DEPARTMENT OF STATE REVENUE

04-20090769.LOF

Letter of Findings: 09-0769
Sales Tax
For Tax Years 2006-2008

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ISSUES

I**. Sales Tax–Imposition.**

Authority: IC § 6-2.5-1-5; IC § 6-2.5-2-1; IC § 6-2.5-4-10; IC § 6-8.1-3-3; 45 IAC 2.2-4-27; 45 IAC 15-3-2.

Taxpayer protests the imposition of sales tax on "optional damage waiver charges."

II. Tax Administration–Negligence Penalty.

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

Taxpayer requests that the Department exercise its discretion to abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a retailer in the business of renting equipment and party supplies to customers in Indiana. After an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional sales tax and assessed tax, interest, and negligence penalties for the 2006, 2007, and 2008 tax years. The Department determined that Taxpayer should have been collecting sales tax on its "optional damage waiver charges." Taxpayer protests this imposition of sales tax. An administrative hearing was conducted, and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax–Imposition.

DISCUSSION

The Department determined that Taxpayer failed to collect sales tax on "optional damage waiver charges." Taxpayer charges the customer, in addition to the "rental charges," an amount for "optional damage waiver charges" to cover the risk of loss concerning rental property. The customer pays this charge unless the customer chooses to opt out of the charge by checking a box located at the bottom of the rental agreement.

Indiana imposes "[a]n excise tax, known as the state gross retail tax ["sales tax"]... on retail transactions made in Indiana." IC § 6-2.5-2-1(a). Pursuant to IC § 6-2.5-4-10(a) "a person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person."

Additionally, 45 IAC 2.2-4-27 states:

> (a) In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation [45 IAC 2.2] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction.
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> (b) Every person engaged in the business of the rental or leasing of tangible personal property, other than a public utility, shall be deemed to be a retail merchant in respect thereto and such rental or leasing transaction shall constitute a retail transaction subject to the state gross retail tax on the amount of the actual receipts from such rental or leasing.
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> (c) In general, the gross receipts from renting or leasing tangible personal property are subject to tax. The rental or leasing of tangible personal property constitutes a retail transaction, and every lessor is a retail merchant with respect to such transactions. The lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts as agent for the state of Indiana. The tax is borne by the lessee, except when the lessee is otherwise exempt from taxation.
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> (d) The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
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> (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. **The gross receipts include any consideration received from the exercise of an option contained in the rental of lease agreement**; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
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> (2) Rental or lease period. For purposes of the imposition of the gross retail tax or use tax on rental or leasing transactions, each period for which a rental is payable shall be considered a complete transaction. In the case of a weekly rate, each week shall be considered a complete transaction. In the case of a continuing lease or contract, with or without a definite expiration date, where rental payments are to be made monthly or on some other periodic basis, each payment period shall be considered a completed transaction.
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> (**Emphasis Added**.)

Accordingly, a taxpayer's gross receipts from renting and leasing are subject to sales tax. The taxpayer's gross receipts include all of the taxpayer's actual receipts from renting and leasing without a reduction for the taxpayer's costs. The taxpayer's actual receipts specifically include amounts paid for the exercise of an option of the rental or lease agreement.

Taxpayer asserts that its "damage waiver charges" are not gross receipts subject to sales tax. Taxpayer maintains that it uses these payments to offset the costs of the insurance policy that Taxpayer has on the rental equipment. Taxpayer argues that the "damage waiver charges" are similar to the insurance payments and are gross receipts not subject to sales tax as provided under IC § 6-2.5-1-5(b)(2).

Notwithstanding that the receipts that are excluded from gross receipts in IC § 6-2.5-1-5(b)(2) are those from specific types of insurance premiums–i.e., "insurance premiums on either a promissory note or an installment sales contract"–Taxpayer's "damage waiver charges" are not insurance premiums. Taxpayer's "damage waiver charges" are charges that its customers pay pursuant to the damage waiver clause that is in Taxpayer's rental agreement. The "damage waiver clause" states, "If you pay the damage waiver charge (DWC) as specified, subject to the limitation and exclusion below, [Taxpayer] agrees to modify the terms of the Rental Contract...." This language clearly indicates that the damage waiver is an option of the rental contact that modifies the rental contract. In fact, the fee for the damage waiver is a percentage of the rate used in the original contract before modification. The damage waiver charges are clearly from an exercisable option of the rental agreement and, pursuant to 45 IAC 2.2-4-27, are properly included in the amount of "actual receipts" received for the rental of property. Therefore, the damage waiver charges are subject to sales tax.

Alternatively, Taxpayer maintains that if the Department concludes that the damage waiver charges are subject to gross retail tax, that determination should be applied on a prospective basis. Taxpayer sets out a general equitable argument – unsupported by citations to statutory or regulatory authority – that the Department, having found that the damage waiver charges are subject to the sales tax, should impose that tax liability on a prospective basis only.

IC § 6-8.1-3-3(b) states that "[n]o change in the department's interpretation of a listed tax may take effect before the date the change is: (1) adopted in a rule under this section; or (2) published in the Indiana Register... if the change would increase a taxpayer's liability for a listed tax." Under IC § 6-8.1-3-3, the Department is without authority to reinterpret a taxpayer's tax liability without promulgating and publishing a regulation giving Taxpayer notice of that reinterpretation. Absent any indication that the Department has changed its interpretation of the gross retail tax, IC § 6-8.1-3-3 does not require the Department to give effect to Taxpayer's sales tax liabilities only on a prospective basis. Absent any requirement to do otherwise, the Department has no independent authority whatsoever to grant Taxpayer's equitable request for prospective treatment of its sales tax liabilities.

Taxpayer claims to have received oral advice from a Department employee that these charges are not subject to sales tax. Presumably, Taxpayer argues that this employee's oral advice is an interpretation and the Department's assessment would amount to a change in an interpretation of a listed tax as found in IC § 6-8.1-3-3(b). However, even if Taxpayer's claims are taken at face value, pursuant to 45 IAC 15-3-2(e) "oral opinions will not be binding on the Department. Even when a taxpayer orally receives technical assistance from the Department, the advice is advisory only and is not binding." This rule is supported by Indiana case law and compelling public policy.

Therefore, Taxpayer has not met its burden of proof providing sufficient justification warranting prospective treatment.

FINDING

Taxpayer's protest is respectfully denied.

II. 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. Taxpayer's protest to the imposition of penalty is sustained, as discussed in Issue II.

Posted: 06/23/2010 by Legislative Services Agency
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