DEPARTMENT OF STATE REVENUE

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Letter of Findings: 09-0418
Sales and Use Tax
For the Years 2006 and 2007

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ISSUES

I. Sales and Use Tax–Imposition.

Authority: IC § 6-2.5-1-14; IC § 6-2.5-1-24; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-6-13; IC § 6-8.1-5-1.

Taxpayer protests the imposition of use tax.

II. Tax Administration–Negligence Penalty.

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

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer has business operations in Indiana selling new and used vehicles. Taxpayer also sells parts and has a complete service department. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional use tax and assessed tax, interest, and negligence penalties for the 2006 and 2007 tax years. The Department determined that Taxpayer had made a number of purchases without either paying sales tax at the time of the purchase or remitting use tax to the Department. Taxpayer protested the tax and penalty assessments. An administrative hearing was held, and this Letter of Findings results.

I. Sales and Use Tax–Imposition.

DISCUSSION

The Department determined that Taxpayer had made a number of purchases without either paying sales tax at the time of the purchase or remitting use tax to the Department.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

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. 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.

A. Software.

The Department found that Taxpayer had purchased software without paying sales tax at the time of the purchase or remitting use tax to the Department. The Department determined that Taxpayer had purchased and used in Indiana "canned, prewritten software" that is subject to the sales and use tax. The Department assessed use tax on the computer software pursuant to IC § 6-2.5-3-2.

IC § 6-2.5-1-27 provides that "prewritten computer software" is "tangible personal property." IC § 6-2.5-1-14 generally defines "computer software" as "a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task." Additionally, IC § 6-2.5-1-24 defines "prewritten computer software" as:

> Subject to the following provisions, "prewritten computer software" means computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser:
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> (1) The combining of two (2) or more prewritten computer software programs or prewritten parts of the programs does not cause the combination to be other than prewritten computer software.
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> (2) Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the purchaser.
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> (3) If a person modifies or enhances computer software of which the person is not the author or creator, the person is considered to be the author or creator only of the person's modifications or enhancements.
>
> (4) Prewritten computer software or a prewritten part of the software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software. However, where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such a

modification or enhancement, the modification or enhancement is not prewritten computer software.

Taxpayer maintains that the payments were for "software support" and are payments for services, which are not subject to sales and use tax. Taxpayer also claims that the software is accessed "through the internet" and that Taxpayer "do[es] not own or have purchased software." However, Taxpayer did not provide documentation to support its assertions. In fact, Taxpayer's "Master Software License Agreement" governing the software in question contradicts the Taxpayer's assertions. The "Master Software License Agreement" provides Taxpayer the right to use all of the software listed in Exhibit A at the Taxpayer's location. The agreement also states that the computer software company "shall deliver the [software] to [Taxpayer], and [Taxpayer] shall install the [software]."

Taxpayer claims that this software agreement has not been updated to recognize that Taxpayer now accesses the software over the internet–i.e., in a web-based software program. Nonetheless, even if the agreement software had been updated because the software was provided in a web-based software program, a web-based software program is computer software. As long as the web-based software program is also not designed and developed to the specifications of a specific purchaser, the web-based software program is prewritten computer software that constitutes tangible personal property. The fact that a computer software program is accessed via the Internet as opposed to on the customer's own computer is irrelevant to the taxability of the program; the program in whatever form constitutes tangible personal property, and the company's charges for access to the program is subject to sales and use tax.

B. Consumables/Materials for Resale.

Taxpayer was in the business of performing repair services and repairing vehicles for resale. In performing these repairs, Taxpayer used consumable items such shop supplies. The Department assessed use tax on the Taxpayer's use of these items. Taxpayer protested this assessment. Taxpayer alleges that it included the taxed consumable supplies as materials on the invoices to customers pursuant to insurance industry rules. Thus, as invoiced materials, Taxpayer collected and remitted sales tax on the consumable supplies on which the Department assessed use tax. Taxpayer argued that if sales tax was collected and remitted on these items, the Department should not be able to assess use tax on the consumable supplies.

As stated previously, Indiana imposes a sales tax on the transfer of tangible personal property in a retail transaction. IC § 6-2.5-2-1. Indiana also imposes a complementary excise tax, the use tax, on tangible personal property purchased in a retail transaction and stored, used, or consumed in Indiana. IC § 6-2.5-3-2(a).

The shop supplies were consumed in the provision of a service, the repair of damaged vehicles. Taxpayer was the final user of the shop supplies. Thus, the shop supplies were not sold to the customers in a retail transaction. Therefore, the Department properly imposed use tax on Taxpayer's use of the shop supplies.

Taxpayer protested that it should not have to pay tax twice. However, Taxpayer is not being assessed sales tax twice. If Taxpayer did bill sales tax to its customers on the consumable supplies, this was done in error. Those customers would have the right to claim a refund of the sales taxes improperly paid. IC § 6-2.5-6-13. The Department properly imposed use tax on the consumable supplies that the Taxpayer used in repairing the vehicles.

C. Sample Population.

Taxpayer asserts that its purchase of "tooling" should be excluded from the sample population because this is a "one-time purchase." Presumably, Taxpayer is suggesting that the purchase of tooling is an "extraordinary expense" and should not be included in the projection. Notwithstanding that Taxpayer failed to identify to which assessment(s) it was referring to in the audit report as extraordinary "tooling" purchase, it does not seem likely that a repair service department's purchases of tools would be highly abnormal, unrelated, or incidentally related to its vehicle repair operations. Moreover, during the hearing process, Taxpayer was asked to provide, but did not provide, a more detailed explanation and to specifically address how the audit report's projections–that were based upon the division of the purchases into different stratums of related purchase–failed to address Taxpayer's concerns.

Other than Taxpayer's bare assertion that the amount of the assessment is disproportionate because of the inclusion of the "tooling" purchase(s), Taxpayer has failed to explain how or on what basis the assessment should be modified. Taxpayer has failed to meet its statutory burden under IC § 6-8.1-5-1(c) of demonstrating that the assessment is incorrect.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides, "[I]f a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

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 is sustained.

CONCLUSION

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

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