

**Letter of Findings: 09-0994
Sales Tax
For the Year 2006**

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ISSUES

I. Sales Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-8.1-5-1; [45 IAC 2.2-4-1](#); [45 IAC 2.2-4-2](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of sales tax on its sales of maintenance agreements.

II. Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, an Indiana S corporation, specializes in building and supporting information technology (IT) network infrastructures for small business. In addition to providing IT support and consulting services, Taxpayer sells computer equipment, software, and maintenance agreements to customers in various industries, including, but not limited to, health care, finance, retail, automotive, and real estate.

Pursuant to an audit, the Indiana Department of Revenue ("Department") assessed Taxpayer additional sales tax on sales of maintenance agreements and delivery charges because Taxpayer failed to collect sales tax at the time of the transactions. Believing that it provided a nontaxable service, Taxpayer protested the assessment on the sales of the maintenance agreements. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales Tax – Imposition.

DISCUSSION

Pursuant to the audit, the Department assessed Taxpayer sales tax on its sales of the maintenance agreements because Taxpayer did not collect sales tax at the time of the transactions. Taxpayer, to the contrary, maintains that it provided a nontaxable service.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. "Tangible personal property," as defined in IC § 6-2.5-1-27, "means personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses," including "electricity, water, gas, steam, and prewritten computer software."

IC § 6-2.5-2-1 states:

- (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 § 6-2.5-4-1, in pertinent part, provides:

- (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) transfers that property to another person 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.

[45 IAC 2.2-4-1](#) further illustrates:

- (a) Where ownership of tangible personal property is transferred for a 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".

(b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:

- (1) The price arrived at between purchaser and seller.
- (2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.
- (3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to transfer of such property at retail.

Accordingly, Taxpayer, a retail merchant selling computer hardware and software, is responsible for collecting and remitting to the Department the sales tax due.

In this instance, the Department's audit noted that Taxpayer's "maintenance agreements provide for security updates, software patches and use of the [Cisco] PIX Firewall System for the entire term of the maintenance agreements." Thus, the Department's audit determined that the maintenance agreements "contained provisions for periodic services where there is a reasonable expectation that tangible personal property will be provided" and, therefore, the agreements were subject to sales tax as part of a unitary transaction. "Unitary transaction," as defined in IC § 6-2.5-1-1(a), "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."

Nonetheless, [45 IAC 2.2-4-2](#) provides an exception and, in relevant part, states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge; **and**
- (4) **The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition. (Emphasis added).**

At the administrative hearing, Taxpayer claimed that there were two sets of maintenance agreements (Agreements 1 and Agreements 2) sold during the audit period and listed in the audit summary. While Taxpayer provided copies of both sets of the maintenance agreements and invoices of Agreements 1 to support its protest, it did not produce the invoices concerning Agreements 2.

For Agreements 1, Taxpayer stated that it offered its customers the use of the "Cisco PIX Firewall System" when the customers purchased Taxpayer's maintenance agreements. While Taxpayer's invoices showed that there was no charge for the "Hardware Rental: Equipment Rental Cisco Firewall Part#PIX-501-BUN-K9," Taxpayer did charge for maintenance of other items, including, but not limited to, firewall, router, data circuit, switch, and network printer. Taxpayer, however, did not produce sufficient documentation demonstrating that it met all four requirements outlined in [45 IAC 2.2-4-2\(a\)](#).

Additionally, Taxpayer maintained that Agreements 2 only covered maintenance of the items, both hardware and software, owned by its customers. Taxpayer further asserted that its customers were responsible for the cost of hardware, software, and any replacements. Taxpayer also failed to produce sufficient documentation demonstrating that it met all four requirements outlined in [45 IAC 2.2-4-2\(a\)](#).

After the hearing, the Department allowed Taxpayer ample time to submit more documentation to support its protest but Taxpayer chose not to do so. As mentioned above, both maintenance agreements, in the Description section, in relevant part, listed that periodic or "weekly inspection and analysis of all devices covered," "on site physical inspection of all devices covered," and "[r]elevant security updates and software patches applied to covered devices as needed." The maintenance agreements "contained provisions for periodic services where there is a reasonable expectation that tangible personal property will be provided."

Given the totality of circumstances, in the absence of other documentation, the Department is not able to agree with Taxpayer that it has met its burden demonstrating the Department's proposed assessment is wrong.

FINDING

Taxpayer's protest on the imposition of sales tax regarding its sales of maintenance agreements is respectfully denied.

II. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a tax return;

- (2) fails to pay the full amount of tax shown on the tax return;
- (3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
- (4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

[45 IAC 15-11-2](#)(b) further states:

"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 Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), in part, 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. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer did not provide sufficient documentation establishing that its failure to pay tax or timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of the negligence penalty is respectfully denied.

SUMMARY

For the reasons discussed above, Taxpayer's protest on the imposition of sales tax on sales of its maintenance agreements is respectfully denied. Taxpayer's protest on the imposition of the negligence penalty is also respectfully denied.

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