DEPARTMENT OF STATE REVENUE

04-20100008
60-20100010
03-20100011.LOF

Letter of Findings: 10-0008; 10-0010; 10-0011
Gross Retail Tax, Waste Tire Management Fee, Withholding Tax
For 2006 through 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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Extended Warranties – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2(a); IC § 6-2.5-4-1; IC § 6-8.1-5-1(c); Sales Tax Information Bulletin 2 (December 2006).

Taxpayer argues that it was not required to collect sales tax on the sale of extended automobile warranties.

II. Marketing and Data Providers – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2(a); IC § 6-8.1-5-1(c); 45 IAC 2.2-4-1(a); Letter of Findings 09-0797 (January 4, 2010); Letter of Findings 09-0827 (December 2, 2009).

Taxpayer states that amounts it paid to certain marketing companies and data providers were not subject to the sales or use tax.

III. Demonstrator Automobiles – Gross Retail Tax.

Authority: IC § 6-2.5-3-2(a); Tax Policy Directive 8 (September 2009).

Taxpayer maintains that the Department overstated the amount of sales/use tax due on the value of its demonstrator cars.

IV. Waste Tire Management Fee.

Authority: IC § 13-11-2-231(b); IC § 13-11-2-245(d); IC § 13-20-13-7; Commissioner's Directive 16 (September 2005).

Taxpayer argues that it is not required to collect Indiana's Waste Tire Management Fee on its sale of tires.

V. Withholding Tax.

Authority: 45 IAC 3.1-1-97.

Taxpayer argues that it was not required to withhold county income taxes on behalf of its employees.

VI. 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 maintains that it is entitled to abatement of the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana business which sells used and new cars. The Indiana Department of Revenue (Department) conducted an audit review of Taxpayer's business records. As a result of that review, the Department assessed additional withholding, gross retail, and tire fees. Taxpayer disagreed with portions of the assessments and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Extended Warranties – Gross Retail Tax.

DISCUSSION

Taxpayer sold its new and used car customers optional, extended warranties. Under the terms of the warranties, and according to the audit report, "parts and services would be provided by the taxpayer in the event of a break down or malfunction of the covered part." Taxpayer charged its warranty customers a "lump sum" which included the cost of both service and parts. Taxpayer did not collect sales or use tax on the warranties. The Department made "an adjustment to assess sales tax on the optional warranties under [45 IAC 2.2-4-2]."

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). IC § 6-2.5-4-1 defines "retail transactions" stating in part as follows:

(a) A person is a retail merchant making a retail transaction when he engages in selling at retail.

(b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business he:

(1) acquires tangible personal property for the purpose of resale; and

(2) transfer that property to another for consideration.

(c) For purposes of determining what constitutes selling at retail, it does not matter whether:

(1) the property is transferred in the same form as when it was acquired;

(2) the property is transferred alone or in conjunction with other property or services; or

(3) the property is transferred conditionally or otherwise.

Here, Taxpayer is purportedly the "retail merchant" selling "tangible personal property" in conjunction with "other property or services."

The Department has previously addressed the issue of optional maintenance agreements in Sales Tax Information Bulletin 2 (December 2006) which states in part as follows:

> 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. Any parts or tangible personal property supplied pursuant to this type of agreement are not subject to sales or use tax. The supplier of the parts or property is not liable for the use tax on the parts or property because the supplier is using the material to fulfill the service called for by the terms of the warranty or maintenance agreement. A merchant that maintains an inventory of parts for resale and uses some of the parts in fulfilling the terms of the warranty or maintenance agreement is not required to self assess use tax on any parts so used. (Emphasis added).

