

Letter of Findings: 08-0513
Sales and Use Tax
For the Year 2007

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ISSUES

I. Sales and Use Tax – Imposition and Reporting.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-8; IC § 6-2.5-6-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax. Ct. 2007); Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); Indiana Dep't of Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988).

Taxpayer protests denial of rental exemption and subsequent imposition of use tax on the purchase of an aircraft.

II. Tax Administration – Imposition of Negligence Penalty.

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

The Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation. On December 17, 2007, Taxpayer purchased a 2007 Cessna T182T for \$373,000. Taxpayer did not pay sales tax on the purchase of the aircraft. On January 28, 2008, the Indiana Department of Revenue ("Department") received Taxpayer's application for registration and rental exemption. On June 9, 2008, the Department disallowed the rental exemption and assessed Indiana use tax based on the purchase price of the aircraft. Taxpayer timely protested the denial of the rental exemption and the subsequent assessment of use tax. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition and Reporting.

DISCUSSION

On initial review of Taxpayer's application for the rental exemption, the Department noted that while Taxpayer had purchased an aircraft without paying sales tax at the time of purchase, it nonetheless had not filed the required monthly 2008 ST-103s and remitted sales tax on its claimed lease sales nor submitted sufficient documentation of its application. The Department denied Taxpayer's application for rental exemption and assessed Taxpayer use tax based on the purchase price of the aircraft. Taxpayer protested the denial and assessment.

All tax assessments are prima facie evidence that the Department's claim for the 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).

IC § 6-2.5-2-1 provides:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

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.

Accordingly, Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. 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. IC § 6-2.5-5 provides for other exemptions from sales and use tax.

Taxpayer contends that it's *[sic]* use of the aircraft qualified for the rental exemption, therefore, Taxpayer did not pay the sales at the time of purchase or use tax since.

The rental to others exemption is provided in IC § 6-2.5-5-8(b), as follows:

Transactions involving tangible personal property other than a new motor vehicle 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.

The exemption for rental to others is further explained at [45 IAC 2.2-5-15](#) as follows:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who

purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.

(b) General rule. Sales 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.

(c) Application of general rule.

- (1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.
- (2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.
- (3) The property must be resold, rented or leased in the same form in which it was purchased.

IC § 6-2.5-3-4(a)(2) allows for a use tax exemption for property that is acquired in a transaction that is exempt from sales tax under a provision in IC § 6-2.5-5 if the property is being stored, used, or consumed for the purpose for which the property was exempted.

In applying any tax exemption, the general rule is that tax exemptions are strictly construed in favor of taxation and against the exemption. *Indiana Dep't. of Revenue v. Interstate Warehousing*, 783 N.E.2d 248, 250 (Ind. 2003); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). When a taxpayer claims it is entitled to a tax exemption, it bears the burden of proving that the terms of the exemption have been met. *Interstate Warehousing*, 783 N.E.2d at 250.

At the time the Department denied Taxpayer the rental exemption in June 2008, Taxpayer had not reported any sales to the Department. Taxpayer subsequently stated that it collected payment on its lease arrangements annually. Since the hearing Taxpayer, on March 2, 2009, reported to the Department its sales of \$38,280 for 2008 upon which it remitted sales tax. Taxpayer has also reported sales and remitted sales tax on a monthly basis for the periods ending January 31, 2009, and February 28, 2009.

Taxpayer argues that its annual reporting is justified, because:

Indiana law does not command the relationship between lessor and lessee, rather it requires that tax be paid in the tax reporting period where rental payments are made. (See, e.g., Informational Bulletin 42, 1993 Ind. Tax LEXIS 90, providing that "For purposes of payment on rental or lease transactions, a complete transaction is comprised of the period for which the rental or lease payment is determined. For example, if the rental payments is determined on a weekly basis, the rental of property during a week period is considered a complete transaction. For a continuing lease, a complete transaction is comprised of the period for which the lease payment is made.")

