DEPARTMENT OF STATE REVENUE

04-20110343.SLOF

Supplemental Letter of Findings: 04-20110343
Sales and Use Tax
For the Years 2008 and 2009

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ISSUES

I. Sales and Use Tax–Manufacturing Exemption.
Authority: IC § 6-2.5-5-3; IC § 6-8.1-5-1; 45 IAC 2.2-5-8; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Letter of Findings 04-20110343 (February 1, 2012).

Taxpayer protests the assessment of use tax on its purchases from "Toyota Motor Credit."

II. Sales and Use Tax–"Maintenance Agreements."
Authority: IC § 6-8.1-5-1; 45 IAC 2.2-4-2; 50 IAC 4.2-4-10; Letter of Findings 04-20110343 (February 1, 2012).

Taxpayer protests the assessment of use tax on its purchases of "maintenance agreements."

III. Sales and Use Tax–Improvements to Realty.
Authority: IC § 6-2.5-3-2; IC § 6-8.1-5-1; 45 IAC 2.2-3-4; 45 IAC 2.2-4-21; 45 IAC 2.2-4-22; 45 IAC 2.2-4-23; Sales Tax Information Bulletin 60 (July 2006); Letter of Findings 04-20110343 (February 1, 2012).

Taxpayer protests the imposition of use tax on materials used in construction projects.

STATEMENT OF FACTS

Taxpayer is an Indiana manufacturer. The Indiana Department of Revenue ("Department") conducted an audit for the tax years 2008 and 2009. Due to the volume of Taxpayer's records, the Department and Taxpayer agreed to utilize a sample selected from Taxpayer's records and a projection method to perform the audit. Pursuant to the audit, the Department determined that Taxpayer owed additional use tax. The Department found that Taxpayer had made a variety of purchases on which sales tax was not paid at the time of purchase nor was use tax remitted to the Department. Taxpayer disagreed with some of the audit results and protested. A hearing was held and Letter of Findings Number 04-2011343 (February 1, 2012) was issued sustaining Taxpayer's protest in part and denying Taxpayer's protest in part.

Subsequently, Taxpayer submitted additional documentation and requested a rehearing. Upon reviewing the additional documentation, a rehearing was granted. The rehearing was held, and this Supplemental Letter of Findings, based on the additional information submitted, results. Additional facts will be provided as necessary.

I. Sales and Use Tax – Manufacturing Exemption.

DISCUSSION

Taxpayer asserts that certain of its purchases are not subject to use tax because the purchases would qualify for the manufacturing equipment exemption as found in IC § 6-2.5-5-3.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Taxpayer claims that the purchases from "Toyota Motor Credit" qualify for a partial exemption from use tax under 45 IAC 2.2-5-8(f)(2), which states that "[t]ransportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process." Taxpayer asserts that "all of the invoices listed for 'Toyota Motor Credit' are for lease or rental of forklifts that [Taxpayer] uses in the facility." Since the Department's audit applied 45 IAC 2.2-5-8(f) to Taxpayer's forklift usage and determined that Taxpayer's forklift usage was ten percent taxable, Taxpayer maintains that only ten percent of the "Toyota Motor Credit" invoices amounts should be subject to use tax as well.

During the hearing, Taxpayer's representative was asked to provide the invoices in question. Taxpayer did not provide documentation other than its own assertion that the invoices are for forklift rentals. In Letter of Findings 04-20110343 (February 1, 2012), Taxpayer's protest was denied in part because Taxpayer's representative did not provide any additional documentation for these transactions.

Taxpayer's representative, however, did present invoices for these transactions with its rehearing request. These invoices listed description codes for the equipment, but did not identify the type of equipment by name. The Department, in the course of its own research, found that these description codes represented forklifts as the items of equipment being leased. Since the equipment leased from "Toyota Motor Credit" was, in fact, forklifts, the equipment qualifies for the exemption as determined by the Department's audit (audit report p. 3, ninety percent exempt and ten percent taxable).

FINDING

Taxpayer's protest to the imposition of use tax on ninety percent of the amount from "Toyota Motor credit" transactions is sustained.

