

Letter of Findings Number: 04-20110020
Sales Tax
For the Years 2007-2009

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ISSUES

I. Sales Tax—Contractors.

Authority: IC § 6-8.1-5-1; [45 IAC 2.2-3-9](#); [45 IAC 2.2-3-10](#); [45 IAC 2.2-4-22](#); [45 IAC 2.2-4-23](#).

Taxpayer protests the Department's assessment of sales tax on its construction contracts.

II. Sales Tax—Deposits.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1 to -17; IC § 6-8.1-5-1.

Taxpayer protests the imposition of sales tax on certain deposits and rentals.

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 a corporation doing business in Indiana. Taxpayer sells merchandise at its stores. A portion of the merchandise it sells consists of construction materials and other items that are incorporated into real estate.

Whenever a customer wishes to have Taxpayer's products constructed by Taxpayer, Taxpayer hires third-party agents to perform the actual installation. Taxpayer entered into contracts with its customers for the tangible personal property and installation of the property.

Taxpayer treated these contracts as lump sum contracts for sales and use tax purposes. Thus, Taxpayer self-assessed use tax on the tangible personal property specified the contract and did not charge its customers sales tax on the tangible personal property. The use tax was remitted based on Taxpayer's purchase price of the tangible personal property.

The Indiana Department of Revenue ("Department") disagreed with Taxpayer's characterization of its construction contracts as "lump sum" contracts. Instead, the Department characterized the contracts as "time and materials" contracts.

Because the Department characterized the contracts as time and materials contracts, Taxpayer was a retail merchant with regard to the tangible personal property portion of the contracts and, according to the Department, should have assessed sales tax on the retail value of the materials sold. The Department assessed sales tax based on Taxpayer's contracts, while permitting an offset for the use tax previously remitted by Taxpayer. Taxpayer protested this portion of the assessment. However, Taxpayer acknowledged at hearing that, to the extent the tangible personal property was not incorporated in real property (e.g., appliances), these sales of tangible personal property were subject to sales tax.

In addition, the Department also assessed sales tax on various "deposits" for equipment and other items. Taxpayer also protested this portion of the assessment. Additional facts will be supplied as necessary.

I. Sales Tax—Contractors.

DISCUSSION

Taxpayer protests the assessment of additional sales tax on various items used in fulfillment of construction contracts. The issue is whether Taxpayer's contracts are lump sum contracts or time and materials contracts.

Under IC § 6-8.1-5-1(c):

If the person has a surety bond guaranteeing payment of the tax for which the proposed assessment is made, the department shall furnish a copy of the proposed assessment to the surety. The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

A "lump sum" contract is a contract for which all necessary materials and labor are performed for one specified price. In a lump sum contract, the customer is not charged sales tax; however, the construction contractor generally must pay sales tax or self-assess use tax on its purchase price for the materials. [45 IAC 2.2-3-9\(e\)\(3\)](#); [45 IAC 2.2-3-10\(3\)](#); [45 IAC 2.2-4-22\(d\)\(3\)](#); [45 IAC 2.2-4-23\(3\)](#). Thus, if B enters into a lump sum contract with C for \$10,000, B is not a retail merchant on this transaction and does not collect sales tax. However, if B pays A \$4,000 for materials incorporated in C's real property, B must pay sales tax or self-assess use tax on the \$4,000 unless C could have purchased the materials directly without incurring sales and use tax.

A "time and materials" contract is a contract in which the materials and labor are sold for separately quoted prices. Using the transaction described above, if B and C entered in a contract for a \$10,000 total price, with

\$4,500 for materials and \$5,500 for labor, B is treated as a retail merchant selling the materials to C and must collect sales tax on the \$4,500 in materials. However, when B purchases the materials for \$4,000 from A, B can purchase the materials exempt because B is treated as a reseller. [45 IAC 2.2-3-9\(d\)\(1\)](#); [45 IAC 2.2-4-22\(d\)\(1\)](#). However, the fact that an invoice provides a separate listing for materials and labor does not necessarily result in a contract being a time and materials contract. [45 IAC 2.2-3-12\(e\)](#).

Taxpayer provided copies of several contracts. In reviewing the contracts provided, the invoices distinguish material charges and labor charges. The material charges roughly equal the retail price of the listed materials per Taxpayer's website without sales or use tax. Further, whereas a lump sum contract does not provide for a specific quantity of tangible personal property, Taxpayer's contract provide for specific quantities of tangible personal property. Taxpayer's business is selling tangible personal property at retail. The portion of the contract that is most visible to the customer—pages one and two—are written in a readily readable typeface. That portion of the contract distinguishes material and labor prices. However, the portion relied upon by Taxpayer to establish that the contract is a lump sum contract is pages three and five, consisting of boilerplate language written in approximately six or seven-point font. As a result, the customer reasonably would view the contract as a time and materials contract. Thus, Taxpayer is a time and materials contractor, and its protest is denied.

FINDING

Taxpayer's protest is denied.

II. Sales Tax—Deposits.

DISCUSSION

Taxpayer also protests the imposition of sales tax on various deposits. For instance, if a customer asks to review overnight a sample book of carpet or paint, the customer is required to pay a deposit to Taxpayer for that book. Upon return of the book, the customer's deposit is refunded. The issue is whether the deposit is subject to sales tax.

Under IC § 6-8.1-5-1(c):

If the person has a surety bond guaranteeing payment of the tax for which the proposed assessment is made, the department shall furnish a copy of the proposed assessment to the surety. The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

IC § 6-2.5-2-1(a) imposes Indiana sales tax on "retail transactions made in Indiana." IC § 6-2.5-1-2(a) defines a retail transaction as "a transaction of a retail merchant that constitutes selling at retail as described in [IC 6-2.5-4-1](#), that constitutes making a wholesale sale as described in [IC 6-2.5-4-2](#), or that is described in any other section of [IC 6-2.5-4](#)."

IC §§ 6-2.5-4-1 to -17 define various transactions as retail transactions. However, for each set of transactions is a common thread—the transfer of property or other taxable item for consideration. With regard to the customer's deposits, Taxpayer is ultimately not receiving any consideration when the relevant is returned. Thus, with regard to deposits that are reimbursed to customers, Taxpayer's protest is sustained on the amount of the deposits returned to customers.

However, in some cases, the customer does not return the item to Taxpayer. For these transactions, the deposit is now payment for the lost tangible personal property, and thus sales tax is due on these deposits because the transaction is for the transfer of tangible personal property for consideration.

Further, for some items, a customer is allowed to use the item for a specified period for no charge. However, if the customer uses the item for longer than a specified period, the customer is charged an additional amount based on the excess usage. Taxpayer states that it collects sales tax on these transactions.

While the Department is prepared to agree with Taxpayer on these issues, the adjustments necessary to the Department assessment are subject to audit review and verification.

FINDING

Taxpayer's protest is sustained on deposits repaid to customers and denied on deposits not repaid to customers.

III. Tax Administration—Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of the ten percent negligence penalty on the use tax imposed as a result of the Department's audit.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, [45 IAC 15-11-2](#) further provides:

(b) "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.

(c) 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.

For the protested items, Taxpayer has assumed a reasonable position on its construction contracts. Even though the Department disagrees with Taxpayer's treatment of the construction contracts, Taxpayer acted reasonably for the tax periods in this protest. However, Taxpayer is on notice that the Department may not waive penalties in future periods.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's protest is denied on the construction contracts found to be subject to sales tax. Taxpayer's protest is sustained in part and denied in part without regard to its deposits and its equipment rentals, subject to audit verification. Taxpayer's protest is sustained regarding the penalty assessment.

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