

DEPARTMENT OF STATE REVENUE

04-20140005.LOF

Letter of Findings Number: 04-20140005
Use Tax
For Tax Years 2010-12

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

ISSUES**I. Use Tax—Imposition.**

Authority: Morton Buildings, Inc. v. Indiana Dep't of State Revenue, 819 N.E.2d 913 (Ind. Tax Ct. 2004); General Motors Corp. v. Ind. Dep't of State Revenue, 578 N.E.2d 399 (Ind. Tax 1991); IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); [45 IAC 2.2-4-26](#).

Taxpayer protests the assessment of use tax on certain items.

II. Tax Administration—Negligence Penalties.

Authority: IC § 6-8.1-10-2.1; IC § 6-8.1-5-1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of negligence penalties.

STATEMENT OF FACTS

Taxpayer is an Indiana contractor which produces the tangible personal property it installs into its customers' realty. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had under-collected sales tax as a retail merchant and had under-paid sales tax as a consumer for the tax years 2010, 2011, and 2012. The Department therefore issued proposed assessments for sales tax, use tax, ten percent negligence penalties, and interest for those years. Taxpayer disagreed with some of the use tax assessments and filed a protest. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Imposition.**DISCUSSION**

Taxpayer protests the imposition of use tax on certain items it purchased during the tax years 2010-12. Specifically, Taxpayer protests that some items listed as "Capital Assets" in the Department's audit report were considered partially taxable and partially exempt. The Department based its determination that use tax was owed on a percentage of the purchases in question due to the determination that Taxpayer was acting as a contractor and was installing tangible personal property ("TPP") into realty via both lump-sum contracts and in time and materials contracts. The Department determined that the percentage of lump-sum installations resulted in an equivalent taxable use of machinery used by Taxpayer to create the TPP which it then installed in realty at its customers' locations. The Department did not impose use tax on the corresponding percentage of use of the same machinery which created the TPP which Taxpayer installed in realty at its customers' locations via time and materials contracts. Taxpayer argues that the machinery is used in manufacturing regardless of the status of the installation contract and that the machinery is therefore wholly exempt. 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).

Sales tax is imposed by 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.

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](#) further explains:

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.

Therefore, when TPP is used in Indiana but sales tax is not paid at the time of purchase, use tax will be imposed.

Also of relevance is [45 IAC 2.2-4-26](#), which 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).

The Department, as provided by [45 IAC 2.2-4-26\(a\)](#) and (e), therefore considered Taxpayer's purchases of machinery and equipment to be subject to use tax to the extent that those items were used in the process of installing TPP into realty via lump-sum contracts. The Department did not impose use tax to the extent that those items were used in the process of installing TPP into realty via time and materials contracts, pursuant to [45 IAC 2.2-4-26\(b\)](#).

Taxpayer protests that the machinery and equipment in question is used for manufacturing regardless of the billing method used for a particular project. Taxpayer refers to *Morton Buildings, Inc. v. Indiana Dep't of State Revenue*, 819 N.E.2d 913 (Ind. Tax Ct. 2004) in support of its position. In that case, the Indiana Tax Court determined that tangible personal property did have a different character when it underwent a construction process. Taxpayer states that it purchased TPP and, as in *Morton Buildings*, converted it into real property which gave the TPP a different character.

Such a change in character of the TPP it purchases, Taxpayer argues, constitutes manufacturing and thus the machinery and equipment it uses in such a manner qualify for the exemption found under IC § 6-2.5-5-3(b), which provides:

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

The Department does not agree that *Morton Buildings* supports Taxpayer's position. *Morton Buildings* addresses the taxable status of raw materials purchased by a builder for incorporation into realty. The issue in the instant case is the taxable status of the tools and equipment used to change the form of raw materials prior to any

installation into realty.

Taxpayer also refers to *General Motors Corp. v. Ind. Dep't of State Revenue*, 578 N.E.2d 399 (Ind. Tax 1991), in support of its position that it is a manufacturer and that the equipment and machinery is therefore exempt. In that case, the Indiana Tax Court provided that the taxpayer had an integrated production process and that packing materials required to protect the work-in-process was exempt as part of that integrated production process. Taxpayer states that it too has an integrated production process and that its equipment and machinery is also exempt under the manufacturing exemption provided by IC § 6-2.5-5-3(b).

As explained above, Taxpayer is not merely producing tangible personal property. Taxpayer is a contractor installing the tangible personal property into realty. Since that is the case and since [45 IAC 2.2-4-26](#) provides that a contractor's billing methods do affect the taxable status of tools and machinery it purchases to facilitate the improvements to real estate, the Department finds that the original estimation of taxable and non-taxable percentages of Taxpayer's production machinery was correct. Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) of proving the proposed assessment wrong.

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Negligence Penalties.

DISCUSSION

Taxpayer protests the imposition of penalties assessed against it for the tax years at issue. Taxpayer states that it acted reasonably in performing its use tax duties. As provided in Issue I above, the Department notes that the burden of proving a proposed assessment wrong, including the assessment of penalty, rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The Department refers to IC § 6-8.1-10-2.1(d), which states:

If a person subject to the penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

. . . .

(Emphasis added).

Next, the Department refers to [45 IAC 15-11-2](#)(b), which 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.

(Emphasis added).

Finally, [45 IAC 15-11-2](#)(c) provides in pertinent part:

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.

(Emphasis added).

Taxpayer's protest is in regards to the Department's assessment of penalties. IC § 6-8.1-10-2.1 and [45 IAC 15-11-2](#)(c) require a taxpayer to show that failure to remit taxes in a timely manner is due to reasonable cause. As provided by the discussion in Issue I above, the taxable status of the machinery which Taxpayer used to create

tangible personal property which it installed in its contracting capacity is taxable in the case of lump-sum contracts and is not taxable in the case of time and materials contracts.

This is a very specific distinction and if it were the only category of items upon which tax was assessed, then waiver of penalty might be warranted. However, there were other items such as parts, light bulbs, shop tools, copy charges, and lawn products which were clearly subject to sales or use tax but upon which no tax was remitted. Also, the Department assessed sales tax which it determined that Taxpayer should have collected and remitted as a retail merchant. Taken together, Taxpayer did not exercise ordinary business care and prudence in performing its sales and use tax duties. Taxpayer has not met the burden imposed under IC § 6-8.1-5-1(c) of proving the proposed assessment wrong.

FINDING

Taxpayer's protest is denied.

SUMMARY

Taxpayer's protest is denied on Issue I regarding the imposition of use tax on machinery and equipment in the percentage relating to the use of those items in performing contracting installation of tangible personal property into realty via lump sum contracts. Taxpayer's protest is denied on Issue II regarding the imposition of negligence penalties for the years at issue.

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