II. Sales and Use Tax–"Maintenance Agreements."

DISCUSSION

The Department imposed use tax on several transactions on which Taxpayer did not pay sales tax at the time of the retail transactions. Taxpayer asserts that it purchased "maintenance agreements" that are not taxable in Indiana.

Again, 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).

A. "RDC Maintenance Agreement."

Taxpayer asserts that the "maintenance agreement" from RDC is not subject to use tax because it transfers real property and not tangible personal property. Taxpayer maintains that "the RDC maintenance agreement... covers [Taxpayer's] dock which is permanently attached to [Taxpayer's] building. As such the agreement covers real property maintenance and is thus not a transfer of tangible personal property."

During the protest hearing, Taxpayer's representative was asked to provide additional information and a copy of the "maintenance agreement" to establish the nature of the transaction. Taxpayer's representative did not provide any additional documentation for these transactions. In Letter of Findings 04-20110343 (February 1, 2012), Taxpayer's protest was denied in part because Taxpayer's representative did not provide any additional documentation for these transactions.

Taxpayer's representative presented a copy of the "Planned Maintenance Program Agreement" from RDC and a picture of the dock with its rehearing request. The provisions of the "Planned Maintenance Program Agreement" state that the services included are "cleaning, adjustment, lubrication, and safety inspection" and "any extra work not covered by [this agreement] will be billed [to Taxpayer separately]." The equipment covered under the service agreement are twenty-five dock levelers, twenty-six sectional dock doors, four "Loks," two "Fastrax doors," and one "Rytec door."

Taxpayer's argument is as follows. The "maintenance agreement" from RDC transfers real property and not tangible personal property. Therefore, the "maintenance agreement" is a lump sum contract for improvements to realty and is not subject to use tax. However, most, if not all the property, covered under the service agreement–i.e., dock levelers and truck locks–is not property that is considered improvements to realty. See 50 IAC 4.2-4-10(d) (explaining that dock levelers and related items such as bumpers and truck locks are considered personal property, and, therefore, are not improvements to realty). Notwithstanding, based upon the documentation presented, the charges, in question, that were covered under the "Planned Maintenance Program Agreement" represent service charges from a "service provider," and are not subject to sales tax.

As explained in 45 IAC 2.2-4-2, "service providers" are granted a narrow exception to collecting sales tax on the entire retail transaction and instead pay sales tax/use tax on the "inconsequential" tangible personal property that is "consumed as a necessary incident to the service." 45 IAC 2.2-4-2(a) illustrates the exception, as follows:

> (a) Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant unless:
>
> (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
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> (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
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> (3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and
>
> (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Accordingly, in transactions with a "service provider" meeting all of the four requirements, the "service provider" does not have to collect sales tax on the transaction. Therefore, since sales tax is not due to be collected by the "service provider," sales tax/use tax is also not due to be paid from the customer on these transactions.

The "Planned Maintenance Program Agreement" states that it is for "cleaning, adjustment, lubrication, and safety inspection" services. Under the terms of the agreement, only these services are covered and if any other work is performed Taxpayer will be billed separately for any work performed outside of the agreement. These services covered under the agreement are not the type of services which would contemplate or involve the transfer of tangible personal property other than the "inconsequential" tangible personal property allowed by a service provider–i.e. the lubricant applied during lubrication. Therefore, these transactions qualify for the "service provider" exception from sales/use tax.

Accordingly, Taxpayer's protest to the imposition of use tax on the "RDC maintenance agreement" payments is sustained.

B. "TFS Maintenance."

Taxpayer asserts that the "TFS Maintenance" transactions are for industrial cleaning services and are not transactions subject to sales and use tax.

During the protest hearing, Taxpayer's representative was asked to provide documentation establishing the

nature of these transactions. Taxpayer's representative did not provide any additional documentation for these transactions. In Letter of Findings 04-20110343 (February 1, 2012), Taxpayer's protest was denied in part because Taxpayer's representative did not provide any additional documentation for these transactions.

