoices contradicted what Taxpayer had claimed. The invoice itself actually stated the material charge was more than ten percent compared with the design and labor charges. Additionally, Taxpayer did not provide any documentation demonstrating that it has met all of the four requirements outlined in [45 IAC 2.2-4-2\(a\)](#).

Furthermore, Taxpayer's assertion is similar to the one offered by the taxpayer in *Frame Station, Inc. v. Indiana Dep't of State Revenue*, 771 N.E.2d 129 (Ind. Tax Ct. 2002). In *Frame Station*, the taxpayer, Framemakers, provided custom framing services. *Id.* at 130. Specifically, Framemakers framed its customers' art in frames that it built or special ordered. *Id.* Framemakers, when it billed its customers, "record[ed] separate subtotals on the invoices: one for the service of framing the art and the other for the frame itself." *Id.* Framemakers collected sales tax only on the price of the frame itself, not on the price for framing the art. *Id.* The court concluded that Framemakers' services were performed prior to the transfer of the property and constituted taxable retail unitary transactions pursuant to IC § 6-2.5-4-1(e). *Id.* at 131. Therefore, the court, ruling in favor of the Department, determined that Framemakers' service charges were subject to sales tax. *Id.*

IC § 6-2.5-4-1(e), in pertinent part, states:

The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:

- (1) the price of the property transferred, without the rendition of any service; and
- (2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.

For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.

In this instance, Taxpayer, like the taxpayer in *Frame Station*, provided custom services of making mascots and costumes. Similarly, Taxpayer recorded separate subtotals on the invoices, one for the service of making custom mascots and/or costumes and the other for the material itself when Taxpayer billed its customers. Taxpayer also collected sales tax only on the price of the materials, not on the price for making custom mascots and costumes. Taxpayer's services were performed prior to the transfer of the property (i.e., custom mascots and costumes) and, therefore, constitute taxable unitary transactions pursuant to *Frame Station*.

In short, Taxpayer failed to meet its burden demonstrating that the assessment is not correct.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protests the assessment 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 did not provide sufficient documentation establishing that its failure to timely remit tax held in trust was due to reasonable cause and not due to negligence.

FINDING

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

SUMMARY

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

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