DEPARTMENT OF STATE REVENUE

04-20080413.LOF

Letter of Findings: 08-0413
Sales and Use Tax
For the Tax Years 2003-2005

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ISSUES

I. Sales and Use Tax–"Multiple Points of Use Software."

Authority: IC § 6-2.5-13-2 (repealed effective Jan. 1, 2008); IC § 6-8.1-5-1.

Taxpayer protests the imposition of use tax on certain of its software purchases.

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

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-8.1-5-1; 45 IAC 2.2-4-2; Sales Tax Information Bulletin 2 (May 2, 1983); Sales Tax Information Bulletin 2 (August 1991); Sales Tax Information Bulletin 2 (November 2000); Sales Tax Information Bulletin 2 (May 2002); Enter. Leasing Co. v. Ind. Dep't of State Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002).

Taxpayer protests the imposition of use tax on its purchase of certain of "maintenance agreements."

III. Sales and Use Tax–"Employee Time Clocks and Security Systems."

Authority: IC § 6-8.1-5-1.

Taxpayer protests the imposition of use tax on its purchase of time clocks and security systems.

IV. Sales and Use Tax–"Subscriptions."

Authority: IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-8.1-5-1; 45 IAC 2.2-1-1; Sales Tax Information Bulletin 8 (issued February 1990 and reissued in May 2002).

Taxpayer protests the imposition of use tax on subscriptions.

V. Sales and Use Tax–"Aircraft Upgrades and Repairs."

Authority: IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-3-5; IC § 6-8.1-5-1; USAir, Inc. v. Indiana Dep't. of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993).

Taxpayer protests the imposition of use tax on aircraft upgrades and repairs.

VI. Tax Administration–"Negligence Penalty."

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten (10) percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a manufacturer with two plants in Indiana. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional use tax and assessed a negligence penalty for the tax years 2003, 2004, and 2005. 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 protested this imposition of the tax and penalties. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as required.

I. Sales and Use Tax–"Multiple Points of Use Software."

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that Taxpayer had purchased software without paying sales tax at the time of purchase, and assessed used tax on the purchases.

Taxpayer asserts that its software purchases qualify for a "multiple points of use exemption" found at IC § 6-2.5-13-2 (repealed effective Jan. 1, 2008). During the course of the protest, Taxpayer presented documentation demonstrating its current use of the software. However, during the course of the protest, Taxpayer stated that it did not present any "MUP exemption forms" to the sellers at the time of purchase of the software. Moreover, Taxpayer failed to present any evidence that, at the time of purchase, Taxpayer disclosed its written intention to the seller to use the software at specific multiple locations or that any use tax was paid to other jurisdictions based upon that written intention for use that was disclosed at the time of purchase.

Furthermore, IC § 6-2.5-13-2(a) (repealed effective Jan. 1, 2008) explained what occurred for a "business purchaser" that presented a "MPU exemption form" to a seller "in conjunction with its purchase." In fact, IC 6-2.5-13-2(c) provided that this stream- lined sales tax provision pertained to "[a] purchaser delivering the MPU exemption form" to the seller at the time of purchase. Since Taxpayer did not present "MPU exemption forms" to the sellers at the time of the purchases, this streamlined sales tax provision does not apply to Taxpayer.

FINDING

Taxpayer's protest is respectfully denied.

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

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that Taxpayer had purchased "maintenance agreements" without paying sales tax at the time of purchase, and assessed used tax on the purchases.

IC § 6-2.5-3-2(a) provides, "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." An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

Taxpayer asserts that its purchases of certain "software maintenance agreements" were not purchases of tangible personal property, but were purchases of support services that are not subject to sales and use tax. Taxpayer cites 45 IAC 2.2-4-2 and Sales Tax Information Bulletin 2 (November 2000 and as updated May 2002) as authority.

45 IAC 2.2-4-2(a) states:

> 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:
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> (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
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> (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.
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> (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.
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> (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.
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> (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.

There is no regulation that sets out the Department's position regarding the application of sales and use tax to optional warranties. The Department first issued Sales Tax Information Bulletin 2 on May 2, 1983. In that Information Bulletin, the Department explained that if there was a possibility that no tangible personal property would be transferred with the warranty, then there was no certainty that there would be a retail sale and the sales and related use tax did not apply. This position was restated in the revised Sales Tax Information Bulletins issued in August 1991, November 2000, and May 2002. Each of the revisions restated the general rule. In the May 2002 revision, it was stated "[o]ptional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax." Each of the revisions also gave a specific example concerning computer software situations. The examples stated that sales and use tax would apply to the sale of an optional warranty or maintenance agreement in the software situation only if there was a guarantee of the transfer of tangible personal property (updates or upgrades) pursuant to the agreement.