Taxpayer's representative, however, did present invoices for these transactions with its rehearing request. These invoices listed description codes for the services provided, but also included an item code that appeared to identify equipment that was transferred. However, the Department, in the course of its own research, found that these item codes represented the piece of equipment that was cleaned. Therefore, since the transactions involved the performance of a service without the transfer of property, the transactions are not subject to sales and use tax.

Accordingly, Taxpayer's protest to the imposition of use tax on the "TFS Maintenance" transactions is sustained.

FINDING

Taxpayer's protest to the imposition of use tax on the payments for the "RDC maintenance agreement" and the "TFS Maintenance" transactions is sustained.

III. Sales and Use Tax–Improvements to Realty.

DISCUSSION

The Department imposed use tax on several transactions on which Taxpayer did not pay sales tax at the time of the retail transactions. Taxpayer maintains that it engaged a contractor, on a lump sum basis, to perform a number of projects through the audit periods which Taxpayer considered improvements to realty. Again, 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 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.

Also, 45 IAC 2.2-3-4 provides:

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.

Also of relevance is 45 IAC 2.2-4-21, which states:

(a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.

(b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt (See 6-2.5-5 [45 IAC 2.2-5]).

Also, 45 IAC 2.2-4-22 states:

(a) A contractor may purchase construction material exempt from the state gross retail tax only if he issues either an exemption certificate or a direct pay certificate to the seller at the time of purchase.

(b) A contractor, who purchases construction material exempt from the state gross retail tax or otherwise acquires construction material "tax-free", is accountable to the Department of Revenue for the state gross retail tax when he disposes of such property unless the ultimate recipient could have purchased it exempt (See 6-2.5-5 [45 IAC 2.2-5]).

(c) A contractor has the burden of proof to establish exempt sale or use when construction material, which was acquired "taxfree", is not subject to either the state gross retail tax or use tax upon disposition.

(d) Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

(1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax); or

(2) Construction material sold over-the-counter. Over the counter sales of construction materials will be treated as exempt from the state gross retail tax only if the contractor receives a valid exemption certificate issued by the person for whom the construction is being performed or by the customer who purchases over-the-counter, or a direct pay permit issued by the customer who purchases over-the-counter.

(e) Disposition subject to the use tax. With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:

(1) He converts the construction material into realty on land he owns and then sells the improved real estate;

(2) He utilizes the construction material for his own benefit; or

(3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

A disposition under C. [subsection (e)(3) of this section] will be exempt from the use tax if the contractor received a valid exemption certificate from the ultimate purchases (purchaser) or recipient of the construction material (as converted), provided such person could have initially purchased such property exempt from the state gross retail tax.

(Emphasis added).

Finally, 45 IAC 2.2-4-23 states:

A contractor has no further liability for either the state gross retail tax or use tax with respect to construction material acquired by the contractor in a taxable transaction, provided the contractor disposes of such property in the following manner:

(1) He converts the construction materials into realty on land he owns and then sells the improved real estate;

(2) He utilizes the construction material for his own benefit and does not resell or transfer such property to others; or

(3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

(Emphasis added).

Accordingly, the fact that tangible personal property was incorporated into real property does not relieve a taxpayer of its obligation to pay sales or use tax. A contractor may convert tangible personal property into realty under a "lump sum contract" or under a "time and materials contract." Sales Tax Information Bulletin 60 (July 2006), 20060823 Ind. Reg. 045060287NRA, defines a "lump sum contract" as "a contract in which all of charges are quoted as a single price. A construction contractor may furnish a breakdown of the charges for labor, material and other items without changing the nature of the lump sum contract." A "time and materials contract" is defined as "a contract in which all charges for labor, construction materials and other items are separately stated." Id. Generally, in a lump sum contract between a customer and its contractor, the contractor bears responsibility for paying the tax on the construction materials. In a time and materials contract between a customer and its contractor, the contractor acts as a retail merchant and sales or use tax is due from the contractor's customers on the cost of the materials.

