

Letter of Findings: 04-20120506
Gross Retail Tax
For the Years 2009, 2010, and 2011

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ISSUES

I. Component Parts – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-2(a); IC § 6-2.5-5-6; IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a).

Taxpayer argues that it should not be required to pay sales tax on items purchased from an on-line Internet vendor because some of the component parts were directly incorporated into Taxpayer's manufactured products.

II. Calculation Error – Gross Retail tax.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a).

Taxpayer maintains that the audit report erred when it assessed sales tax on the same purchase invoices twice.

STATEMENT OF FACTS

Taxpayer is an Indiana business which manufactures "vibratory feeding" equipment. The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records. The audit resulted in the assessment of sales/use tax. Taxpayer disagreed with portions of the assessment and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Component Parts – Gross Retail Tax.

DISCUSSION

Taxpayer purchased items from a particular on-line vendor. This particular vendor sold it supplies in various mixed "lots." Each particular "lot" contained more than item.

Taxpayer paid a single price for each purchase invoice even though the purchase invoice represented the purchase of multiple items contained in a single "lot."

Some of the items in a particular "lot" were purchased and incorporated into one of Taxpayer's manufactured products. The other items in that particular "lot" were discarded because they could not be incorporated into one of Taxpayer's manufactured products.

For example, Taxpayer might purchase a particular "lot" from the on-line vendor. The total price of the "lot" was \$100 but the "lot" consisted of three items; the first item cost \$10, the second item cost \$30, and the third item cost \$60. However, Taxpayer purchased the \$100 "lot" with the intention of discarding the first two items.

In reviewing the invoices from this particular on-line vendor, the audit found that "[T]axpayer failed to keep some of the invoices documenting purchases made from this vendor." The audit concluded that without the invoices, "[T]he taxability of the purchases could not be verified."

The audit assessed use tax on the total price for each invoice issued by this particular on-line vendor. In the example cited above, the audit assessed use tax on the entire \$100 charge because Taxpayer did not maintain or retain record of which items were incorporated into one of Taxpayer's manufactured products and which items were discarded. There is no disagreement that items incorporated into one of Taxpayer's products would have been exempt but that the discarded items were subject to Indiana's use tax.

Taxpayer disagrees with the audit's conclusion taxing the full price on each invoice stating that approximately 80 percent of the purchases consisted of items incorporated into Taxpayer's manufactured products and that the tax should only have been assessed against the 20 percent of the purchases which were discarded.

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-3-2(a). A complementary 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. IC § 6-2.5-3-2.

However, IC § 6-2.5-5-6 provides an exemption for items purchased and incorporated into a taxpayer's manufactured goods.

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

There is no dispute that Taxpayer is in the business of manufacturing "vibratory feeding" equipment and that it sells this equipment to its customers. There is no dispute that items purchased and incorporated into this

equipment are exempt pursuant to IC § 6-2.5-5-6. There is also no dispute that it is likely some of the items purchased from the on-line vendor were actually incorporated into Taxpayer's products because the on-line vendor sold Taxpayer such mundane items as cylinders, valves, and electrical components which are just the sort of items a manufacturer might typically purchase for use in the production of its manufactured goods.

The issue is whether Taxpayer has established that 80 percent of the items were used in an exempt fashion. As with any "proposed assessment," it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "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."

Taxpayer explains that it arrived at its determination in the following manner:

The [vendor's] invoices placed a value on every item within the package and the sum of the individual values totaled the total purchase price for the package. We have randomly selected three test months from each year to review the invoices in detail. [] Our review entailed looking at each package to determine the useful and unwanted items. We then used the [vendor's] value on the invoice to allocate the purchase price to the useful and unwanted items within the package. The allocated cost for the three months was then added together. The total of the useful items were divided by the total of all the items to determine a percentage for the three months.

Taxpayer explained that its representative chose the three sample months by randomly drawing selections "out of a hat" and that its methodology reduces the proposed assessment by approximately \$2,800.

Indiana law imposes on Taxpayer a requirement to maintain adequate, source documentation. IC § 6-8.1-5-4(a) states:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

As noted above, the Department concedes that it is reasonably certain that items purchased from the on-line vendor were incorporated into Taxpayer's equipment but the issue is whether Taxpayer's calculation is correct and the Department's is wrong. In this case, Taxpayer must resort to an "after-the-fact" calculation because Taxpayer did not maintain the required source documentation conclusively establishing what items were entitled to the exemption and what items were not. As such, the Department is unable to sustain Taxpayer's protest. Taxpayer's "back-of-the-envelope" calculation may be valid but it does not meet the standard establishing that the audit assessment was wrong.

FINDING

Taxpayer's protest is respectfully denied.

II. Calculation Error – Gross Retail tax.

DISCUSSION

Taxpayer notes that the audit report assessed use tax on items purchased from on-line vendors and retailers. Those purchased are noted under "General Expense Purchases Insufficient Documentation" and are summarized at the top of page four of the audit report.

The audit report also assessed use tax on items purchased by means of "on-line transactions." According to the audit report, these items were "not directly related to [T]axpayer's business" but included such items as a Kitchen Aid Mixer, backpacks, golf bags, canned software, paper supplies, trash bags, a poster program, and pocket-sized tool kit. These purchases are summarized under "General Expense Purchases Operating Supplies" summarized at the top of page five of the audit report.

Taxpayer believes that certain of the items assessed on page four of the audit report are also assessed on page five of the audit report. Taxpayer argues that all of the items summarized at the top of page five of the report should be removed.

The difficulty encountered during the audit was compounded by the fact that Taxpayer's records were missing or incomplete. A cursory review of the actual transactions and invoices detailed on the subsequent pages of the audit (pages 12 to 15) does not support Taxpayer's blanket assertion that the assessment summarized on page five of the audit report should be entirely abated. The dates listed on the page five transactions and the page four transactions do not correspond because the transactions appear to have occurred on different days.

As noted above, IC § 6-8.1-5-4(a) requires that each taxpayer retain "all source documents necessary to determine... tax, including invoices, register tapes, receipts, and canceled checks."

Taxpayer has failed to demonstrate that the audit assessment is "wrong" as required under IC § 6-8.1-5-1(c) but has simply set out a theory that two different sections of the audit report are entirely duplicative. Taxpayer has not pointed to any specific invoice that is listed in both the page four summary and the page five summary.

FINDING

Taxpayer's protest is respectfully denied.