Computer technology and use has evolved since the issuance of the first Sales Tax Information Bulletin 2 on May 2, 1983. Almost all software optional warranties and software maintenance agreements sold today include the automatic provision of updates or upgrades-sometimes on a day-by-day or week-by-week basis. Purchasers of these agreements have a reasonable expectation that they will receive the updates or upgrades whether or not the actual contract couches the provision of updates or upgrades as "optional." The substance of the agreements is that tangible personal property in the form of software updates or upgrades will be provided no matter what the language of the contract says. The Department determines tax consequences by construing the substance of the agreement over the form. Enter. Leasing Co. v. Ind. Dep't of State Revenue, 779 N.E.2d 1284, 1291 (Ind. Tax Ct. 2002). In the case of software maintenance agreements or optional warranties, it is clear that the parties anticipate that tangible personal property in the form of updates or upgrades will be transferred. Therefore, the Department will construe software maintenance agreements and optional agreements as presumed to be subject to the sales and use tax. A taxpayer could rebut this presumption by demonstrating that no updates or upgrades were actually received pursuant to a particular maintenance agreement or optional warranty. Sales Tax

Information Bulletin 2 was updated in December 2006 to state the Department's interpretation. Taxpayer should take note of this treatment for future purposes.

Under the versions of Information Bulletin 2 that applied to the tax periods 2003 to 2005, an optional maintenance or warranty agreement that entitles the purchaser to updates or upgrades but does not guarantee them is not subject to tax. Accordingly, to determine if a particular optional maintenance or warranty agreement is subject to the sales and use tax, one must look to the specific circumstances of the agreement to determine the taxability. If the optional maintenance or warranty agreement guarantees the transfer of tangible personal property, then the maintenance or warranty agreement is subject to sales and use tax unless the taxpayer can demonstrate that either the transfer of tangible personal property was not guaranteed pursuant to the warranty/maintenance agreement or that any such transfer of tangible personal property was in compliance with 45 IAC 2.2-4-2. Thus, optional maintenance or warranty agreements are subject to sales and use tax unless a taxpayer can demonstrate that either the value of the tangible personal property transferred was an inconsequential portion of the cost of the warranty/maintenance agreement.

During the course of the protest, Taxpayer submitted a list of "maintenance agreement" purchases, numerous invoices, and numerous agreements. Taxpayer did not provide evidence of the value of any tangible personal property that was transferred in the performance of the maintenance agreements.

Under the terms of certain of the software maintenance agreements, the agreements stated that Taxpayer may receive tangible personal property in the form of updates or upgrades. Since the transfer of tangible personal property was not guaranteed under the terms of these maintenance agreements, these agreements are not subject to tax under the versions Information Bulletin 2 that applied to the period 2003 to 2005. Pursuant to IC § 6-8.1-5-1(c), Taxpayer has met its burden of demonstrating that the following "maintenance agreements" are not subject to sales and use tax:

CG Tech, "Annual Software Maintenance" agreement;

G3 Technology Partners, "Service Agreement" for maintenance with effective date 07/01/1998.

Therefore, Taxpayer's protest, as it pertains to the above listed "maintenance agreement," to the extent that tax was assessed is sustained subject to the findings of a supplemental audit.

However, the documentation Taxpayer submitted was insufficient to prove that there was not a guarantee of tangible personal property to be transferred for Taxpayer's other purchases of "maintenance agreements," which were not included in the above list. Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Since Taxpayer failed to produce documentation that demonstrates that the Department's assessment was incorrect for these other purchases, then Taxpayer has failed to meet its burden to proof. Therefore, Taxpayer's protest, as it relates to the other purchases, is denied.

FINDING

Taxpayer's protest is denied in part and sustained in part subject to the findings of a supplemental audit.

III. Sales and Use Tax–"Employee Time Clocks and Security Equipment."

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

Taxpayer was assessed use tax on its purchases of several pieces of equipment and materials used to install numerous employee time clock and security systems that were purchased from out-of-state vendors without paying sales tax at the time of purchase. The Department assessed use tax on each piece of equipment by use of a statistical percentage, which was based upon the total number of systems that were installed in Indiana divided by the total number of systems purchased. The Department also gave Taxpayer credit for Indiana sales tax that was paid to out-of-state vendors for items that were not used in Indiana by use of a statistical percentage, which was based upon the total number of systems shipped to non-Indiana locations divided by the total number of systems purchased. The Department did not review the several hundreds of line items of individual pieces of equipment and/or materials for each system to determine exactly where each of the pieces–i.e., cable, scan port, bracket–were installed.

Taxpayer asserts that the assessment was incorrect and that a separate determination should be made for each piece of equipment and/or materials based upon where each of the time clock or security systems was installed. During, the course of the protest, Taxpayer presented numerous invoices and summaries estimating where each of the line items were installed. However, the documentation Taxpayer submitted was insufficient to prove that the Department's assessments, based upon percentages, were unreasonable. Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Since Taxpayer failed to produce documentation that demonstrates that the Department's assessment was incorrect, Taxpayer has failed to meet its burden to proof.

FINDING

Taxpayer's protest is respectfully denied.

IV. Sales and Use Tax–"Subscriptions."

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that Taxpayer had purchased "subscriptions" without paying sales tax at the time of purchase, and assessed used tax on the purchases.

IC § 6-2.5-3-2(a) provides, "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." An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

Taxpayer asserts that its purchases of certain "on-line database subscriptions" were not purchases of tangible personal property, but were purchases of services that are not subject to sales and use tax.

