DEPARTMENT OF STATE REVENUE

04-20100299.LOF

Letter of Findings Number: 10-0299
Use Tax
For Tax Year 2006

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ISSUES

I. Use Tax–Recreational Vehicle.

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); Helvering v. Gregory, 69 F.2d 809 (2d Cir. 1934); Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570 (2d Cir. 1949); Horn v. Comm'r, 968 F.2d 1229 (D.C. Cir. 1992); Lee v. Comm'r, 155 F.3d 584 (2d Cir. 1998); IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; 45 IAC 2.2-3-4.

Taxpayer protests the imposition of use tax on the use of a recreational vehicle.

II. Tax Administration–Negligence Penalty.

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

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an individual and is a resident of Indiana. The Indiana Department of Revenue ("Department") determined that on September 22, 2006, Taxpayer purchased a recreational vehicle ("RV") in Kentucky and had been using the RV in Indiana and other states without paying sales tax in any jurisdiction. As a result, the Department issued proposed assessments for Indiana use tax, ten percent negligence penalty, and interest. Taxpayer protests that the RV was purchased and titled by a Montana LLC, of which Taxpayer was the sole member, that Taxpayer's fiancée controlled and used the RV, and that no Indiana sales or use tax is due. Taxpayer also protests the imposition of negligence penalty. An administrative hearing was conducted and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Recreational Vehicle.

DISCUSSION

Taxpayer protests the imposition of use tax on the use and storage of an RV in Indiana. The Department imposed use tax after determining that Taxpayer had been using and storing the RV in Indiana and that no sales tax had been paid on the purchase of the RV. Taxpayer protests that the RV was titled by a Montana LLC and that all legal documents establishing the existence of the LLC were properly filed in Montana. Also, Taxpayer also states that her fiancée was the one who used and controlled the RV and that her own use of the RV was minimal. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which 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.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

(a) 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.

Also, 45 IAC 2.2-3-4 provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. The Department determined that Taxpayer purchased the RV in Kentucky in a retail transaction on September 22, 2006, but did not pay Kentucky sales tax on the purchase. The Department therefore issued proposed assessments for Indiana use tax.

As provided by Article III of the LLC's Articles of Organization (dated September 21, 2006):

The LLC is formed to acquire, by purchase, lease or otherwise, any real and/or personal property, to maintain such ownership and to manage such real and/or personal property and to dispose of it, in any manner.

Other than the purchase of the RV, Taxpayer was unable to provide any documents establishing any LLC business or non-business activity at all in Indiana, Montana, or any other state in the union. While the LLC made no attempt to undertake any further activity, the titling of the RV by the LLC did have a significant impact on

Taxpayer's sales taxes. Taxpayer's April 21, 2010, protest letter states, "The structuring of this transaction as a Montana LLC was clearly to avoid sales tax, but that was and is totally proper to do. There is nothing illegal or improper in doing that."

This leads to consideration of the "sham transaction" doctrine, which is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id. at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[T]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id. at 470.

The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570, 572 (2d Cir. 1949), cert. denied, 338 U.S. 955 (1950). "[T]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Comm'r, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992). In determining whether a business transaction was an economic sham, two factors can be considered; "(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" Id. at 1237. The question of whether or not a transaction is a sham, for purposes of the doctrine, is primarily a factual one. Lee v. Comm'r, 155 F.3d 584, 586 (2d Cir. 1998).

In this case, the facts are that the officially stated purpose of the LLC's formation was to acquire, maintain, manage, and dispose of any property, but that the Montana LLC had no business or non-business functions and never attempted to acquire, maintain, or dispose of any property other than the RV in question. In fact, the LLC had no functions of any kind other that those directly related to the purchase of the RV in question. The LLC was involuntarily dissolved by the Montana Secretary of State on December 1, 2008, for failure to file required annual reports and fees. The titling of the RV in Montana, a state without a sales tax, was merely an attempt to reduce or eliminate Taxpayer's sales and use tax liabilities. The formation of the LLC and the titling of the RV in the name of the LLC was therefore a "sham transaction."

