

Letter of Findings: 02-20160493; 04-20160494
Corporate Income Tax
Sales and Use Tax
For the Year 2013

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

The Department was unable to agree that Indiana Lawn Care Provider was not required to collect sales tax on the lawn care charges made to its customers; however, the Department agreed to review exemption certificates provided during the hearing to determine if the sales tax assessment should be adjusted.

ISSUES

I. Gross Retail and Sales Tax - Credit for Taxes Paid.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-5 et seq.; IC § 6-2.5-5-8(b); IC § 6-8.1-5-1(c); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Sales Tax Information Bulletin 21 (May 2002).

Taxpayer argues that the Department should grant additional credit for sales tax paid on items which it later resold.

II. Gross Retail and Sales Tax - Sample Size.

Authority: IC § 6-2.5-8-8(a); IC § 6-8.1-3-12.

Taxpayer states that the sample of transactions reviewed by the audit was too small in light of the number of transactions which took place during 2013.

III. Gross Retail and Sales Tax - Exempt Transactions.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-8-8(a).

Taxpayer maintains that the Department assessed sales tax on transactions for which it had an exemption certificate from the customer.

IV. Corporate Income Tax - Business Loans.

Authority: IC § 6-8.1-5-1(c); [45 IAC 3.1-1-29](#).

Taxpayer argues that the Department erred in including as gross income loans which was contributed by one of the business shareholders.

STATEMENT OF FACTS

Taxpayer is an Indiana business organized as a C Corporation. Taxpayer is a local retailer of lawn mowing and lawn maintenance equipment such as lawn mowers, leaf blowers, and lawn trimmers.

Taxpayer also sells repair parts and supplies for this type of lawn equipment. In addition to acting as a retailer, Taxpayer is also a lawn care provider. In this capacity, Taxpayer applies lawn fertilizer and provides landscaping services.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and tax returns. The audit process extended over a period of time with eventually three different auditors assigned to review the records. The audit resulted in an assessment of additional sales and use tax and an additional assessment of corporate income tax.

Taxpayer disagreed with both the sales and use tax assessments and with the corporate income tax assessment. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Gross Retail and Sales Tax - Credit for Taxes Paid.

DISCUSSION

The Department's audit found that "the taxpayer had been making retail sales of tangible personal property but had failed to collect sales tax on some sales during the audit year." The audit "summarized [these sales] into a spreadsheet and sent to the [T]axpayer for further clarification as to why sales tax had not been collected"

Taxpayer explained that it purchased and paid taxes on items which it later resold. Taxpayer maintains that it should be given a credit for the sales tax it paid at the time it purchased these items because the items were exempt at the time of the initial purchase.

Since the sales and use tax portion of the audit resulted in additional tax, it is the Taxpayer's responsibility to establish that the pending 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." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Consequently, the taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

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. IC § 6-2.5-5 et seq. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-1-2; IC § 6-2.5-4-1. 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, Indiana law provides an exemption for the purchase of items which were intended to be resold. IC § 6-2.5-5-8(b) provides an exemption for transactions in which tangible personal property is purchased with the intent of reselling that property:

Transactions involving tangible personal property . . . are exempt from state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.

In this instance, Taxpayer maintains that it should not be required to collect sales tax on the price it charges its customers for lawn care services even though those costs include both labor and materials. However, Taxpayer is mistaken.

The provision of lawn care services - such as that conducted by Taxpayer - is subject to sales tax as prescribed in Sales Tax Information Bulletin 21 (May 2002), 25 Ind. Reg. 3939, as follows:

The relationship between a lawn care company and its customer is contractual. The customer agrees to pay a set price and the company agrees to apply the necessary chemicals to a lawn for its proper care and maintenance. The chemical cannot be purchased separately from the company and applied by the customer. A unitary transaction is the purchase of tangible personal property and services under a single agreement for which a total combined charge is calculated. A retail unitary transaction is a unitary transaction that is also a retail transaction. A retail transaction means a transaction that constitutes selling at retail. A lawn care application is a retail transaction because the lawn care company acquires tangible personal property (chemicals) and transfers them to its customers for consideration in the ordinary course of its regularly conducted business.

The Department's position is clear; lawn services are inherently unitary transactions in which the provider is required, "in the ordinary course of its regularly conducted business," to collect sales tax on the amount charged its customers.

FINDING

Taxpayer's protest is respectfully denied.

II. Gross Retail and Sales Tax - Sample Size.

DISCUSSION

Taxpayer argues that the audit assessed the additional sales/use tax based on a sampling of transactions by which the audit differentiated between that portion of each transaction which was charged for exempt labor/services and that portion of the transaction which was charged for tangible personal property. It is Taxpayer's contention that if each and every transaction were reviewed - copies of which were presented during the administrative hearing - that the sales/use tax assessment would be diminished.

It should be noted that the Department's audit attempted to review Taxpayer's sales transactions. The Department provided Taxpayer a preliminary spreadsheet of transactions for which sales tax had not been collected. As explained in the report:

These [taxable] sales were summarized into a spreadsheet and sent to the [T]axpayer for further clarification as to why sales tax had not been collected upon these specific sales. The audit was set aside for a period of time that was provided to the [T]axpayer so that the necessary records and documentation to explain why sales tax had not been collected upon the previously mentioned sales could be gathered. The [T]axpayer did not take this time to provide any additional documentation to support why these sales should be exempt from tax.

