

**Letter of Findings Number: 09-0531**  
**Sales and Use Tax**  
**For The Tax Years 2006-2008**

**NOTICE:** Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUES**

**I. Sales and Use Tax—Credit Reports.**

**Authority:** 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; Sales Tax Information Bulletin 8 (May 2002).

Taxpayer protests the assessment of use tax on credit reports.

**II. Sales and Use Tax—Air Conditioner.**

**Authority:** IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); North Cent. Industries, Inc., Co. v. Indiana Dep't of State Revenue, 790 N.E.2d 198 (Ind. Tax Ct. 2003); Indiana Waste Sys. v. Indiana Dep't of State Revenue, 633 N.E.2d 359 (Ind. Tax Ct. 1994); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988).

Taxpayer protests the assessment of use tax on an air conditioner.

**III. Tax Administration—Negligence 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 operates as wholesaler/distributor in Indiana. Taxpayer receives products from vendors in bulk and resells the products to retailers. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed use tax, interest, and penalty for the 2006, 2007, and 2008 tax years. The Department found that Taxpayer had made purchases without paying sales tax at the time of purchase or remitting use tax to the Department. Taxpayer protested this imposition of the tax and penalty. An administrative hearing was held, and this Letter of Findings results. Additional facts will be provided as necessary.

**I. Sales and Use Tax—Credit Reports.**

**DISCUSSION**

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

The Department found that Taxpayer had purchased credit reports without paying sales tax at the time of purchase or remitting use tax to the Department.

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-3-2(a). A complementary 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. IC § 6-2.5-3-2.

Specifically, IC § 6-2.5-2-1 provides as follows:

(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 for the complementary use tax:

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 when sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. Since Taxpayer failed to pay sales tax at the time of the purchase, the Department found that the purchases were subject to use tax.

Taxpayer asserts that the costs for the credit reports constitute services that are not subject to sales and use tax. Taxpayer maintains that the only tangible personal property involved is the few pieces of paper used to print the credit reports.

During the hearing, Taxpayer provided a sample invoice that indicated that Taxpayer was billed a certain set amount for each report provided. While Taxpayer did not provide the contract, Taxpayer did provide a letter that stated "feel free to fax in your credit report request to us. Use the attached report request form." Essentially, Taxpayer requests an individual "credit report" for one of its potential customers and is billed for each credit report

requested depending on the type of report requested of which the prices vary. The issue is whether this "information" or credit report is subject to sales tax and use tax.

The issue of whether that "information" is subject to sales and use tax is addressed in the Sales Tax Information Bulletin 8 (May 2002) which states as follows:

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.

Taxpayer purchases credit reports. The reports consist of information "compiled by a computer [and] sold or reproduced for sale in substantially the same form as it is so produced...." Therefore, the reports – by whatever means transmitted – constitute "tangible personal property" obtained in a retail transaction, and the cost of the reports is subject to sales tax.

#### FINDING

Taxpayer's protest is respectfully denied.

#### II. Sales and Use Tax–Air Conditioner.

#### DISCUSSION

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

The Department found that Taxpayer had purchased an air conditioner without paying sales tax at the time of purchase or remitting use tax to the Department.

Indiana imposes "an excise tax, known as the use tax," on tangible personal property that is acquired in retail transactions and is stored, used, or consumed in Indiana. IC § 6-2.5-3-2(a). An exemption from the use tax is granted for transactions when sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. Since Taxpayer failed to pay sales tax at the time of the purchase, the Department found that the purchases were subject to use tax.

Taxpayer maintains that, as a distributor of manufactured products, its air conditioner purchase is used for production activities and is exempt under the "manufacturing equipment exemption" found in IC § 6-2.5-5-3.

IC § 6-2.5-5-3(b) provides an exemption from sales tax for "manufacturing machinery, tools, and equipment... if the person acquiring the property acquires it for direct use in the direct production [or] manufacture... of other tangible personal property." Property acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." *Id.*

Accordingly, tangible personal property purchased for the direct use in the direct production of a manufactured good is subject to sales and use tax unless the property used has an immediate effect on and is essential to the production of the marketable good. Additionally, 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 State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

Taxpayer asserts that since it purchased the air conditioner to maintain its vendors' manufactured products that Taxpayer purchases in bulk and repackages for resale, the air conditioner is exempt manufacturing equipment under IC § 6-2.5-5-3(b). Taxpayer maintains that its repacking of the products is manufacturing because it is a continuation of the vendors' manufacturing process.