Sales Tax Information Bulletin 8 (issued February 1990 and reissued in May 2002) states:

> The sale of statistical reports, graphs, diagrams or any other information produced or compiled by a computer and sold or reproduced for sale in substantially the same form as it is so produced is considered to be the sale of tangible personal property unless the information from which such reports was compiled was furnished by the same person to whom the finished report is sold.

Accordingly, a taxpayer purchases a service when a service provider takes the taxpayer's information, reorganizes it into a new format, and returns the newly organized information to the taxpayer. However, a taxpayer purchases tangible personal property from a vendor when the vendor compiles or packages, the vendor's own information, for sale to the general public. Any transfer of this type of property in any format, electronic or otherwise, is subject to sales and use tax.

During the course of the protest, Taxpayer submitted a listed of "subscription" purchases, invoices, and contracts. For one of these "subscriptions," which Taxpayer notes was subjected to use tax on audit report line number 1042 in the amount of $3,950.00, is denied as this purchase was listed as a service and was not listed with any amount subject to use tax. For certain of the "subscriptions" under the specific terms of those "subscriptions," the Taxpayer is not receiving the transfer of property that has been compiled or packaged for sale to the general public. Since these "subscriptions" do not include the receipt of compiled or packaged property, the "subscriptions are not subject to sales and use tax." Pursuant to IC § 6-8.1-5-1(c), Taxpayer has met its burden of demonstrating that the following "subscriptions" are not subject to sales and use tax:

"Flight Traking, *[sic]*" audit report line numbers 339, 340, 341781, 784, 1106, 1107, 1109, 1110, 1111, 1112, 1113, and 1114, amount $14.95 each;

"TR2 Annual Fee," audit report line number 842, amount $10,000.

Therefore, Taxpayer's protest, as it pertains to the above listed "subscriptions," to the extent that tax was assessed, is sustained subject to the findings of a supplemental audit.

However, the documentation Taxpayer submitted was insufficient to prove that the other "subscriptions," which were not included in the above list, were not subject to sales tax. The other "subscriptions" either involved the exclusive transfer of property that has been compiled or packaged for sale to the general public or a "unitary transaction" in which at least one element of the transaction included the transfer of such compiled or packaged property. See 45 IAC 2.2-1-1(a) (stating that for a "unitary transaction," which in one combined total includes otherwise non-taxable service charges with taxable charges for property, the entire combined total is subject to sales and use tax). Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Since Taxpayer failed to produce documentation that demonstrates that the Department's assessment was incorrect for these other purchases, then Taxpayer has failed to meet its burden to proof. Therefore, Taxpayer's protest, as it relates to these other purchases, is denied.

FINDING

Taxpayer's protest is denied in part and sustained in part subject to the findings of a supplemental audit.

V. Sales and Use Tax–"Aircraft Upgrades and Repairs."

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that Taxpayer had purchased upgrades for and materials to maintain and/or repair an aircraft, which was based in Indiana, without paying sales tax at the time of purchase. Thus, the Department assessed used tax on the purchase of those materials.

IC § 6-2.5-3-2(a) provides, "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." An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4.

Taxpayer asserts that since the repairs where performed outside of Indiana, the upgrades and repair parts were "first used" outside of Indiana and cannot be subjected to Indiana use tax. Taxpayer cites to USAir, Inc. v. Indiana Dep't. of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993), which is irrelevant to support its assertion.

Taxpayer also maintains that if the property is subject to Indiana use tax, even though the aircraft is based in Indiana, the assessment should allow for Taxpayer's use of the aircraft in multiple states.

During the course of the protest, Taxpayer submitted a summary of the aircraft's use by flight hour to demonstrate that the aircraft is used in multiple locations. Notwithstanding, Taxpayer failed to present any evidence that any use tax was paid to any of the jurisdictions based upon this percentage of use of the aircraft. See IC § 6-2.5-3-5 (providing for a credit not for the use in other jurisdictions, but for the amount of any sales tax, purchase tax, or use tax rightfully paid to other jurisdictions.) Since the repaired and upgraded aircraft was used in Indiana and no sales or use tax was remitted for the materials used for the upgrades and repairs, the materials are subject to use tax in Indiana. Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect. Since Taxpayer failed to produce documentation that demonstrates that the Department's assessment was incorrect, Taxpayer has failed to meet its burden to proof.

FINDING

Taxpayer's protest is respectfully denied.

VI. Tax Administration–"Negligence Penalty."

DISCUSSION

The Department issued proposed assessments and ten (10) percent negligence penalties for the tax years in question. Taxpayer protests the imposition of the penalties. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides "if a person... 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.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), as follows:

> 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. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
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> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has provided sufficient information to establish that its failure to pay the deficiency was not due to Taxpayer's negligence, but was due to reasonable cause as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest to the imposition of the penalty is sustained.

CONCLUSION

In summary, Taxpayer's protests of Issues I, III, and V are denied, and Taxpayer's protest of Issue VI is sustained. Taxpayer's protest of Issue II is denied in part and sustained in part subject to the findings of a supplemental audit. Taxpayer's protest of Issue IV is denied in part and sustained in part subject to the findings of a supplemental audit.

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