

Letter of Findings Number: 08-0097
Use Tax
For Tax Years 2004-06

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ISSUES

I. Use Tax—Imposition.

Authority: IC § 6-2.5-1-5; IC § 6-2.5-3-2; IC § 6-2.5-5-1; IC § 6-8.1-5-1; [45 IAC 2.2-3-4](#); [45 IAC 2.2-3-20](#); [45 IAC 2.2-4-1](#); [45 IAC 2.2-4-2](#).

Taxpayer protests the assessment of use tax.

II. Tax Administration—Negligence Penalty.

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

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana resident corporation. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had additional use tax liabilities for the tax years 2004, 2005, and 2006. The Department issued proposed assessments for use tax, penalty and interest for those tax years. Taxpayer protests the imposition of use tax on two of the categories determined to be subject to use tax. Taxpayer also protests the imposition of penalty. 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 two categories. The first category is credit cards which are initially purchased as blank cards and then are processed into individualized credit cards for Taxpayer's clients. The cards are used for several purposes, such as credit cards, debit cards, ATM cards, Health Savings Account cards, and other similar cards. For convenience, all cards will be referred to as "credit cards." Taxpayer purchased blank credit cards from an unrelated company which later processed those blanks into individualized credit cards. The Department imposed use tax on the total cost of the completed cards as delivered to Taxpayer's Indiana customers. Those Indiana customers constituted ninety-two percent of Taxpayer's total customers. The Department therefore assessed use tax on ninety-two percent of total costs for all completed credit card costs. Due to the large number of invoices involved, this number was used in a sample and projection method to determine use tax compliance. Taxpayer states that it paid sales tax on the blank credit cards when it purchased them and that the tangible personal property transferred in the course of processing the cards is minimal. Taxpayer protests that the processing is merely a service and that services are not subject to sales and use tax.

The second category is amounts paid for postage by Taxpayer to another unrelated company for the mailing of Taxpayer's monthly statements. Taxpayer states that the postage is merely a pass-through expense. The Department also entered ninety-two percent of the amounts of these invoices into the sample and projection method for use tax compliance. 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 of relevance is [45 IAC 2.2-3-4](#), which states:

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.

In its audit report, the Department referred to [45 IAC 2.2-4-1](#), which states:

(a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant".

(b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:

(1) The price arrived at between purchaser and seller.

(2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor

charges for work done with respect to such property prior to transfer.

(3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to transfer of such property at retail.

Regarding the credit cards, Taxpayer states that there were two separate transactions. The first was the purchase of the blanks and the second was the purchase of the processed cards. Taxpayer asserts that the second transaction is for services only. The relevant regulation is [45 IAC 2.2-4-2](#), which states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. 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 constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (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.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

(Emphasis added.)

In the course of the protest process Taxpayer provided documentation establishing that, even though there is one vendor, there are indeed two distinct transactions involving the credit cards. The first transaction occurred when Taxpayer purchased the blanks from the supplier. The supplier charged Taxpayer for that sale and charged sales tax for the state where that transfer occurred. Then, the second transaction occurred when the supplier removed the blanks from inventory, individualized the cards for Taxpayer's specific customers, and mailed the individualized cards to Taxpayer's Indiana customers. Taxpayer supplied documentation which shows that, after the audit period, Taxpayer switched from the first company to another company for individualization purposes. The blanks were transferred, without Taxpayer paying for them, from Taxpayer's inventory at the first company to Taxpayer's inventory at the second company. None of these locations are in Indiana and the blank cards never entered Indiana. Therefore, it is clear that Taxpayer purchased the blanks in a transaction entirely outside Indiana's borders and wholly separate from the transaction which involved individualization of the cards. Taxpayer never took possession of the blanks in Indiana.

Having established that the purchase of the blank cards is not subject to Indiana use tax, it is important to note that the only invoices listed in the Department's audit report are for the second type of transactions. Those transactions are the ones where Taxpayer paid the processor for the cards after they were individualized and sent to Taxpayer's customers. At hearing, Taxpayer stated that the individualization of the cards was a service and that there was very little tangible personal property involved in the individualization. The tangible personal property in question consists primarily of stickers, envelopes, and card holders inserted into envelopes. Taxpayer believes that the service of individualizing the cards is not subject to use tax.

