

Letter of Findings Number: 04-20100711
Sales and Use Tax
For Tax Years 2007-2009

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ISSUE

I. Sales and Use Tax—Exemptions.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-3-7; IC § 6-2.5-4-1; IC § 6-2.5-5-7; IC § 6-2.5-8-8; IC § 6-2.5-5-12; IC § 6-8.1-5-1; [45 IAC 2.2-3-7](#); [45 IAC 2.2-3-8](#); [45 IAC 2.2-3-9](#); [45 IAC 2.2-4-22](#); [45 IAC 2.2-5-8](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Gross Income Tax Division v. National Bank and Trust Co., 79 N.E.2d 651 (Ind. 1948); Sales Tax Information Bulletin 60 (July 2006) 20060823 Ind. Reg. 045060287NRA; Uniform System of Accounts, available on Indiana State Government website, <http://www.in.gov/sboa/files/SPCDST23_2006.pdf> (visited March 21, 2011).

Taxpayer protests the assessment of use tax.

STATEMENT OF FACTS

Taxpayer is a contractor that performs water well repairs and rehabilitations. Taxpayer also drills elevator shafts. As the result of an audit for tax years 2007, 2008, and 2009 ("Tax Years"), the Indiana Department of Revenue ("Department") assessed use tax on various chemicals and tools utilized by taxpayer during the Tax Years. Taxpayer protests the assessments on the grounds that certain items qualify for an exemption from tax. Further facts will be supplied as required.

I. Sales and Use Tax—Exemptions.

DISCUSSION

All tax assessments are prima facie evidence that the Department's claim for the 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).

Taxpayer protests the assessment of use tax on chemicals used in taxpayer's well rehabilitation work. When taxpayer purchased the chemicals, taxpayer did not pay sales tax. Taxpayer asserts that it purchases, and then sells the chemicals to customers either on a time and material basis or as part of a contracted amount. Taxpayer also asserts that taxpayer performs most of its well repair and rehabilitation work for public utility companies and other municipalities. When taxpayer rehabilitated a well for a for-profit entity, taxpayer charged the customer sales tax on the time and material jobs, or paid use tax on contracted jobs. Taxpayer argues that its consumption of chemicals used on the work performed for municipalities should extinguish taxpayer's obligation to collect sales tax for chemicals used on those jobs.

Indiana imposes sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a). Indiana imposes a complementary use tax on the storage, use or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction as defined for sales tax purposes. IC § 6-2.5-3-2(a). A "retail transaction" is defined as the transfer of tangible personal property for consideration by a retail merchant. IC § 6-2.5-4-1(b). The tax statutes have provisions exempting specific transactions and/or specific purchasers from taxation. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., 79 N.E.2d 651, 653 (Ind. 1948).

IC § 6-2.5-3-4 provides an exemption from use tax on the storage, use, and consumption of tangible personal property if "the property was acquired in a transaction that is wholly or partially exempt from the state gross retail tax under any part of [IC 6-2.5-5](#), except [IC 6-2.5-5-24](#)(b), and the property is being used, stored, or consumed for the purpose for which it was exempted."

Taxpayer contends that it should enjoy an exemption from use tax with respect to chemicals that Taxpayer consumed while performing well repair or rehabilitation services for municipal, or public utility customers. Taxpayer argues that those customers provided exemption certificates or were in fact using the property sold by taxpayer for exempt purposes.

Taxpayer's drilling and excavation work falls under work performed by a "contractor," as defined in [45 IAC 2.2-3-7](#):

The term "contractor" refers to general or prime contractors, subcontractors, and specialty contractors, including but not limited to persons engaged in building, cement work, carpentry, plumbing, heating, electrical work, roofing, wrecking, excavating, plastering, tile and road construction.

The same Code section defines "construction material" as "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 is situated." [45 IAC 2.2-3-7\(b\)](#). Further, "[m]achinery, tools, equipment and supplies used by a contractor to perform a construction contract are not construction materials." [45 IAC 2.2-3-7\(c\)](#).

[45 IAC 2.2-3-8](#) provides that:

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.