Taxpayer provided a sample copy of its warranty agreement along with a more detailed description of its "Preferred Customer Vehicle Protection Plan Coverage." The warranty document stipulates that the agreement between the parties "is not an Insurance Policy." Depending on the level of coverage chosen, the warranty coverage includes: (1) engine components such as the cylinder block, cylinder heads, rotor housing, intake manifold, timing gears, timing chain or belt, valve covers, flywheel, oil pump, fuel pump, vacuum pump, oil pan, thermostat, turbochargers, intercooler, and engine mounts. The warranty coverage includes: (2) transmission components such as transmission case, transaxle case, transfer case, torque convertor, vacuum modulator, cooler, cooler lines, and transmission parts. The warranty coverage include: (3) "front or rear wheel drive" parts such as final drive, axle housing, flex disc, axle shafts, bearings, universal joints, constant velocity joints, drive shaft, center bearings, and drive shaft yokes. In addition – in the case of new car warranties – the warranty also includes: (4) a "seals and gaskets packages" which covers cylinder head gaskets, intake manifold gaskets, exhaust manifold gaskets, rear main seal, valve cover gaskets, oil pan gaskets, front crankshaft seal, timing cover gasket, and cam housing gaskets.

The details of the warranty coverage listed above describes the basic "Bronze Preferred Coverage." The "Gold" and "Platinum" coverage provide broader coverage and includes additional parts such as "powertrain electronics."

Taxpayer makes two arguments; the warranty contracts are not subject to tax because the warranty itself "is not the sale of tangible personal property" and that Taxpayer paid use tax on those parts which were supplied to it warranty customers. The second reason is that the cost of the parts was minimal when compared to the price of the warranty contracts. Taxpayer buttresses this secondary argument by explaining that in 2005 Taxpayer sold approximately $393,000 in warranty contracts but only spent $550 for parts to fulfill the terms of the existing warranties; in 2006 Taxpayer sold approximately $617,000 in warranty contracts but only spent $189 for parts to fulfill the terms of the warranties; in 2007 Taxpayer sold approximately $757,000 in warranty contracts but only spent $2,200 for parts to fulfill the terms of the warranties; in 2008 taxpayer sold approximately $501,000 in warranty contracts but only spent $790 for parts to fulfill the terms of the warranties. As noted by Taxpayer, "the cost of the parts used in servicing these contracts was less than 3 [percent] (almost zero in 2006) of the revenue from the sale of these contracts which suggest that there was a reasonable expectation that tangible personal property would not be provided...." (Emphasis added).

The Department is unable to agree that the warranty contracts are purely intangible, "insurance-like" agreements under which no "tangible personal property" is transferred. Plainly – to one degree or another – the signatories to the warranty agreements contemplated that tangible personal property would be transferred. As to Taxpayer's argument that pursuant to the Taxpayer's experience in fulfilling the warranties, there was no reasonable expectation that parts would ever be supplied to the warranty customers, the Department is unable to agree that both Taxpayer and its customers contemplated an arrangement in which Taxpayer would supply such a small number of parts. The Department, of course, is not privy to the parties' unspoken intentions but, based upon the literature supplied by Taxpayer and the representations made to its customers, there was a "reasonable expectation" that parts would be supplied. Taxpayer's customers purchased and paid for warranties and it is not unreasonable that those customers believed they would receive the necessary parts when and if their vehicles malfunctioned.

FINDING

Taxpayer's protest is respectfully denied.

II. Marketing and Data Providers – Gross Retail Tax.

DISCUSSION

Taxpayer argues that it was not required to pay sales tax on invoices received from vendors named Impact

Direct, Kia Motors America, Zimmerman Advertising, CarFax, and HCS. Taxpayer states that these vendors did not "deliver any tangible personal property.

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.

Specifically, the Department's regulation provides that, "Where ownership of tangible personal property is transferred for consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a 'retail merchant.'" 45 IAC 2.2-4-1(a).