The Information Bulletin that Taxpayer refers to was suspended in April 2005. Sales tax reporting is governed by IC § 6-2.5-6-1. "Version a" of the statute is effective until January 1, 2009, when "version b" takes effect. The main difference between the versions is in subsection (d) which allows a taxpayer, upon approval by the Department, to file returns for periods other than monthly subject to prior year sales. IC § 6-2.5-6-1 "Version a," effective until January 1, 2009, states:

(a) Except as otherwise provided in this section, each person liable for collecting the state gross retail or use tax shall file a return for each calendar month and pay the state gross retail and use taxes that the person collects during that month. A person shall file the person's return for a particular month with the department and make the person's tax payment for that month to the department not more than thirty (30) days after the end of that month, if that person's average monthly liability for collections of state gross retail and use taxes under this section as determined by the department for the preceding calendar year did not exceed one thousand dollars (\$1,000). If a person's average monthly liability for collections of state gross retail and use taxes under this section as determined by the department for the preceding calendar year exceeded one thousand dollars (\$1,000), that person shall file the person's return for a particular month and make the person's tax payment for that month to the department not more than twenty (20) days after the end of that month.

(b) If a person files a combined sales and withholding tax report and either this section or [IC 6-3-4-8.1](#) requires sales or withholding tax reports to be filed and remittances to be made within twenty (20) days after the end of each month, then the person shall file the combined report and remit the sales and withholding taxes due within twenty (20) days after the end of each month.

(c) Instead of the twelve (12) monthly reporting periods required by subsection (a), the department may

permit a person to divide a year into a different number of reporting periods. The return and payment for each reporting period is due not more than twenty (20) days after the end of the period.

(d) Instead of the reporting periods required under subsection (a), the department may permit a retail merchant to report and pay the merchant's state gross retail and use taxes for a period covering:

- (1) a calendar year, if the retail merchant's average monthly state gross retail and use tax liability in the previous calendar year does not exceed ten dollars (\$10);
- (2) a calendar half year, if the retail merchant's average monthly state gross retail and use tax liability in the previous calendar year does not exceed twenty-five dollars (\$25); or
- (3) a calendar quarter, if the retail merchant's average monthly state gross retail and use tax liability in the previous calendar year does not exceed seventy-five dollars (\$75).

A retail merchant using a reporting period allowed under this subsection must file the merchant's return and pay the merchant's tax for a reporting period not later than the last day of the month immediately following the close of that reporting period.

(e) If a retail merchant reports the merchant's adjusted gross income tax, or the tax the merchant pays in place of the adjusted gross income tax, over a fiscal year or fiscal quarter not corresponding to the calendar year or calendar quarter, the merchant may, without prior departmental approval, report and pay the merchant's state gross retail and use taxes over the merchant's fiscal period that corresponds to the calendar period the merchant is permitted to use under subsection (d). However, the department may, at any time, require the retail merchant to stop using the fiscal reporting period.

(f) If a retail merchant files a combined sales and withholding tax report, the reporting period for the combined report is the shortest period required under:

- (1) this section;
- (2) [IC 6-3-4-8](#); or
- (3) [IC 6-3-4-8.1](#).

(g) If the department determines that a person's:

- (1) estimated monthly gross retail and use tax liability for the current year; or
- (2) average monthly gross retail and use tax liability for the preceding year;

exceeds five thousand dollars (\$5,000), the person shall pay the monthly gross retail and use taxes due by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)) or by delivering in person or by overnight courier a payment by cashier's check, certified check, or money order to the department. The transfer or payment shall be made on or before the date the tax is due.

(h) If a person's gross retail and use tax payment is made by electronic funds transfer, the taxpayer is not required to file a monthly gross retail and use tax return. However, the person shall file a quarterly gross retail and use tax return before the twentieth day after the end of each calendar quarter.

(i) A person:

- (1) who has voluntarily registered as a seller under the Streamlined Sales and Use Tax Agreement;
- (2) who is not a Model 1, Model 2, or Model 3 seller (as defined in the Streamlined Sales and Use Tax Agreement); and
- (3) whose liability for collections of state gross retail and use taxes under this section for the preceding calendar year as determined by the department does not exceed one thousand dollars (\$1,000);

is not required to file a monthly gross retail and use tax return.

(Emphasis added).

