DEPARTMENT OF STATE REVENUE

04-20090858.LOF

Letter of Findings: 09-0858
Gross Retail Tax
For 2006, 2007, and 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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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. Advertising Materials – Gross Retail Tax.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-1 et seq.; IC § 6-2.5-1-2; IC § 6-2.5-3-2; IC § 6-2.5-3-2(a); IC § 6-2.5-5-31; IC § 6-2.5-5-31(a)(6); (d); IC § 6-8.1-5-1(c); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); 45 IAC 2.2-1-1(a).

Taxpayer argues that it is not subject to use tax on the purchase of advertising materials.

II. 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 heating and air-conditioning business. The Department of Revenue (Department) conducted a sales and use tax audit finding that Taxpayer failed to pay sales or use tax on the price it paid for direct mail advertising materials. As a result, the Department assessed additional use tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative further explained the basis for the protest. This Letter of Findings results.

I. Advertising Materials – Gross Retail Tax.

DISCUSSION

Taxpayer contracted with an Indiana company to purchase advertising services. The services consisted of the preparation and delivery of advertising materials. After the materials were prepared, they were sent to a Florida company which – in turn – mailed the materials to Indiana prospective customers.

The Department concluded that Taxpayer should have paid use tax on the price paid for the advertising materials.

Indiana imposes a sales tax on retail transactions and a complimentary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. 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." IC § 6-2.5-3-2.

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."

A. Exempt Services: Taxpayer argues that it never took possession of the advertising materials and that it entered into an agreement to purchase exempt services and not tangible personal property.

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 the transaction."

In effect, the audit found that taxpayer's purchase of advertising materials 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.

The Department is unable to agree that Taxpayer purchased exempt services. Taxpayer entered into an agreement to purchase advertising materials and have those materials delivered to multiple Indiana locations. In effect, the "consumption" of the materials took place in Indiana; Taxpayer's "use" of the advertising materials occurred when the materials were placed in the hands of its prospective Indiana customers. The audit was correct

in concluding that taxpayer bought the advertising materials by means of a unitary transaction. There is no evidence that taxpayer negotiated for or purchased labor or delivery services separately from the cost of the materials. Taxpayer wanted advertising materials, taxpayer bought advertising materials, taxpayer paid for advertising materials, and these advertising materials were "used" in Indiana.

B. Newspaper Exemption: IC § 6-2.5-5-31 exempts from the sales and use tax production costs incurred in the publication of free distribution newspapers. A free distribution newspaper is defined as:

> [A]ny community newspaper, shopping paper, shoppers' consumer paper, pennysaver, shopping guide, town crier, dollar stretcher, or other similar publication which:
>
> (1) is distributed to the public on a community-wide basis, free of charge;
>
> (2) is published at stated intervals of at least once a month;
>
> (3) has continuity as to title and general nature of content from issue to issue;
>
> (4) does not constitute a book, either singly or when successive issues are put together;
>
> (5) contains advertisements from numerous unrelated advertisers in each issue;
>
> (6) contains news of general or community interest, community notices, or editorial commentary by different authors, in each issue; and
>
> (7) is not owned by, or under the control of, the owners or lessees of a shopping center, a merchant's association, or a business that sells property or services (other than advertising) whose advertisements for their sales of property or services constitute the predominant advertising in the publication.
>
> (b) The term "free distribution newspaper" does not include mail order catalogs or other catalogs, advertising fliers, travel brochures, house organs, theater programs, telephone directories, restaurant guides, shopping center advertising sheets, and similar publications.
>
> (c) Transactions involving manufacturing machinery, tools and equipment, and other tangible personal property are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use, or for his direct consumption as a material to be consumed, in the direct production or publication of a free distribution newspaper, or for incorporation as a material part of a free distribution newspaper published by that person.
>
> (d) Transactions involving a sale of a free distribution newspaper, or of printing services performed in publishing a free distribution newspaper, are exempt from the state gross retail tax if the purchaser is the publisher of the free distribution newspaper.

Taxpayer points out that the advertising materials are regularly delivered to Indiana customers in envelopes labeled as "Valupak." However, the Department is unable to agree that Taxpayer is entitled to the exemption set out IC § 6-2.5-5-31. At the outset, it should be noted that in applying any tax exemption, the rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). Besides the fact that the "Valupak" does not "contain[] news of general or community interest," Taxpayer is not "the publisher of the free distribution newspaper." IC § 6-2.5-5-31(a)(6); (d).

FINDING

Taxpayer's protest is respectfully denied.

II. Ten-Percent Negligence Penalty.

DISCUSSION

Taxpayer argues that it is entitled to abatement of the ten-percent negligence penalty.

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.

Given the number of items for which taxpayer failed to self-assess use tax, and the fact that the taxpayer had no established internal procedure by which to self-assess use tax, the Department is unable to agree that the taxpayer exercised ordinary business care in determining its use tax liabilities.

The Department believes that taxpayer erred in determining its sales and use tax liability. However, there is insufficient information to establish that Taxpayer's position was so egregious as to constitute "willful neglect." In addition to its substantive argument, Taxpayer points to a previous Letter of Findings which – although out-dated – appears to support its contention that the advertising materials were exempt. Therefore, 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 substantive protest is denied because the Department correctly found that the purchase of the advertising materials was subject to use tax. However, the ten-percent negligence penalty should be abated.

Posted: 06/23/2010 by Legislative Services Agency
An html version of this document.