

Letter of Findings Number: 04-20100716
Sales Tax
For Tax Years 2007-09

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ISSUE

I. Sales Tax–Audit Methodology.

Authority: IC § 6-2.5-1-5; IC § 6-2.5-2-1; IC § 6-2.5-3-7; IC § 6-8.1-5-1; [45 IAC 2.2-8-12](#).

Taxpayer protests the methodology used in an audit.

STATEMENT OF FACTS

Taxpayer is an Indiana retail merchant. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not charged sales tax on the full amount of taxable transactions. The Department therefore issued proposed assessments for uncollected and unremitted sales tax and interest for the tax years 2007, 2008, and 2009. Taxpayer protests that the Department's audit methodology was not accurate and that the total of the taxable transactions was not as high as the Department determined. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax–Audit Methodology.

DISCUSSION

Taxpayer protests that the Department over-estimated the amount of Taxpayer's taxable transactions for the tax years 2007-09. The Department used a projection method to determine Taxpayer's overall sales and compliance percentage for the years at issue. Those calculations resulted in the determination that Taxpayer had not collected and remitted sales tax on the total amount of its transactions with its customers. Specifically, the Department determined that Taxpayer had not collected and remitted sales tax on freight charges and on sales where the customer was treated as tax-exempt, but for whom no exemption certificate was retained. Taxpayer protests that the Department's projection method did not take into account instances where it potentially over-collected sales tax.

Also, Taxpayer protests that the projection method included labor charges which were charged by Taxpayer to its customers when the customers required service agreement work on the equipment in question. Taxpayer is not protesting the imposition of sales tax on the sales of the service agreements themselves. Rather, the labor rates are established in the service agreements and then separately charged on an hourly basis. Taxpayer is protesting that those labor charges are not subject to sales tax and should not have been included in the sample and projection method. 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 sales tax is imposed under IC § 6-2.5-2-1, which states:

- (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.

Next, IC § 6-2.5-1-5 provides:

- (a) Except as provided in subsection (b), "gross retail income" means the total amount of consideration, including cash, credit, property, and services, for which tangible personal property is sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for:
 - (1) the seller's cost of the property sold;
 - (2) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
 - (3) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
 - (4) delivery charges; or
 - (5) consideration received by the seller from a third party if:
 - (A) the seller actually receives consideration from a party other than the purchaser and the consideration is directly related to a price reduction or discount on the sale;
 - (B) the seller has an obligation to pass the price reduction or discount through to the purchaser;
 - (C) the amount of the consideration attributable to the sale is fixed and determinable by the seller at the time of the sale of the item to the purchaser; and
 - (D) the price reduction or discount is identified as a third party price reduction or discount on the invoice received by the purchaser or on a coupon, certificate, or other documentation presented by the

purchaser.

For purposes of subdivision (4), delivery charges are charges by the seller for preparation and delivery of the property to a location designated by the purchaser of property, including but not limited to transportation, shipping, postage, handling, crating, and packing.

- (b) "Gross retail income" does not include that part of the gross receipts attributable to:
- (1) the value of any tangible personal property received in a like kind exchange in the retail transaction, if the value of the property given in exchange is separately stated on the invoice, bill of sale, or similar document given to the purchaser;
 - (2) the receipts received in a retail transaction which constitute interest, finance charges, or insurance premiums on either a promissory note or an installment sales contract;
 - (3) discounts, including cash, terms, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale;
 - (4) interest, financing, and carrying charges from credit extended on the sale of personal property if the amount is separately stated on the invoice, bill of sale, or similar document given to the purchaser;
 - (5) any taxes legally imposed directly on the consumer that are separately stated on the invoice, bill of sale, or similar document given to the purchaser;
 - (6) installation charges that are separately stated on the invoice, bill of sale, or similar document given to the purchaser; or
 - (7) telecommunications nonrecurring charges.

(c) A public utility's or a power subsidiary's gross retail income includes all gross retail income received by the public utility or power subsidiary, including any minimum charge, flat charge, membership fee, or any other form of charge or billing.

