

Letter of Findings: 04-20100064
Sales and Use Tax
For the Years 2005, 2006, and 2007

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ISSUES

I. Sales and Use Tax – Imposition – Environmental Quality Control Exemption.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-3-4; IC § 6-2.5-5-30; IC § 6-8.1-5-1; [45 IAC 2.2-4-1](#); [45 IAC 2.2-5-8](#); [45 IAC 2.2-5-70](#); [326 IAC 20-1-1](#) et seq.; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer protests the imposition of use tax on its purchases of tangible personal property.

II. Sales and Use Tax – Imposition – Lump Sum Contracts.

Authority: IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); [45 IAC 2.2-4-1](#); [45 IAC 2.2-4-21](#); [45 IAC 2.2-4-22](#); [45 IAC 2.2-4-23](#); [45 IAC 2.2-4-26](#); [50 IAC 4.2-4-10](#); Sales Tax Information Bulletin 60 (July 2006).

Taxpayer protests the imposition of use tax on its purchases of tangible personal property.

III. 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 is an out-of-state refiner and manufacturer of metal. Taxpayer operates a smelting facility in Indiana which processes and refines metal products. Pursuant to an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer did not pay sales tax or did not self-assess and remit the use tax to the Department on its purchases. As a result, the Department's audit assessed additional use tax, interest, and penalty.

Taxpayer protests the imposition of use tax and negligence penalty. Specifically, Taxpayer claimed that it purchased several items to comply with the federal and state environmental quality control requirements and should be exempt from sales/use tax. Taxpayer also claimed that some of the purchases related to lump sum contracts for improvements to realty. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition – Environmental Quality Control Exemptions.

DISCUSSION

The Department's audit assessed use tax on three items: (1) a Plenum Baghouse Conveyor, (2) a Dust Collection Fan, and (3) an IPC 5300 DV Analytical Spectrograph. Taxpayer protests that those purchases were used to comply with the federal and state environmental quality control requirements and, thus, those purchases were exempt from sales/use tax.

As a threshold issue, 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. Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). An exemption from 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. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974).

IC § 6-2.5-5-30 provides:

Sales of tangible personal property are exempt from the state gross retail tax if:

- (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure **predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and**
- (2) **the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.**

The portion of the sales price of tangible personal property which is exempt from state gross retail and use

taxes under this section equals the product of: (A) the total sales price; multiplied by (B) one hundred percent (100 [percent]). **(Emphasis added).**

[45 IAC 2.2-5-70](#), in relevant part, further states:

(a) The state gross retail tax does not apply to sales of tangible personal property which constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure **predominately used and acquired for the purpose of complying with any state, local or federal environmental quality [sic] statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.**

(b) Definitions. (1) Consumed as used in this regulation [\[45 IAC 2.2\]](#) means the dissipation or expenditure by combustion, use or application, and does not mean or include the obsolescence, discarding, disuse, depreciation, damage, wear or breakage of tools, machinery, devices or furnishings.

(2) Incorporated as used in this regulation [\[45 IAC 2.2\]](#) means the material must be physically combined into and become a component of the environmental quality device, facility, or structure. The material must constitute [sic] a material or integral part of the finished product. **(Emphasis added).**

To support its protest, Taxpayer submitted additional documentation and photos depicting the Plenum Baghouse Conveyor, the Dust Collection Fan, and the IPC 5300 DV Analytical Spectrograph. Referring to the federal regulations of the National Emission Standards for Hazardous Air Pollutants and Indiana regulations outlined in [326 IAC 20-1-1](#) et seq., Taxpayer maintains that these items were used to comply with the federal and state environmental quality control requirements. Thus, Taxpayer asserts that it was entitled to the exemption afforded in IC § 6-2.5-5-30 and [45 IAC 2.2-5-70](#) on the above three (3) purchases.

Taxpayer's documentation demonstrates that the Plenum Baghouse Conveyor is a component of the baghouse hazardous waste filtering system and the baghouse hazardous waste filtering system was one of essential requirements for the local environmental agency to grant Taxpayer a permit to operate its facility in Indiana. Thus, Taxpayer has provided sufficient documentation demonstrating that it purchased and used the Plenum Baghouse Conveyor to comply with the requirements outlined in the provisions of [326 IAC 20-1-1](#) et seq.

