DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 08-0580
Indiana Sales and Use Tax
For 2005, 2006, and 2007

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ISSUES

I. Propane Tanks – Use Tax.

Authority: IC § 6-2.5-5-8; Tri-States Double Cola Bottling Co. v Department of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Department of State Revenue v. Indianapolis Transit System, 356 N.E.2d 1204 (Ind. App. 1976); 45 IAC 2.2-5-15(b); Black's Law Dictionary (8th ed. 2004).

Taxpayer protests the proposed assessment of Indiana use tax on the purchase price of propane storage tanks which taxpayer later furnished its customers. Taxpayer maintains that the tanks are "leased" to its customers and that, as a result, the tanks are not subject to the use tax assessment.

II. Ten-Percent Negligence Penalty.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(4); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks the Department to exercise its discretion to abate the ten-percent negligence penalty on the ground that taxpayer believed it interpreted the applicable statutes correctly.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation in the business of supplying customers with liquid propane (LP) gas. Taxpayer also repairs LP gas tanks, and has a business location out of which a limited number of retail sales of tanks take place. However, in a majority of cases, the taxpayer supplies the tanks to its customers for free, or for a $1. The bulk of taxpayer's business consists of delivering LP gas to its customers.

For the 2005, 2006, and 2007 tax years ("Tax Years"), the Department of Revenue (Department) conducted an audit review of taxpayer's business records and tax returns. As a result of that review, the Department concluded that taxpayer owed additional amounts of use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for its protest. This Letter of Findings results.

DISCUSSION

Taxpayer purchased propane tanks which it then provided to its customers. In purchasing the tanks, taxpayer did not pay sales tax. The audit determined that the tanks were not purchased for an exempt purpose and assessed use tax accordingly. The audit concluded that, although the customers paid to use the tanks, the tanks were not "leased" to taxpayer's customers. The audit listed the following reasons justifying the conclusion that the taxpayer did not lease the tanks:

1. Taxpayer did not transfer the possession and use of the tanks to its customers.
2. Customers could not purchase LP gas from any other dealer.
3. Taxpayer retained complete control of the tanks.
4. By using the tanks to supply its customers with LP gas, the taxpayer became the end user and voided the sales or use tax exemption.

Taxpayer maintains that its initial purchase of the propane tanks was not subject to imposition of the Indiana sales tax. Taxpayer is claiming an exemption pursuant to IC § 6-2.5-5-8 which states in part that, "[t]ransactions involving tangible personal property... are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property." 45 IAC 2.2-5-15(b) amplifies the exemption provided for under IC § 6-2.5-5-8, stating, as a general rule, that "[s]ales of tangible personal property for resale, rental or leasing are exempt from tax if all of the following conditions are satisfied: (1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it; (2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and (3) The property is resold, rented or leased in the same form in which it was purchased."

The Indiana courts have provided guidance in determining whether a transaction between parties constitutes a lease agreement. In Department of State Revenue v. Indianapolis Transit System, 356 N.E.2d 1204 (Ind. App. 1976), the court of appeals stated that "[w]hether certain circumstances created a lessor – lessee... relationship between the parties is a matter of fact dependent on possession of and control over the property involved." Id. at 1209 (citing Travelers Ins. Co. v. Pond, Ohio Com.Pl., 143 N.E.2d. 189 (1957)). While finding that the Department's regulation did not contain a definition of "lease," the Tax Court in Tri-States Double Cola Bottling Co. v Department of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999), concluded that a "lease" constituted the

"transfer of a right to possession and use of goods for a term in return for consideration." Id. at 285.

Taxpayer purchases tanks from various vendors, and does not pay sales tax on those purchases. Taxpayer then enters into agreements with its customers to provide the customers with propane tanks to store LP gas that taxpayer supplies. The agreement prohibits the customer from purchasing LP gas from any other dealer. Customer cannot store anything other than taxpayer's LP gas in the storage tank. The agreement allows the taxpayer to set its own schedule for routing and distributing LP gas to its respective customers; allows the taxpayer to fill a specific customer's tank at the taxpayer's option and discretion; and allows the taxpayer to bill the customer for such "topping off."

The agreement prohibits the customer from "install[ing], adjust[ing], repair[ing], replac[ing], or service[ing] any equipment," or allowing any person other than an authorized agent of taxpayer to do so.

The agreement gives the taxpayer the right at all reasonable times to "enter upon the premises of the [customer] to install, inspect, repair, replace or service the tanks and equipment."

The terms of the agreement also prohibit the customer from removing the tank or equipment from the customer's property. In addition, the tank remains the personal property of taxpayer.

Taxpayer charges its customers a "one time cost" of $1. If the customer does not use a pre-determined minimum amount of taxpayer's gas each year, taxpayer imposes a $50 fee.

Taxpayer's agreements with customers do not constitute lease agreements because the customers do not come into "possession" of the tanks. "Possession" means the right to "exercise control over something to the exclusion of all others." Black's Law Dictionary 1201 (8th ed. 2004). By the terms of the agreement, the customer is not entitled to move the tanks or to allow another supplier to fill the tanks with a competitor's LP gas. Although the tanks are located on the customers' property, that does not mean that the customers have "possession." Although the tank is located on the customer's property, taxpayer retains nearly all of the rights to control the tank. Unlike an actual lease agreement, the taxpayer's customers do not acquire the usual rights to control the object of the lease. Instead, the tanks are merely an extension of the agreement by which taxpayer provides propane to its customers with the customer assessed an additional cost for the use of the storage container which – by nature of the transaction – is necessarily located on the customer's property. The fact that the parties' agreement is called a "lease" does not change the fact that taxpayer is not in the business of leasing propane tanks nor that the customers are not interested in leasing propane tanks. Taxpayer's interest lies in selling its product, propane, to its customers and receiving compensation for the cost of doing so. The customers' interest is in obtaining that fuel. Given the fact that the tanks have a limited decorative or utilitarian value outside of their capability of storing taxpayer's propane, it is apparent that the object of the parties' agreement is the delivery, storage, and consumption of propane.

Neither the law nor the dictates of simple common sense allow a conclusion that taxpayer purchased the tanks in order to lease the tanks to its customers. Under IC § 6-2.5-5-8, taxpayer is not "occupationally engaged" in the business of leasing storage tanks in the ordinary course of its business. Under 45 IAC 2.2-5-15(b), taxpayer is not "occupationally engaged" in renting propane tanks in the regular course of its business. Common sense dictates a finding that taxpayer engages in the business of selling propane to customers who are interested in obtaining that fuel. The fact that the sale of propane necessarily involves the use of a storage container located on the customers' property does not alter the nature of the underlying transaction. Taxpayer is, of course, entitled to be fully compensated for the fact that it necessarily incurs expenses in delivering the propane to its customers. However, that compensation does not consist of lease payments.

FINDING

Taxpayer's protest is respectfully denied.

II. Ten-Percent Negligence Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty because it had a reasonable cause for its position that it was exempt from paying use tax when it purchased the propane tanks.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(4) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "[i]f a person subject to the penalty imposed under this section can show that the failure to... pay the full amount of tax shown on the person's return... 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."

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that 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 IC § 6-8.1-5-1(c), "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

The Department is prepared to agree that taxpayer had a "reasonable" cause to believe that it was not required to pay use tax on the purchase price of the propane tanks.

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer is denied as to the substantive issue of whether it was required to pay use tax on the purchase price of the propane tanks. Taxpayer is sustained as to its protest of the negligence penalty.

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