IC § 6-8.1-3-12 authorizes the Department to conduct audit based on a sampling methodology. The provision, in part, states "the department may audit any returns with respect to the listed taxes using sampling methodology."

Taxpayer argues that the sample of approximately 200 transactions does not accurately reflect the exempt services on its customer invoices. Taxpayer contends that if the audit were to review all of its invoices, the percentage of exempt service charges would be much greater with a consequent reduction in the amount of sales tax on the tangible personal property charges.

Taxpayer believes that if the Department were to review each and every invoice which it has now produced, the assessment would be lower. Taxpayer bases this premise on the notion that the sampled transactions were not truly representative of its business during the period under audit.

Taxpayer's argument somewhat misses the mark. It is possible that a re-audit of Taxpayer's transactions would produce a different result; it is possible the assessment would be less; it is equally possible the assessment would be higher. However, Taxpayer has produced nothing more substantial than a 20+ pound box of invoices to prove its point. At a minimum, Taxpayer is required to establish that the assessment is "wrong" under Indiana law. Once that threshold is met, then it becomes the Department's responsibility to review that document and correct the error that Taxpayer has established. In this case, Taxpayer has not met its burden because - as mentioned earlier - the provision of lawn care services is an inherently unitary transaction for which all costs are subject to sales tax.

Nonetheless, Taxpayer does make at least one valid point. Since the provision of lawn services - including the

supplies expended in performing those services - is subject to tax, Taxpayer is entitled to purchase those supplies exempt from sales tax. See IC § 6-2.5-8-8(a).

Taxpayer has produced 31 transactions in which Taxpayer purportedly purchased supplies which Taxpayer presumably resold to its customers and on which Taxpayer paid sales tax at the time of the original purchase.

The Department's Audit Division is requested to review the 31 transactions and - to the extent that any of these transactions were included within the sample - to make whatever adjustment is necessary removing from the sample those transactions where Taxpayer paid sales tax at the time of the original purchase.

III. Gross Retail and Sales Tax - Exempt Transactions.

DISCUSSION

Taxpayer argues that the assessment should be reduced because many of the sales transactions it entered into were with organizations which were exempt from sales tax.

IC § 6-2.5-2-1(a) imposes "[a]n excise tax, known as the state gross retail tax . . . on transactions made in Indiana." Under IC § 6-2.5-2-1(b), the retail merchant is required to "collect the tax as agent for the state."

Under certain circumstances, the retail merchant is not required to collect sales tax. For example, under IC § 6-2.5-8-8(a), "A person . . . who makes a purchase in a transaction which is exempt from the state gross retail tax and use taxes, may issue an exemption certificate to the seller instead of paying the tax." Once the purchaser provides the exemption certificate, the retail merchant is under no obligation to collect sales tax on the transaction. IC § 6-2.5-8-8(a) states that, "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." (Emphasis added).

The Department's Audit Division is requested to review the documents. To the extent that the exemption certificates relate to the sampled transactions, the Audit Division is requested to make whatever adjustment is warranted by removing from the sample those transactions for which the customer provided an exemption certificate.

FINDING

Taxpayer's protest is sustained subject to the results of the Department's review of the exemption certificates.

IV. Corporate Income Tax - Business Loans.

DISCUSSION

Taxpayer's sole shareholder states that he made business loans to Taxpayer during 2013 and that the loans should not be included as "income" for purposes of Indiana's corporate income tax. Taxpayer's representative argues that the loans were necessary to keep the business afloat during Taxpayer's "off-season."

Taxpayer argues that its "balance" sheet reflects the loans and repayments of the loans. The balance sheets purportedly establish that the loans and repayments should cancel each other out because the loans never constituted income to Taxpayer. Presumably Taxpayer argues that the loans were "contribution to capital" not subject to tax.

The audit report noted that "[T]axpayer had made the remark that the bank deposits included deposits from a line of credit from their local bank. No details regarding transferred funds from a line of credit to the operating checking account at the bank were provided by the taxpayer."

Taxpayer has provided no documentation of a loan agreement between shareholder, bank, and/or Taxpayer. However, it should be noted that Taxpayer stated that the Department "did not thoroughly go through the records that were provided as ALL of the information was easily accessible to him."

The audit report cites to [45 IAC 3.1-1-29](#) which defines "business income" as follows:

"Business Income" is defined in the Act as income from transactions and activity in the regular course of the taxpayer's trade or business, including income from tangible and intangible property if the acquisition,

management, or disposition of the property are integral parts of the taxpayer's regular trade or business.

Nonbusiness income means all income other than business income.

The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, non-operating income, etc., is of no aid in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business.

Taxpayer has not established that the \$7,200 at issue was included in the calculation of Taxpayer's income tax, has not established that the money was the result of a loan agreement between owner and Taxpayer, or that that the \$7,200 should not have been treated as ordinary income to the Taxpayer. In other words, Taxpayer has not established that the assessment of \$439 in additional corporate income tax was "wrong" as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

The Department declines the opportunity to conduct another audit of Taxpayer's documents because lawn care transactions are inherently unitary transactions. The Audit Division is requested to review the 31 purchase transactions and to adjust the assessment as warranted by that review. To the extent that the exemption certificates relate to the population of sampled transactions, the Audit Division is requested to adjust the assessment as warranted. The Department does not agree that shareholder's "loan" payments made to Taxpayer did not constitute income to Taxpayer.

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