(Emphasis added).

Next, IC § 6-2.5-3-7 states:

(a) A person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana, unless the person or the retail merchant can produce evidence to rebut that presumption.

(b) 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.

(Emphasis added).

Also, [45 IAC 2.2-8-12](#) provides:

(a) Exemption certificates may be issued [sic.] only by purchasers authorized to issue such certificates by the Department of Revenue. Retail merchants, manufacturers, wholesalers and others who must register with the Department of Revenue and who qualify to purchase exempt from tax under this Act [[IC 6-2.5](#)] may issue exemption certificates with respect to exempt transactions. All persons or entities not required to register with the Department as retail merchants, manufacturers, or wholesalers, and who are exempt under this Act [[IC 6-2.5](#)] with respect to all or a portion of their purchases are authorized to issue exemption certificates with respect to exempt transaction provided an exemption number has been assigned by the Department of Revenue, or provided that the Department of Revenue has specifically provided a form and manner for issuing exemption certificates without the need for assigning an exemption number.

(b) Retail merchants are required to collect the sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used by the purchaser for an exempt purpose.

(c) All retail sales of tangible personal property for delivery in the state of Indiana shall be presumed to be subject to sales or use tax until the contrary is established. The burden of proof is on the buyer and also on the seller unless the seller receives an exemption certificate.

(d) Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the necessity for such proof. The mere filing of a Registered Retail Merchant Certificate number is not sufficient to relieve the seller of the responsibility to collect the sales tax or prove exempt use by the buyer.

(e) No exemption certificates are required for sales in interstate commerce, however, proper records must be maintained to substantiate such sales.

(f) An exemption certificate issued by a purchaser shall not be valid unless it is executed in the prescribed and approved form and unless all information requested on such form is completed.

(g) An exemption certificate or other evidence supporting an exempt sale must be maintained by the seller for at least three (3) years after the due date of the tax return upon which such exempt transaction is reported.

(h) Exemption certificates may be reproduced provided no change is made in the wording or content.

(Emphasis added).

Therefore, a retail merchant is required to collect sales tax on the total amount of a transaction, including

freight charges, unless that customer provides an exemption certificate. In this case the Department determined that Taxpayer had not collected on the freight charges in some transactions and on other transactions treated the customer as an exempt entity but did not have exemption certificates to verify that status.

Taxpayer protests that the Department's projection method overstated the amount of billed freight for the years at issue and that the method only took into account instances where sales tax was under-collected. Taxpayer believes that the methodology did not take into account instances where it over-collected sales tax. Taxpayer provided documentation and analysis in support of this position. Taxpayer reviewed its August 2010 invoices and determined that it was under-collecting on such sales to a much lesser degree than determined by the Department. Taxpayer states that it now has access to its full ledger and protests that the Department should conduct a full review of all of its sales during the audit years to determine the actual amount of compliance or non-compliance with regards to sales tax collection and remittance.

Taxpayer also protests the imposition of sales tax on labor charges for labor provided pursuant to service agreements. Taxpayer provided documentation in support of its position that such labor charges are separately charged from the sale of the service agreements themselves. After review, that documentation is sufficient to establish that the labor charges in question are not part of the sales price of the service agreements.

The Department agrees that sufficient questions have been raised and sufficient documentation supplied to warrant a review of Taxpayer's documents and possible recalculation of Taxpayer's sales tax liabilities for the years in question. The Department's audit division will contact Taxpayer and request any documents it deems necessary to review Taxpayer's sales tax status for 2007, 2008, and 2009. This supplemental review will be conducted at the Department's offices and will not result in a visit to Taxpayer's location. Taxpayer will be allowed thirty (30) days from the date of the audit division's contact on this matter to supply the requested documentation. After the thirty day deadline has passed, the Department will conduct its review based on all documentation supplied at that time. The review will not include the labor charges associated with the service agreements as taxable sales. All other amounts of sales tax in question, both overpayment and underpayment, will be reviewed and recalculated.

FINDING

Taxpayer's protest is sustained to the extent verified in a supplemental audit review, as provided above.

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