Taxpayer, however, does not provide sufficient documentation demonstrating that the Dust Collection Fan (used for maintenance in the welding area) and the IPC 5300 DV Analytical Spectrograph were acquired to be used to comply with the federal and state environmental quality control requirements.

In short, Taxpayer's protest is sustained in part and denied in part. Taxpayer's purchase of the Plenum Baghouse Conveyor is exempt, but the remaining items are not. The Department will recalculate Taxpayer's liability in a supplemental audit.

FINDING

Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest of the Plenum Baghouse Conveyor is sustained. Taxpayer's protest of the Dust Collection Fan and the IPC 5300 DV Analytical Spectrograph, however, is respectfully denied. The Department will recalculate Taxpayer's liability in a supplemental audit.

II. Sales and Use Tax – Imposition – Lump Sum Contracts.

DISCUSSION

The Department's audit assessed use tax on several transactions on which Taxpayer did not pay sales tax at the time of the retail transactions. Taxpayer maintains that it engaged several contractors, on a lump sum basis, to perform work which Taxpayer considered improvements to realty. Thus, Taxpayer asserts that it was not responsible for sales/use tax on these lump sum contracts. Alternatively, Taxpayer claims that some of the transactions were "time and materials" contracts, and that it has obtained separate charges for materials and labor concerning those "time and materials" contracts. Taxpayer, thus, argues that the Department's audit erroneously assessed the use tax on the total charge of the transactions because it is only responsible for the tax on the materials and not the labor charge.

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:

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.

[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.

IC § 6-2.5-4-1, in relevant part, states:

A person is a retail merchant making a retail transaction when he engages in selling at retail.

(b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:

(1) acquires tangible personal property for the purpose of resale; and

(2) transfers that property to another person for consideration.

(c) For purposes of determining what constitutes selling at retail, it does not matter whether:

(1) the property is transferred in the same form as when it was acquired;

(2) the property is transferred alone or in conjunction with other property or services; or

(3) the property is transferred conditionally or otherwise. (Emphasis added).

[45 IAC 2.2-4-1](#) 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.

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).**

[45 IAC 2.2-4-22](#) explains:

(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 "tax-free", 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).**

[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).**

Finally, [45 IAC 2.2-4-26](#) further provides:

(a) A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used.

(b) A person selling tangible personal property to be used as an improvement to real estate may enter into a completely [sic] separate contract to furnish the labor to install or construct such improvement, in which case the sales tax shall be collected and remitted by such seller on the materials sold for this purpose. **Such sales of materials must be identifiable as a separate transaction from the contract for labor. The fact that the seller subsequently furnished information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material.**

(c) Tangible personal property purchased to become a part of an improvement to real estate under a contract with an organization entitled to exemption is eligible for exemption when purchased by the contractor.

(d) In order to be exempt on such purchases the contractor must be registered as a retail merchant and must obtain an exemption certificate from the exempt organization, and must issue an exemption certificate to his supplier.

(e) Utilities, **machinery, tools, forms, supplies, equipment or any other items used by or consumed by the contractor and which do not become a part of the improvement to real estate are not exempt regardless of the exempt status of the person for whom the contract is performed. (Emphasis added).**

Accordingly, the fact that tangible personal property was incorporated into real property does not relieve a taxpayer of its obligation to pay sales or use tax. [45 IAC 2.2-4-21](#)(a). A contractor may convert tangible personal property into realty under a "lump sum contract" or under a "time and materials contract" pursuant to [45 IAC 2.2-4-22](#) and [45 IAC 2.2-4-23](#). Sales Tax Information Bulletin 60 (July 2006), 20060823 Ind. Reg. 045060287NRA, defines a "lump sum contract" as "a contract in which all of charges are quoted as a single price. A construction contractor may furnish a breakdown of the charges for labor, material and other items without changing the nature of the lump sum contract." A "time and materials contract" is defined as "a contract in which all charges for labor, construction materials and other items are separately stated." Id.

Based on the above, if a taxpayer's contract involves an improvement to realty and the contractor's charge is based on a lump sum contract between the taxpayer and its contractor, the contractor bears responsibility for paying the tax on the construction materials. In a time and materials contract between a taxpayer and its contractor, the contractor acts as a retail merchant and sales or use tax is due from the taxpayer on the cost of the materials.