The Tax Court addressed the issue of repacking in *North Cent. Industries, Inc., Co. v. Indiana Dep't of State Revenue*, 790 N.E.2d 198 (Ind. Tax Ct. 2003), where the taxpayer bought fireworks in bulk and sold packages containing a variety of fireworks. In that case, the court explained:

North Central does not create a new, marketable product; it merely packages existing fireworks into boxes, then labels and shrink-wraps them. This is not the sort of substantial change or transformation that places the fireworks "in a form, composition, or character different from that in which [they were] acquired." [45 IAC 2.2-5-8\(k\)](#). See also *Indianapolis Fruit*, 691 N.E.2d at 1386; *Mechanics Laundry & Supplies, Inc. v. Indiana Dep't of State Revenue*, 650 N.E.2d 1223, 1229 (Ind. Tax Ct. 1995) (holding that producing a good is not merely perpetuating already existing goods); *Harlan Sprague Dawley*, 605 N.E.2d at 1229; *Faris Mailing*, 512 N.E.2d at 483. Nor does North Central's process increase the number of "scarce economic goods," see *Harlan Sprague Dawley*, 605 N.E.2d at 1225, because the same number of fireworks are sold regardless of the way they are packaged. Consequently, North Central's activities do not constitute the direct production or manufacture of other tangible personal property. *Id.* at 201-2.

Moreover, in *Indiana Waste Sys. v. Indiana Dep't of State Revenue*, 633 N.E.2d 359, 363 (Ind. Tax Ct. 1994), the Tax Court further expounded on the "equipment exemption" providing that it is not enough that a taxpayer seeking to claim the equipment exemption acts as one part of a larger overall process that results in the production of tangible personal property. *Id.* The Tax Court found that the tangible personal property must be

produced "as part of [the taxpayer's] own process... not as part of an alleged process of another taxpayer." Id. The Tax Court established a "minimum threshold requirement... that the taxpayer who purchases the equipment in question be the entity that uses the equipment 'for his direct use in the direct production... of other tangible personal property.' [IC 6-2.5-5-3\(b\)](#)." Id. at 362-63 (emphasis in original). Thus, the Tax Court determined that in order "to have a colorable claim for the equipment exemption" pursuant to IC § 6-2.5-5-3(b), a taxpayer must use the equipment "as part of its own process to produce other tangible personal property, not as part of an alleged process of another taxpayer." Id.

In the case at hand, Taxpayer uses the air conditioner to maintain the vendors' products that it repackages and sells. It is the vendors that produce the manufactured goods. Taxpayer itself does not produce or manufacture goods. Since repacking is not manufacturing and the Taxpayer's use of the air conditioner fails to meet the requirement that the production equipment cannot be used "as part of an alleged process of another taxpayer," Taxpayer's air conditioner purchase does not meet the exemption found in IC § 6-2.5-5-3(b).

#### **FINDING**

Taxpayer's protest is respectfully denied.

### **III. Tax Administration–Negligence Penalty.**

#### **DISCUSSION**

Taxpayer protests 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.

Taxpayer has provided sufficient information to establish that its failure to pay the deficiency in this instance was not due to Taxpayer's negligence, but was due to reasonable cause as required by [45 IAC 15-11-2\(c\)](#). While Taxpayer's current circumstances show that Taxpayer acted with reasonable cause, Taxpayer should be on notice that should these circumstances arise again, penalty waiver may not be warranted.

#### **FINDING**

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

#### **CONCLUSION**

Taxpayer's protest to the imposition of tax is respectfully denied as discussed in Issue I and in Issue II. Taxpayer's protest to the imposition of penalty is sustained as discussed in Issue III.

*Posted: 12/23/2009 by Legislative Services Agency*

An [html](#) version of this document.