As provided by [45 IAC 2.2-4-2\(a\)](#), services generally are exempt from sales and use tax. Services involving the transfer of tangible personal property will be exempt if all four elements of [45 IAC 2.2-4-2\(a\)](#) are met. While Taxpayer has stated that the amount of tangible personal property is not significant, Taxpayer has not established that the value of what tangible personal property is transferred does not exceed ten percent, as required by [45 IAC 2.2-4-2\(a\)\(3\)](#). Neither has it been established that the processor paid sales tax on the tangible personal property when it was purchased, as required by [45 IAC 2.2-4-2\(a\)\(4\)](#). While it has been established that Taxpayer owns the blanks before the processing company individualizes them into credit cards for specific customers, Taxpayer has not established that all four elements of [45 IAC 2.2-4-2\(a\)](#) have been met. Therefore, since the processor also transfers tangible personal property for consideration, the entire amount charged by the processor constitutes a transaction of a retail merchant selling at retail and is therefore subject to use tax.

Regarding the second point of protest, Taxpayer states that payment of postage to the billing statement processing company is a separate transaction from the payment of the billing services. The Department referred to IC § 6-2.5-1-5, which states in relevant part:

(a) Except as provided in subsection (b), "gross retail income" means the total gross receipts, of any kind or

character, received in a retail transaction, 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) the value of exempt personal property given to the purchaser where taxable and exempt personal property have been bundled together and sold by the seller as a single product or piece of merchandise. 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.

...
(Emphasis added.)

The Department also referred to [45 IAC 2.2-3-20](#), which states:

All purchases of tangible personal property which are delivered to the purchaser for storage, use, or consumption in the state of Indiana are subject to the use tax. The use tax must be collected by the seller if he is a retail merchant described in Reg. 6-2.5-3-6(b)(010) [[45 IAC 2.2-3-19](#)] or if he has Departmental permission to collect the tax. If the seller is not required to collect the tax or fails to collect the tax when required to do so, the purchaser must remit the use tax directly to the Indiana Department of Revenue.

The Department determined that, since Taxpayer was paying postage for mailing the billing statements to the same company which created the billing statements, the postage constituted delivery charges and should therefore be subject to use tax.

Taxpayer has provided sufficient documentation to establish that the postage is paid into a separate account which is used by the billing company to pay for the mailing of the billing statements on a basis unrelated to the particular mailing per month. The postage account is replenished separately from the invoices for processing the billing statements. Since the transactions are in fact two transactions, the postage is not a delivery charge subject to sales and use tax as described by IC § 6-2.5-1-5(a). IC § 6-2.5-1-5(a) includes delivery charges when those delivery charges are incurred in a retail transaction involving the transfer of tangible personal property. Here, the postage is involved in a separate transaction from the transfer of tangible personal property.

In conclusion, whether or not sales tax was charged on the purchase of blank credit cards is not relevant here. Those purchases were not included in the audit report. The audit report only included charges incurred by Taxpayer for the creation of individualized credit cards. Taxpayer has not established that all four elements of [45 IAC 2.2-4-2\(a\)](#) have been satisfied. Therefore, the entire transaction is subject to use tax and those amounts will remain in the sample and projection data. The payment of postage by Taxpayer is a separate transaction from the payment for billing statements. Therefore, under IC § 6-2.5-1-5(a), the postage is not subject to use tax and will be removed from the sample and projection data. A supplemental audit will recalculate the use tax due as determined by the projection method.

FINDING

Taxpayer's protest is sustained in part and denied in part.

II. Tax Administration–Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

- ...
(3) incurs, upon examination by the department, a deficiency that is due to negligence;
...

the person is subject to a penalty.

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.

[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.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer has affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer is sustained in Issue I regarding imposition of use tax on postage. Taxpayer is denied in Issue I regarding imposition of use tax on the payments for individualized credit cards. Taxpayer is sustained on Issue II regarding imposition of penalty.

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