A. Impact Direct: Taxpayer received and paid an invoice from a company called "Impact Direct." The invoice states that Taxpayer is paying for "20,000 Test Market Event Mailers" and "showroom posters." The mailers are items apparently sent to potential car customers because the statement indicates that "[Taxpayer] accepts 6 [percent] undeliverable mail as industry standard." The invoice also states that "[Taxpayer] warrants and understands that all material related to Impact Direct's efforts is the sole and exclusive property of Impact Direct and subject to protection of federal copyright laws. [Taxpayer] agrees that all records, documents and accounts established, developed and maintained during the course of this relationship are the sole property of Impact Direct."

Based on the information provided, Impact Direct apparently prepared and mailed advertising material targeted to certain, select potential car customers. Although the material itself is protected by copyright law, Taxpayer appears to have paid for the mailers.

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." Although there is nothing to indicate that Taxpayer itself came into physical possession of the mailers, the materials were sent – insofar as it is known – to Indiana customers. The mailers were prepared on behalf of and for the benefit of Taxpayer which wanted these potential customers to purchase cars. Under IC § 6-2.5-3-2(a), Taxpayer made "use" of these advertising materials by having Impact Direct put the materials in the hands of potential customers.

B. Kia Motors America: Taxpayer paid $945 to this vendor. The information provided by Taxpayer indicates that the vendor supplied Taxpayer with "iMarketing Lead Services." Taxpayer indicates that this vendor supplied "lead services, not tangible personal property." Based on the scant information available, Taxpayer has met its burden of demonstrating under IC § 6-8.1-5-1 that this invoices was for "services" and that there is no information which establishes that tangible personal property was provided Taxpayer.

C. Zimmerman Advertising: Taxpayer paid $875 to a company called Zimmerman indicating that vendor was charging for "ZTrac." The agreement between Taxpayer and Zimmerman states that the vendor agreed to provide "various 800 numbers to be used in [Taxpayer's] advertising" and to "instantaneously forward any call to [Taxpayer] through ZIMMERMAN ADVERTISING's phone equipment." In addition, Zimmerman agreed to "capture call detail for [Taxpayer] and allow [Taxpayer] secure access to said call detail via the ZTRAC web site... in any easy to read graphic interface." In this instance, Taxpayer has met its burden of demonstrating under IC § 6-8.1-5-1 that the invoice from Zimmerman was for "services" and that there is no information which establishes that tangible personal property was provided Taxpayer.

In the case of the other vendors cited by Taxpayer, there is insufficient information to establish that Taxpayer's contentions are correct. The Department leaves open the possibility that a vendor such as CarFax may have only been providing intangible services, but there remains the distinct possibility that CarFax may have also been providing Taxpayer with tangible personal property. See Letter of Findings 09-0797 (January 4, 2010); 09-0827 (December 2, 2009).

FINDING

Taxpayer is sustained insofar as it relates to the invoices received from Zimmerman Advertising and Kia Motors America.

III. Demonstrator Automobiles – Gross Retail Tax.

DISCUSSION

As an automobile dealership, Taxpayer made use of cars that were licensed with dealer tags. According to the audit report, "These vehicles were driven by company personnel, not full time salesmen." Because Taxpayer failed to self-assess use tax on the vehicles, the Department assessed use tax pursuant to Tax Policy Directive 8 (September 2009).

IC § 6-2.5-3-2(a) states 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 that transaction or of the retail merchant making that transaction." In regard to automobiles such as those belonging to Taxpayer, "The use tax is also imposed on the storage, use, or consumption of a vehicle, an aircraft, or a watercraft, if the vehicle, aircraft, or watercraft... is required to be titled, licensed, or registered by this state for use in Indiana."

Taxpayer argues that the Department erred in its calculation of the amount of sales/use tax owed on its use of demonstrator cars. To that end, Taxpayer contends that "the assessment should be based on 2.0 demo drivers for each year." Taxpayer maintains that only three employees used demo automobiles who could be classified as "non-salespersons." For these three particular employees, the "office manager" purportedly used a demo automobile "for all three years." The "Sr. General Manager" used a demo car for "2.75 years" and the "General Manager" used a demo automobile for ".25 years." Insofar as the remaining Taxpayer personnel, Taxpayer contends, "All the other employees that the auditor listed were directly involved in selling, worked more than 1000 hours in a year, and earned more than 25.00 [percent] of their gross income from sales activities."