A review of [45 IAC 2.2-3-9](#) also proves useful in this analysis:

(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 tax-free, is not subject to either the state gross retail 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 material 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 [subsection (e)(3)] 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.)**

With respect to municipalities or public utilities, IC § 6-2.5-5-7 provides that transactions involving tangible personal property are exempt from sales tax if those transactions satisfy four elements:

(1) the person acquiring the property is in the construction business;

(2) the person acquiring the property acquires it for incorporation as a material or integral part of a public street or of a public water, sewage, or other utility service;

(3) the public street or public utility service into which the property is to be incorporated is required under a subdivision plat, approved and accepted by the appropriate Indiana political subdivision; and

(4) the public street or public utility is to be publicly maintained after its completion.

Taxpayer did not present any evidence during the audit or during the hearing to show that taxpayer's customers incorporated the chemicals as "a material or integral part of a... public water, sewage, or other utility service." On the contrary, when taxpayer provided well repair or rehabilitation services for a customer, taxpayer did not leave any of the chemicals with its customers; taxpayer did not transfer the chemicals to its customers.

Under IC § 6-2.5-5-12, a public water utility could enjoy an exemption from sales tax on transactions involving tangible personal property if:

(1) the property is classified as source of supply plant and expenses, the pumping plant and expenses, or water treatment plant and expenses according to the uniform system of accounts which was adopted and prescribed for the utility by the Indiana utility regulatory commission; and

(2) the person acquiring the property is a public utility that furnishes or sells water in a retail transaction described in [IC 6-2.5-4-5](#).

Chapter 23 of the Uniform System of Accounts includes a classification for "chemicals" under both operation and maintenance expense accounts. Uniform System of Accounts, available on Indiana State Government website, <http://www.in.gov/sboa/files/SPCDST23_2006.pdf> (last visited March 21, 2011). Thus, application of

the aforementioned statutory provisions would allow the public water utility, as the purchaser, to claim an exemption from sales tax on the acquisition of chemicals used in the operation or maintenance of the water utility.

The Department further refers to IC § 6-2.5-3-7(b), which states:

A retail merchant is not required to produce evidence of nontaxability under subsection (a) if the retail merchant receives from the person who acquired the property an exemption certificate which certifies, in the form prescribed by the department, that the acquisition is exempt from the use tax.

The Department also refers IC § 6-2.5-8-8, which states:

(a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

(b) The following are the only persons authorized to issue exemption certificates:

(1) retail merchants, wholesalers, and manufacturers, who are registered with the department under this chapter;

(2) organizations which are exempt from the state gross retail tax under [IC 6-2.5-5-21](#), [IC 6-2.5-5-25](#), or [IC 6-2.5-5-26](#) and which are registered with the department under this chapter; and

(3) other persons who are exempt from the state gross retail tax with respect to any part of their purchases.

(c) The department may also allow a person to issue a blanket exemption certificate to cover exempt purchases over a stated period of time. The department may impose conditions on the use of the blanket exemption certificate and restrictions on the kind or category of purchases that are exempt.

A customer's exempt status does not extend to the construction contractor. Sales Tax Information Bulletin 60 (July 2006) 20060823 Ind. Reg. 045060287NRA. The statutory definition of "construction materials" does not include the chemicals consumed by the taxpayer. When taxpayer provided well repair or rehabilitation services for a customer, taxpayer did not leave any of the chemicals with its customers; taxpayer did not transfer the chemicals to its customers. The customers did not acquire nor use the chemicals. Therefore, the exemption from sales or use tax enjoyed by customers via valid exemption certificates or status as a municipality, city, or public utility does not extend to customers' purchase of chemicals consumed by taxpayer, because that transaction is not exempt from sales or use taxes. As stated in the audit, taxpayer used the chemicals as supplies or tools to carry out its well repair and rehabilitation services. A construction contractor's purchase of machinery, tools, equipment and supplies is subject to sales and/or use tax at the time of purchase.

As a purchaser of materials, pursuant to [45 IAC 2.2-4-22](#), Taxpayer must pay sales tax to the retailer from whom it purchases the materials, or, if the sales tax was not paid in that transaction, then Taxpayer must pay use tax to the state where taxpayer consumes these materials.

In conclusion, taxpayer acted as a service provider, supplying chemicals to assist in the performance of its repair and rehabilitation services. Whether taxpayer uses the chemicals to perform a service for an exempt entity, such as a public water utility, does not matter. Taxpayer did not present evidence or explanations sufficient to overcome the Department's assessment of use tax on the chemicals that taxpayer used to perform its services.

FINDING

Taxpayer's protest is respectfully denied.

Posted: 05/25/2011 by Legislative Services Agency

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