DEPARTMENT OF STATE REVENUE

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Letter of Findings: 09-0027
Sales and Use Tax
For the Years 2005, 2006, and 2007

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ISSUES

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-8.1-5-1(c); IC § 9-18-2-1; IC § 9-18-2-2; 45 IAC 2.2-3-7; 45 IAC 2.2-3-12; 45 IAC 2.2-4-4; 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).

Taxpayer protests the assessment of sales and/or use tax on tangible personal property.

II. Tax Administration – Penalty.

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

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, an Indiana S corporation, conducts custom and specialized machining manufacturing projects for the transportation industry. Taxpayer's products include machinery for farmers and manufacturers as well as race cars. Pursuant to an audit, the Indiana Department of Revenue (Department) assessed sales tax on products which Taxpayer sold to its customers and failed to collect sales tax or obtain exemption certificates from the customers. The Department's audit also assessed use tax on certain items which Taxpayer purchased because Taxpayer acquired these items without paying sales tax or self-assessing and remitting use tax to the Department. Taxpayer protests the assessments and penalty. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

After the audit, the Department assessed sales tax on Taxpayer's sales of the products for which Taxpayer failed to collect sales tax or obtain exemption certificates. The Department's audit also assessed use tax on Taxpayer's purchases, such as office and shop supplies, computer software updates and maintenance agreements, subscriptions, truck rentals, and an RV, because Taxpayer did not pay sales tax nor did it self-assess and remit use tax to the Department.

Taxpayer first claimed that it had obtained an exemption certificate from its customer, so it was not liable for collecting and remitting sales tax on the item which it sold to the customer. Taxpayer also argued that manufacturing exemptions applied to certain of the purchases of the tangible personal property, such as a socket/tool, an LED Cordless, an Angle Lock Vise, two fans, two dust collectors, two Hose Reels, a base light, a AC Power, and a EMF/ELF Meter, because these items were directly used in the direct production. Additionally, Taxpayer claimed that it purchased an oil pump for resale, so it was exempt from sales tax. Moreover, Taxpayer claimed that the computer software support maintenance agreements were directly used in the direct production, so manufacturing exemptions applied to the purchases. Finally, Taxpayer claimed that the RV was owned by its Montana subsidiary company and was registered in Montana. Therefore, Taxpayer argued that it should not be liable for the sales and/or use tax on the RV although the RV was used and stored in Indiana.

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).

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.

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 provides:

(a) 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, all sales of tangible personal property are taxable. An exemption from 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.

Discussion of each of the protested items follows:

A. Exemption Certificate

The Department's audit assessed sales tax on one of the transactions, reference number 11447, where Taxpayer did not collect and remit sales tax to the Department or obtain an exemption certificate. Claiming the transaction was exempt from sales tax, Taxpayer protested the assessment. Prior to the hearing, Taxpayer obtained a copy of the exemption certificate from the customer, a farmer, and submitted the copy to the Department.

Taxpayer's protest is sustained, the transaction, reference number 11447, is exempt.

B. Supplies-Tools and Equipment

The Department's audit assessed use tax on Taxpayer's purchases of tools and equipment, including a socket/tool, a LED cordless, an Angle Lock Vise, fans, and dust collectors, because Taxpayer did not pay sales tax at the time of the purchases nor did Taxpayer self-assess and remit use tax to the Department. Taxpayer, to the contrary, claimed that these items were exempt from sales and/or use tax because they were directly used in the direct production. However, Taxpayer did not provide any documentation to substantiate its claim.

Taxpayer's protest is denied.

C. Oil Pump

The Department's audit assessed use tax on the purchase price of an oil pump, because Taxpayer purchased the oil pump without paying sales tax at the time of the purchase nor did Taxpayer self-assess and remit use tax to the Department. Taxpayer claimed that the oil pump it purchased was later resold to a customer and, therefore, pursuant to 45 IAC 2.2-4-4, the oil pump should not be taxed.

To support its protest, in addition to a copy of the invoice for the purchase of the oil pump, Taxpayer also provided a copy of an invoice showing that an oil pump was later sold to a customer. However, neither invoice specifically describes or identifies the oil pump(s) that are the subject of the transactions. In the absence of documentation identifying the oil pump, the Department is not able to conclude that 45 IAC 2.2-4-4 exemption applied to Taxpayer's purchase of the oil pump.

Even if Taxpayer purchased the oil pump for resale and was entitled to the exemption, Taxpayer, as a retail merchant, should have collected the sales tax from the customer when it sold the oil pump and remitted the sales tax due to the Department. Taxpayer's documentation did not show that the sales tax was collected at the time of the transaction and remitted to the Department, nor did Taxpayer obtain a copy of an exemption certificate from the customer. In this audit, however, the Department did not assess the sales tax on the resale of the oil pump. Taxpayer is on notice that it is responsible for collecting and remitting the sales tax on the items it purchases for resale when it sells them. Alternatively, Taxpayer must obtain exemption certificates in the event that the customers claim they are exempt from paying sales tax.