The distinction Taxpayer makes is more than academic. As noted in Tax Policy Directive 8, "Vehicles provided to other than full-time sales persons... are subject to use tax...." However, "Vehicles used by full-time salespersons for 'qualified automobile demonstration use' are not subject to sales and use tax." As noted previously, under IC § 6-8.1-5-1 Taxpayer has the burden of demonstrating that the proposed assessment is wrong. In this case, Taxpayer has proposed an alternative calculation but that calculation is entirely unsupported. As explained in Tax Policy Directive 8, "Dealers are required to keep records of each vehicle, the miles drive, and when use tax was paid for the miles driven."

FINDING

Taxpayer's protest is respectfully denied.

IV. Waste Tire Management Fee.

DISCUSSION

The Department's audit found that Taxpayer was not registered to collect the "Waste Tire Management Fee" (Tire Fee) and had not remitted any of the tire fees during the audit period. The audit assessed "a 25 cent tire fee on each new tire sold outright or on a new vehicle in Indiana."

Taxpayer disagreed with the assessment stating as follows:

> [T]he Proposed Assessments of the Tire Fee include assessments for non-mounted tires which are simply a component of the sale of a new car. There is no separate sale of a spare tire, and the fee levying statute is specifically limited to "mounted" tires on the sale of new cars.

Essentially, Taxpayer maintains that the four tires each new car are "not mounted by taxpayer," and that the "spare tire isn't mounted."

IC § 13-20-13-7 imposes a fee on each new tire sold in a retail transaction:

> (a) A fee of twenty-five cents ($0.25) is imposed on the sale of the following:
>
> (1) Each new tire that is sold at retail.
>
> (2) Each new tire mounted on a new vehicle sold at retail.
>
> (b) The person that sells the new tire or vehicle at retail to the ultimate consumer of the tire or vehicle shall collect the fee imposed by this section.
>
> (c) A person that collects a fee under subsection (b): (1) shall pay the fees collected under subsection (b): (A) to the department of state revenue; and (B) at the same time and in the same manner that the person pays the state gross retail tax collected by the person to the department of state revenue....

For purposes of this Tire Fee, IC § 13-11-2-231(b) defines "tire" as "a continuous solid or pneumatic rubber covering that is designed to encircle a wheel of a vehicle."

For purposes of the Tire Fee, IC § 13-11-2-245(d) defines a "vehicle" as follows:

> "Vehicle", for purposes of IC 13-20-13-7, means a motor vehicle, a farm tractor (as defined in IC 9-13-2-56, an implement of agriculture (as defined in IC 9-13-2-77), a semitrailer (as defined in IC 9-13-2-164(a) or IC 9-13-2-164(b)), and types of equipment, machinery, implements, or other devices used in transportation, manufacturing, agriculture, construction, or mining. The term does not include a lawn and garden tractor that is propelled by a motor of not more than twenty-five (25) horsepower.

In short, persons selling "vehicles" are required to collect a twenty-five cent "tire fee" for each "tire" used on the "vehicle." However, Taxpayer explains that the spare tires sold with each vehicle are not mounted and the original manufacturer – not Taxpayer – mounted the other four tires on each vehicle sold to one of Taxpayer's customers.

IC § 13-20-13-7(a)(1) imposes the fee on, "Each new tire that is sold at retail" which presumably resolves the question of whether spare, unmounted tires are subject to the fee. IC § 13-20-13-7(a)(2) states that the fee is imposed on "each new tire mounted on a new vehicle sold at retail." The Department finds little or no statutory support for Taxpayer's contention that because the car manufacturer installed the tires, it was not required to collect and pay the fee. The Department's position is spelled out clearly in Commissioner's Directive 16 (September 2005) which states that, "The fee is also imposed on each new tire mounted on a vehicle at the time the vehicle is sold, and any spare tire that is included with the vehicle."