The Department's audit report contains several line items from various transactions with the contractor in question. The Department's audit report made notations where the information indicated the amount was for materials only and subjected the amount to tax. The Department's audit report made notations where the information indicated that the amount was for labor only and did not subject the amount to tax. The Department's audit report also made notations that described transactions that would not appear to be considered improvements to realty and subjected those amounts to tax. Lastly, the Department's audit report, on one occasion, made a notation stating that the information indicated that the billing was under a lump sum contract and did not subject that amount to tax.

Taxpayer asserts that the transactions in question were performed on a lump sum basis and that the Department's determination that the contracts were performed on a time and materials basis was not correct. During the protest hearing, Taxpayer's representative was asked to provide documentation–i.e., invoices, contracts, and/or statements from the contractor–establishing the nature of these transactions. In Letter of Findings 04-20110343 (February 1, 2012), Taxpayer's protest was denied in part because Taxpayer's representative did not provide any additional documentation for these transactions.

Taxpayer's representative, with its rehearing request, did present additional documentation, including invoices and purchase orders for several of these transactions. Upon reviewing this documentation, Taxpayer's protest as to the $3,000 transaction, on p. 50 of the audit report in which $1,925 was subjected to tax, is sustained in part. The invoice provided lists several items of material and labor. The Department determined this was a transaction where the contractor operated under a "time and materials contract" and attempted to only subject the materials to tax. During the protest, Taxpayer failed to present evidence that demonstrated that this was other than a "time and materials contract." Therefore, the materials portion will continue to be subject to tax. Nonetheless, the materials, as listed on the invoice, totaled $625 and only these amounts should be subject to tax ($225 for new ceiling tile, $300 for a cover base, and $100 for two pieces of plexiglass). Thus, Taxpayer's protest as to the $3,000 transaction, on p. 50 of the audit report in which $1,925 was subjected to tax, is sustained in the amount of $1,300 and denied in the amount of $625.

Additionally, upon reviewing the documentation, Taxpayer's protest as to the transaction for $6,881.25, on p. 55 of the audit report in which $6,881.25 was subject to tax, is sustained. The documentation presented demonstrates that this transaction was for an improvement to realty that was billed on a lump sum basis.

However, Taxpayer's protest to the imposition of use tax on the other transactions is denied. For example, some of the transactions protested were not taxed in the audit. Some of the transactions were taxed as transactions for the sale of tangible personal property alone–i.e. drain pads, and Taxpayer has failed to present evidence that demonstrated otherwise. Some of the transactions were taxed as transactions where the contractor

operated under "time and materials contracts," only the materials portions were subject to tax, and Taxpayer has failed to present evidence that demonstrated otherwise. For some of the transactions, Taxpayer presented purchase orders that were computer generated and were dated after the transactions took place. Since Taxpayer failed to provide documentation that supported its assertions about the transactions in question, Taxpayer has failed to meet its burden to show that the assessment was incorrect under IC § 6-8.1-5-1. Therefore, the Department finds no reason to disagree with the audit's conclusion that these materials in these transactions are subject to use tax.

FINDING

Taxpayer's protest as to the $3,000 transaction, on p. 50 of the audit report in which $1,925 was subjected to tax, is sustained in the amount of $1,300 and denied in the amount of $625. Additionally, Taxpayer's protest as to the transaction for $6,881.25, on p. 55 of the audit report in which $6,881.25 was subject to tax, is sustained. However, Taxpayer's protest is denied for the other transactions in question.

SUMMARY

Taxpayer's protest to the imposition of use tax on ninety percent of the amount from "Toyota Motor credit" transactions is sustained, as discussed in Issue I. Taxpayer's protest to the imposition of use tax on the payments for the "RDC maintenance agreement" and the "TFS Maintenance" transactions is sustained, as discussed in Issue II.

Taxpayer's protest as to the $3,000 transaction, on p. 50 of the audit report in which $1,925 was subjected to tax, is sustained in the amount of $1,300 and denied in the amount of $625, as discussed in Issue III. Taxpayer's protest as to the transaction for $6,881.25, on p. 55 of the audit report in which $6,881.25 was subject to tax, is sustained, as discussed in Issue III. In all other respects, Taxpayer's protest is denied.

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