Taxpayer argues that the formation of the Montana LLC was not a sham transaction, stating that the LLC was a properly organized legal entity. Taxpayer refers to a law review article which includes a quote from Judge Learned Hand. That quote provides:

> Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.
> Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

The Department reviewed Helvering v. Gregory and found that in the opinion Judge Learned Hand also wrote:

> We do not indeed agree fully with the way in which the Commissioner treated the transaction; we cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation held a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, and their only defect was that they were not what the statute means by a 'reorganization,' because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect. But the result is the same whether the tax be calculated as the Commissioner calculated it, or upon the value of the Averill shares as a dividend, and the only question that can arise is whether the deficiency must be expunged, though right in result, if it was computed by a method, partly wrong. Although this is argued with some warmth, it is plain that the taxpayer may not avoid her just taxes because the reasoning of the assessing officials has not been entirely our own.
> Order reversed; deficiency assessed.
> (Gregory, 69 F.2d at 811)
> (Emphasis added).

Therefore, Taxpayer in the instant case has referred on an opinion which states that the taxpayer in that case took part in a sham and was not allowed to avoid her just taxes. Also, as previously mentioned, the taxpayer in that case appealed to the United States Supreme Court in the case Gregory v. Helvering. As provided above, the Supreme Court agreed that the business arrangement was a sham and that the taxes were properly due. Taxpayer's reference to Judge Learned Hand's language does not support Taxpayer's protest. Quite to the contrary, it supports the Department's determination that Taxpayer's Montana LLC was in fact a sham transaction and that Indiana use tax is properly due.

Taxpayer also protests that her own use of the RV was extremely limited and that her fiancée used the RV in his business. Furthermore, Taxpayer states that her fiancée was the one who used and stored the vehicle from

the moment it was purchased from the Kentucky dealer, storing it at Taxpayer's house, where he also lived, for less than a month. Taxpayer has not provided any documentation to support this position. Neither has Taxpayer provided any documentation to show that the LLC permitted Taxpayer's fiancée to use the RV.

The Department is not convinced that a legitimate entity, such as Taxpayer claims the LLC was, would allow its only asset to be used exclusively by a non-member of the LLC without any documentation establishing the conditions and potential liabilities of that use. This would constitute a distinct lack of management of the LLC's property, in direct contradiction of Article III of the LLC's Articles of Organization. Rather, this is further confirmation that the LLC was not a legitimate entity, that Taxpayer never intended for the LLC to have any genuine functions, and that the RV was purchased and used by Taxpayer herself, even if that "use" consisted primarily of allowing her fiancée to drive and store it.

Taxpayer also provided a copy of a December 27, 2000, Montana Attorney General opinion letter, which was issued to a Montana county attorney. This letter concludes that a certain Montana motor vehicle registration fee is the equivalent of a tax which could not be imposed on tribal members living on reservations or on non-resident active duty military personnel stationed in Montana. Taxpayer believes that this means that tax was paid in Montana and that, as a result, Indiana may not impose use tax.

After review of the opinion letter, it is clear that the Montana Attorney General concludes that the annual motor vehicle registration fee is the equivalent of an annual motor vehicle tax, not of a transactional sales or use tax. Additionally, since it has already been determined that the formation of the LLC and the purchase of the RV by the LLC constituted a sham transaction and that the Indiana resident purchased the RV, Taxpayer's reference to Montana's registration fees is irrelevant.

In conclusion, Taxpayer never intended for the LLC to have any valid functions beyond avoiding sales and use taxes on the purchase of the RV. Therefore, the formation of the LLC and the titling of the RV by the LLC was a sham transaction and Taxpayer's references to Montana's registration of the LLC are irrelevant. Consequently, Taxpayer acquired tangible personal property in a retail transaction, used and stored it in Indiana, but did not pay sales tax at the point of purchase or anywhere else. In such circumstances, Indiana use tax is due, as explained by 45 IAC 2.2-3-4.

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Negligence Penalty.

DISCUSSION

The Department issued a proposed assessment and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty and states that the equipment discussed in Issue I was used at least for some exempt purposes. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

> If a person:
>
> . . .
>
> (3) incurs, upon examination by the department, a deficiency that is due to negligence;
>
> . . .
>
> the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which 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.
>
> (Emphasis added.)

45 IAC 15-11-2(c) provides in pertinent part:

> 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.

In this case, Taxpayer incurred an assessment which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer states that she did act reasonably by asking the dealer and the Montana attorney if the arrangement was legitimate. The Department is not convinced that it was reasonable for an Indiana resident to expect to purchase a recreational vehicle in Kentucky via a Montana LLC formed for the sole purpose of purchasing the RV and which had no other functions of any kind and expect to not pay sales or use tax somewhere. Taxpayer has not established that the assessment arose due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer is denied on Issue I regarding the imposition of use tax on the purchase of a recreational vehicle. Taxpayer is denied on Issue II regarding imposition of penalty.

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