FINDING

Taxpayer's protest is respectfully denied.

V. Withholding Tax.

DISCUSSION

Taxpayer is an Indiana business which employs various managers, salesperson, service advisors, mechanics, clerical personnel, and several miscellaneous employees. The Department's audit found that "taxpayer failed to withhold and remit any Indiana county income tax." The audit report concluded that because the Taxpayer was located in a county which had adopted a county income tax, "all of the taxpayer's employees [were] subject to some Indiana county income tax, and the taxpayer is responsible for withholding and remitting the appropriate tax."

After differentiating between Taxpayer's employees who lived in an "adopting county" and employees who did not live in an "adopting county," the Department issued proposed assessments of withholding tax. The amount of the assessment was approximately $46,000. The audit imposed this assessment under authority of 45 IAC 3.1-1-97 which states in relevant part as follows:

> Withholding Agent's Returns and Reports to the Department. Employers who make payments of wages subject to the Adjusted Gross Income Tax Act, and who are required to withhold Federal taxes pursuant to the Internal Revenue Code (U.S.C. Title 26), are required to withhold from employees' wages Adjusted Gross and County Adjusted Gross Income Tax.
>
> Withholding agents who are required to withhold Indiana Adjusted Gross Income Tax and County Adjusted Gross Income Tax (where applicable), shall make return of and payment to the Department monthly whenever the amount of tax due, for either County and State, exceeds an aggregate of $50 per month with such payment due on the thirtieth (30th) day of the following month. Where the aggregate amount of tax due under the Adjusted Gross Income Tax or County Adjusted Gross Income Tax does not exceed $50 per month, payment and return of the amount of tax due shall be made quarterly, with such payment due on the last day of the month following the end of the quarter. The following criteria should be used:
>
> (1) A withholding agent who falls within the monthly reporting system, due to maintaining an aggregate of fifty dollars ($50) per month, but who in any month thereafter may maintain an aggregate of less than fifty dollars ($50) per month, should remit that lesser amount on a monthly basis so as to maintain the status of being on the monthly system.
>
> (2) A withholding agent who falls within the quarterly reporting system, due to not maintaining an aggregate of fifty dollars ($50) per month, but who in any month thereafter does maintain an aggregate of fifty dollars ($50) per month, should then, and thereafter, begin reporting and making returns on a monthly basis and thereby maintain the status of being on the monthly system.

Under 45 IAC 3.1-1-97, Taxpayer was required to withhold and remit county income tax. Nonetheless, Taxpayer argues that it should be given credit for the amount of county withholding tax actually paid by its employees. The Department takes no position on whether it should or should not be given credit for the amount of county income tax actually paid by its employees. What is undisputed is that 45 IAC 3.1-1-97 clearly requires the Taxpayer to withhold that amount.

FINDING

Taxpayer's protest is respectfully denied.

VI. Administration – Ten-Percent Negligence Penalty.

DISCUSSION

The Department's audit recommended imposition of the ten-percent negligence penalty, because Taxpayer – as an Indiana business – "failed to withhold Indiana county income tax on ANY employees." (Emphasis in original). Taxpayer disagrees arguing that the underlying assessments – as addressed above – are "illegal and contrary to law" and that the Taxpayer "exercised the level of reasonable care, caution, and diligence expected of an ordinary reasonable taxpayer, notwithstanding the challenges presented by the Department's changing interpretations of the law and changes in local income tax laws."

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.

Among other reasons, the Department is unable to agree that failure to withhold county income tax on behalf of its employees constitutes "ordinary business care and prudence" and does not believe that the penalty should be waived.

FINDING

Taxpayer's protest respectfully denied.

SUMMARY

The invoices received from Zimmerman Advertising and Kia Motors America are not subject to tax; in all other respects, Taxpayer's protest is denied.

Posted: 05/26/2010 by Legislative Services Agency
An html version of this document.