In short, Taxpayer did not provide sufficient documentation to show that its purchase of the oil pump was for resale and the wholesale exemption applied to it. Therefore, Taxpayer's protest is denied.

D. Computer Software Support Maintenance Agreements

The Department's audit assessed use tax on two computer software support maintenance agreements because Taxpayer did not pay sales tax at the time of the purchases nor did Taxpayer self-assess and remit use tax to the Department. Taxpayer agreed that computer software support maintenance agreements from the vender were tangible personal property and subject to sales tax. However, Taxpayer claimed that it used the computer software to manufacture its products, therefore, the computer software was directly used in and integral to its manufacturing process exempting it from tax under IC § 6-2.5-5-3 and 45 IAC 2.2-5-8.

To support its protest, Taxpayer provided copies of the purchase invoices and computer software support maintenance agreements for these years. Each agreement included:

- Version updates–for [Taxpayer's] convenience, download from [the software company's] website at any time.
- Enhancements and bug fixes etc., throughout the year.
- Unlimited Tech Support–by phone, fax and e-mail.
- Discounts for add-on modules or additional ports as [Taxpayer's] shop grows.
- 10 [percent] discount for [some of software company's products].
- On-line training for shop personnel.

Taxpayer's documentation, however, did not show how the computer software was directly used in the direct manufacturing process. In the absence of further documentation showing the use of the computer software, the Department is not able to conclude that Taxpayer is entitled to the manufacturing exemption.

Taxpayer's protest is denied.

E. Recreational Vehicle

The Department's audit assessed use tax on the purchase price of the RV because the RV was stored in Indiana and used by Taxpayer's shareholders, all Indiana residents, but no sales or use tax had been remitted to the State of Indiana on the purchase of the RV.

Taxpayer claimed that the RV was owned by Taxpayer's subsidiary company, a nonresident entity incorporated in Montana (Montana LLC). Taxpayer referred to IC § 9-18-2-2, which states in relevant part, "a

nonresident who owns a vehicle required to be registered under this article may operate... the vehicle in Indiana without registering the vehicle or paying any fees if the vehicle is properly registered in the jurisdiction in which the nonresident is a resident." Taxpayer believes that this means that it was not required to pay sales tax on the purchase of the RV.

Taxpayer is mistaken. IC § 9-18-2-1 specifically outlines the situations in which a person is responsible for excise tax under IC § 6-6 while IC § 9-18-2-2 allows a nonresident operator of a vehicle to own and use the vehicle without registering the vehicle in Indiana or paying any fees if the vehicle is properly registered in the nonresident's home state. The statute's language clearly distinguishes between a "fee" and "tax." IC § 9-18-2-2 refers to "fees" as fees for registration, licensing, etc., and does not include taxes. In short, the statute, IC § 9-18-2-2, has no bearing on Taxpayer's protest and does not apply to whether or not Taxpayer owes sales or use tax on the purchase of the RV.

To support its protest, Taxpayer also submitted a copy of the cover letter from a Montana attorney, the operating agreement establishing that the Montana LLC is wholly owned by Taxpayer, and the RV's Montana registration. Taxpayer's documentation showed that the Montana attorney's law office was the Montana LLC's principal place of business, that Taxpayer is sole owner of the Montana LLC, and that the RV is its only asset. According to the Indiana Bureau of Motor Vehicles (BMV) record, the operators were Indiana residents for these years. Moreover, the users (operators) of the RV, Taxpayer's shareholders, used the RV and stored the RV in Indiana. The BMV record also showed that the RV occasionally traveled to Illinois, Ohio, Kentucky, Missouri, and Tennessee, but the RV was never in Montana during the years in question. Taxpayer claimed the RV purchase was exempt from Indiana sales and/or use tax because the RV was owned and registered under the Montana LLC, but Taxpayer did not provide any documentation which showed that sales and/or use tax on the RV were paid to the State of Montana to receive the tax credit in Indiana. Since Taxpayer used and stored the RV in Indiana, and since Taxpayer did not pay sales or use tax in any other state, use tax was properly imposed.

Taxpayer's protest is denied.

FINDING

Taxpayer's protest in Part A is sustained, but the remainder of Taxpayer's protest is respectfully denied.

II. Tax Administration – Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

(1) fails to file a tax return;
(2) fails to pay the full amount of tax shown on the tax return;
(3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
(4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

45 IAC 15-11-2(b) further 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), in part, 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 did not provide sufficient documentation establishing that its failure to timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of the negligence penalty is denied.

SUMMARY

For the reasons discussed above, Taxpayer's protest in Part I, Subpart A is sustained. However, the remainder of Taxpayer's protest is respectfully denied.

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