IC § 6-2.5-6-1(d) of "Version b," effective January 1, 2009, states:

Instead of the reporting periods required under subsection (a), the department may permit a retail merchant to report and pay the merchant's state gross retail and use taxes for a period covering a calendar year, if the retail merchant's state gross retail and use tax liability in the previous calendar year does not exceed one thousand dollars (\$1,000). A retail merchant using a reporting period allowed under this subsection must file the merchant's return and pay the merchant's tax for a reporting period not later than the last day of the month immediately following the close of that reporting period.

Taxpayer leases its aircraft to three separate entities. Under the terms of the agreements, the lessees are to calculate and pay their rent annually. Based on the above, since Taxpayer is liable for collecting sales tax, Taxpayer "shall file a return for each calendar month and pay the state gross retail and use taxes that the person collects during that month." IC § 6-2.5-5-8(a). As of January 1, 2009, only a taxpayer whose tax liability was under \$1,000 the prior calendar year may, subject to the Department's permission, file a sales tax return annually. IC § 6-2.5-5-8(d). This means that even if Taxpayer only collects rent and sales tax at the end of its year, it is nonetheless obligated to file monthly "zero returns" ("zero," because it has not collected on its sales) for those months preceding the end of year filing. Or, if Taxpayer actually collects rent and sales tax monthly, as it appears to have done in January and February of 2009, it should continue to report its sales and remit sales tax monthly.

The Department could, at its discretion, permit a taxpayer to "divide a year into a different number of reporting periods." IC § 6-2.5-6-1(c). This is not the case, however, in this instance.

As for its other qualifications for the rental exemption, Taxpayer remitted sales tax on sales totaling \$38,280

in 2008.

The Department refers to IC § 6-2.5-5-8(e), which provides, as follows:

This subsection applies only after June 30, 2008. A transaction in which a person acquires an aircraft for rental or leasing in the ordinary course of the person's business is not exempt from the state gross retail tax unless the person establishes, under guidelines adopted by the department in the manner provided in [IC 4-22-2-37.1](#) for the adoption of emergency rules, that the annual amount of the lease revenue derived from leasing the aircraft is equal to or greater than:

- (1) ten percent (10 [percent]) of the greater of the original cost or the book value of the aircraft, if the original cost of the aircraft was less than one million dollars (\$1,000,000); or
- (2) seven and five-tenths percent (7.5 [percent]) of the greater of the original cost or the book value of the aircraft, if the original cost of the aircraft was at least one million dollars (\$1,000,000).

While this statute was not yet in effect for a 2007 aircraft purchase and part of the sales tax reporting period in 2008, it is a useful guide, along with the other documentation Taxpayer has provided, of what constitutes reasonable annual rental revenues for a person occupationally engaged in renting or leasing an aircraft, especially in light of the fact that for the rest of 2008, Taxpayer was subject to the new statutory requirements. Here, the purchase price of the aircraft was \$373,000. As provided by IC § 6-2.5-5-8(e)(2), after June 30, 2008, the annual amount of lease revenue that Taxpayer derives from the leasing of the aircraft would need to be equal or greater than ten (10) percent of the greater of the original cost or the book value of the aircraft in order for Taxpayer to qualify for the exemption; i.e., a minimum of \$37,300. Taxpayer remitted sales tax, as stated above, on \$38,280 in sales, just exceeding the required statutory minimum to be presumed to be in the business of renting and leasing and therefore qualify for the related exemption.

Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) and therefore is qualified for the rental exemption. Taxpayer is placed on notice that it must file monthly sales tax returns that reflect the payments and tax it collects on its sales – whether they are "zero" returns or otherwise.

FINDING

Taxpayer's protest that it qualifies for the rental exemption is sustained.

II. Tax Administration – Imposition of Negligence Penalty.

DISCUSSION

The Taxpayer also protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation [45 IAC 15-11-2](#)(b) clarifies the standard for the imposition of the negligence penalty as follows:

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 standard for waiving the negligence penalty is given at [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:

- (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.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer is sustained on Issue I, therefore there is no proposed assessment upon which to subject Taxpayer to a negligence penalty.

FINDING

Taxpayer's protest of the assessment of the negligence penalty is sustained.

CONCLUSION

Taxpayer's protest that it qualifies for the rental exemption is sustained, as is its protest of the ten percent negligence penalty.

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