DEPARTMENT OF STATE REVENUE

04-20090617.LOF

Letter of Findings: 09-0617
Gross Retail Tax
For the Years 2006 through 2008

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ISSUES

I. Like-Kind Exchange – Gross Retail Tax.

Authority: IC § 6-2.5-1-5; IC § 6-2.5-1-6; IC § 6-2.5-2-1; IC § 6-2.5-2-2; IC § 6-8.1-5-1(c).

Taxpayer argues that it was not subject to sales tax on a portion of the purchase price of a truck because it purchased the truck with insurance proceeds.

II. Software Maintenance Agreement – Gross Retail Tax.

Authority: IC § 6-2.5-1-4; IC § 6-2.5-1-1; IC § 6-2.5-1-2; IC § 6-2.5-3-2(a); IC § 6-8.1-5-1(c); 45 IAC 2.2-1-1(a); Sales Tax Information Bulletin 2 (December 2006); Sales Tax Information Bulletin 8 (May 2002); Sales Tax Information Bulletin 8 (February 1990).

Taxpayer maintains that it is not subject to sales tax on the entire cost of software maintenance contracts.

III. Tax Administration – 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 that the Department exercise its authority to abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana wholesaler of petroleum products. Taxpayer is registered as a qualified distributor responsible for collecting prepaid sales tax on gasoline. Taxpayer sells and delivers gasoline and diesel fuel from bulk plants to service stations. In addition, Taxpayer sells diesel fuel, fuel oil, lubricants, and other bulk petroleum products to farmers, transportation companies, and manufacturers. The Department of Revenue (Department) conducted an audit review of Taxpayer's business records and concluded that Taxpayer owed additional gross retail tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative further explained the basis for its protest. This Letter of Findings results.

I. Like-Kind Exchange – Gross Retail Tax.

DISCUSSION

Taxpayer lost a truck and trailer in a collision. Taxpayer filed an insurance claim and received payment. The payment was used to replace the truck and trailer. The truck was purchased without paying sales tax on the ground that the insurance proceeds constituted a "like-kind" exchange.

The Department's audit concluded that the insurance payment did not qualify as a "like-kind" exchange and assessed sales tax on the full purchase price of the truck. Taxpayer explains its protest as follows:

> The insurance company issued us a payment for the value of the vehicle, which I do not understand why it was not allowed to be applied against the purchase of a replacement. If the vehicle would not have been totaled, we would have been allowed to trade it in on a replacement vehicle and apply the trade in against the purchase cost of the replacement vehicle and paid sales tax on the difference.

As a threshold issue, it is the Taxpayer's responsibility to establish that the proposed 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."

Indiana imposes a sales tax on retail sales. IC § 6-2.5-2-1. The sales tax is measured by the gross retail income received by the retail merchant from the purchaser. IC § 6-2.5-2-2. Gross retail income does not include the value of "any tangible personal property received in a like-kind exchange...." IC § 6-2.5-1-5. A like-kind exchange is the exchange of personal property of the "same kind or character, regardless of grade or character." IC § 6-2.5-1-6.

Taxpayer is correct in that if it had traded in its original truck for the new truck, the amount of sales tax would have been reduced because the amount of "gross retail income" received by the truck dealer would have decreased. However, a "like-kind" exchange consists of "tangible personal property" and Taxpayer did not offer "tangible personal property" to the truck dealer. Taxpayer paid the truck dealer with the insurance proceeds. The insurance proceeds are not of the "same kind or character" as Taxpayer's replacement vehicle, and the audit was correct in concluding that Taxpayer should have paid sales tax on the entire cost of the replacement vehicle.

FINDING

Taxpayer's protest is respectfully denied.

II. Software Maintenance Agreements – Gross Retail Tax.

DISCUSSION

Taxpayer argues that it is not subject to sales tax on the entire cost of computer maintenance contracts. The audit determined that Taxpayer was subject to sales tax on these contracts; Taxpayer disagrees arguing that it should be entitled to distinguish the price it paid for "revisions" and the price it paid for "software support."

IC § 6-2.5-3-2(a) provides that "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 the transaction or of the retail merchant making that transaction." The Department has determined that the purchase of computer updates constitutes a retail transaction in which the buyer acquires tangible personal property.

Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook. Sales Tax Information Bulletin 8 (May 2002); See also Sales Tax Information Bulletin 8 (February 1990).

The particular updates of which Taxpayer complains were obtained by virtue of maintenance agreements. However, whether or not the updates were obtained pursuant to the terms of a maintenance agreement does not resolve the issue of whether the entire cost of the maintenance agreements was subject to Indiana's gross retail tax. "Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are subject to sales tax if there is a reasonable expectation that tangible personal property will be provided." Sales Tax Information Bulletin 2 (December 2006).

In effect, the audit found that Taxpayer's purchase of software maintenance agreements constituted a "unitary transaction" under 45 IAC 2.2-1-1(a). This regulation states as follow:

> For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

The regulation derives from IC § 6-2.5-1-1 which states that a "'unitary transaction' includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." A "retail unitary transaction" occurs when a retail merchant purchases tangible personal property in his ordinary course of business and then sells that property along with services as a unitary transaction. IC § 6-2.5-1-2.

Taxpayer asks that the Department conduct an after-the-fact review of the maintenance agreements and distinguish the amount paid for tangible personal property – the software "updates" – and the amount paid for exempt services. However, Taxpayer has offered no information or authority by which this review could be accomplished. Taxpayer asks for more than the Department can provide and, under IC § 6-8.1-5-1(c), has not met its burden of establishing that the "proposed assessment is wrong."

FINDING

Taxpayer's protest is respectfully denied.

III. Tax Administration – Ten-Percent Negligence Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty arguing that it "made our tax payments on time and there were no intentions of trying to avoid any taxes that may be owed."

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, "If 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 wave 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), "The 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 disagrees with its decision to categorize its insurance proceeds as a "like-kind exchange." However, there is insufficient information to establish that Taxpayer's position was so egregious as to constitute "willful neglect." Based on a "case-by-case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department agrees that the ten-percent negligence penalty should be abated.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's protest of the ten-percent negligence penalty is sustained; in all other respects, Taxpayer's protest is denied.

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