A review of the documentation supplied in the protest process shows that ten (10) of Taxpayer's transactions were with contractors that used "lump sum contracts" for the jobs in question and that Taxpayer did not claim and provide exemption certificates to those contractors. The following ten (10) transactions thus are qualified as "lump sum" contracts and Taxpayer is not responsible for sales/use tax:

| Date | Reference | Item Descriptions | Amount |
|------------|-----------|--------------------------------|--------------|
| 1/17/2005 | 6794 | Lunchroom HVAC 7.5 ton | \$ 7,928.15 |
| 7/15/2005 | 10045 | Condenser 6 ton HVAC SRF | \$ 6,827.15 |
| 1/28/2005 | 253703 | Gutters for Shipping dock | \$ 17,950.00 |
| 3/30/2006 | 2982 | Laundry hot water heater | \$ 13,980.00 |
| 12/13/2006 | 50033943 | Wrecker dock coating materials | \$ 34,000.00 |
| 6/9/2006 | xxx | Concrete floor top SRF Ramp | \$ 68,244.00 |
| 6/15/2007 | 4558 | Epoxy floor materials | \$ 38,300.00 |
| 5/14/2007 | 25286 | Asphalt Work materials | \$146,261.00 |
| 4/24/2007 | po75311 | Shower floor coating materials | \$ 3,774.00 |
| 10/15/2007 | 4692-98 | Tank coating materials | \$139,066.00 |

For other transactions that are not listed above, Taxpayer's documentation demonstrates that either the contractors operated under "time and materials contracts" or the transactions were not improvements of realty.

When the transactions are not improvements to realty, the transactions are subject to sales/use tax under general rules of sales/use tax law. In this instance, Taxpayer's documentation showed that several transactions were related to purchases of dock levelers, dust collection fan, surveillance cameras, and digital recorders.

Pursuant to [50 IAC 4.2-4-10](#), dock levelers and dust catchers are tangible personal property. Thus, they are not improvements of realty, and are subject to sales/use tax. Additionally, cameras and recorders are mobile items and are not fixtures incorporated as improvements to real property. Taxpayer could remove or sell the items if it so chooses. Thus, surveillance cameras and digital recorders are also tangible personal property pursuant to [50 IAC 4.2-4-10](#). Thus, pursuant to [45 IAC 2.2-4-1](#), Taxpayer's purchases were retail transactions subject to sales/use tax. Since Taxpayer did not pay sales tax at the time of the purchases, the use tax is properly imposed.

When the contractors operate under "time and materials contracts" and the contractors separate the charge of labor and the charge of materials, only the charge of materials (including equipment rentals) is subject sales/use tax. Taxpayer's documentation established that one of the contractors separated its charge of materials (windows and doors) from its charge of labor. Thus, the materials, i.e., windows and doors, are subject to sales/use tax. As for the remaining transactions, however, Taxpayer does not provide sufficient documentation establishing that the contractors separated the charges in the contracts. When the contractors did not separate the charges, the transactions were considered unitary. Since Taxpayer did not pay sales tax at the time of the purchases, the use tax is properly imposed.

In short, Taxpayer's protest of the above ten (10) transactions considered "lump sum" contracts is sustained. Taxpayer's protest to the imposition of use tax on these other transactions, which are not included in the list, is respectfully denied.

FINDING

Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest of the imposition of use tax is sustained on the ten (10) transactions listed above. Taxpayer's protest to the imposition of use tax is denied for the remaining transactions. The Department will recalculate Taxpayer's liability in a supplemental audit.

III. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

[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.

The Department is not able to agree that Taxpayer's failure to pay tax or timely remit tax 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 is sustained in part and denied in part.

For Issue I, Taxpayer's protest of the Plenum Baghouse Conveyor is sustained. Taxpayer's protest of the Dust Collection Fan and the IPC 5300 DV Analytical Spectrograph, however, is respectfully denied.

For Issue II, Taxpayer's protest is also sustained in part and denied in part. Taxpayer's protest to the imposition of use tax is sustained on the ten (10) transactions listed above. Taxpayer's protest of the remaining transactions is respectfully denied.

For Issue III, Taxpayer's protest on the imposition of the negligence penalty is also respectfully denied.

The Department will recalculate Taxpayer's liability in a supplemental audit.

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