

DEPARTMENT OF STATE REVENUE

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Letters of Findings: 10-0153; 10-0154; 10-0155; 10-0156; 10-0157; 10-0158; 10-0159

Use Tax

For the Years 2004, 2005, 2006

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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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. Use Tax – Imposition and Appropriate Base for Calculation.**

Authority: IC § 6-2.5-1-1; IC § 6-2.5-2-2; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-5-1-1; IC § 6-8.1-5-1; IC § 6-8.1-5-4; [45 IAC 2.2-1-1](#); [45 IAC 2.2-4-1](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); Frame Station, Inc. vs. Indiana Dep't of Revenue, 771 N.E.2d 129 (Ind. Tax Ct. 2002); Ameritech Publishing, Inc. v. Indiana Dep't of State Revenue, 916 N.E.2d 752 (Ind. Tax Ct. 2009); Ameritech Publishing, Inc. v. Indiana Dep't of State Revenue, 49T10-0305-TA-26 (Ind. Tax Ct., October 19, 2006); Cowden & Sons Trucking, Inc. v. Indiana Dep't of State Revenue, 575 N.E.2d 718 (Ind. Tax Ct. 1991).

Taxpayers protest the imposition of use tax on their use of catalogs in Indiana.

Taxpayers also protest that the appropriate measure of use tax is the cost of the paper used to produce the catalogs distributed in Indiana, and not the total cost of producing the catalogs.

II. Tax Administration – Negligence Penalty.

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

Taxpayers protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayers are all related entities in the retail business. Taxpayers produce multiple catalogs under various product lines that are either mailed to Indiana residents or distributed at Taxpayers' Indiana retail stores. Taxpayers, the publishers of the catalogs, contract with several out-of-state printers to produce the catalogs. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayers for the years 2004, 2005, and 2006. As a result of the audit, Taxpayers were assessed additional use tax, interest, and penalties on the use of the catalogs in Indiana. Taxpayers protested the assessments. A hearing was held and this Letter of Findings ensues. Additional facts will be presented as required.

I. Use Tax – Imposition and Appropriate Base for Calculation.**DISCUSSION**

The Department notes that all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(b), (c); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Furthermore, exemption statutes are to be strictly construed against the taxpayer. Indiana Dep't of State Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003).

Indiana imposes "[a]n excise tax, known as the use tax... 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(a). A retail transaction is defined as occurring when a person "acquires tangible personal property... and transfers that property to another person for consideration." IC § 6-2.5-4-1(b)(1)-(2).

A. Imposition.

The Department's audit found that Taxpayers had acquired catalogs for distribution in Indiana from several out-of-state vendors without paying sales tax on the purchases and without accruing and remitting use tax to Indiana. Taxpayers protested the imposition of use tax for the period prior to July 1, 2006, because Taxpayers argue the catalogs were not acquired in retail transactions and were not stored, used, or consumed in Indiana. Taxpayers rely on Ameritech Publishing, Inc. v. Indiana Dep't of State Revenue, 916 N.E.2d 752 (Ind. Tax Ct. 2009) (transfer denied May 13, 2010) ("AP II").

Taxpayers concede that subsequent to July 1, 2006, Taxpayers are subject to use tax on the use of the catalogs in Indiana due to legislative action on the issue.

In Ameritech, Ameritech, in publishing its telephone directories, purchased paper and printing services and

distributed its telephone directories to its Indiana customers. The Tax Court held that Ameritech, a telephone directories publisher, in publishing its telephone directories, purchased paper and printing services that were not subject to Indiana use tax. Id. at 757. The court reached that decision after finding the paper and printing services "were consumed" outside of Indiana and the completed telephone directories were not acquired in a retail transaction. Id. at 754.

In *Ameritech Publishing, Inc. v. Indiana Dep't of State Revenue*, 49T10-0305-TA-26, (Ind. Tax Ct., October 19, 2006) ("API"), the Tax Court's unpublished opinion on which AP II relied, the court identified a number of significant facts in finding that the paper and printing services were consumed outside of Indiana and the completed telephone directories were not acquired in a retail transaction. Specifically, the court found that Ameritech and the phone directory assembler had a contractual agency relationship. API slip op. at 3. The contractual rights and duties of each of the parties in the agency relationship provided for Ameritech's purchase, of all the materials used to make the directories, from each vendor pursuant to specific purchasing contracts with each of the various paper and supply vendors. Id. Slip op. at 3-4. The agency contract and the purchasing contracts detailed the risk of loss of each party and who owned the materials from the date of acquisition to the date of transfer. Id. Slip op. at 4-5. Additionally, the invoices from the phone directory assembler and the vendors were detailed and separately listed all materials purchased, materials used, services performed, and the associated management fees, respectively. Id. Slip op. at 5. It was in the context of those particularized facts and findings that the court held that Ameritech, in publishing its telephone directories, purchased paper and printing services that were not subject to Indiana use tax. Id. slip op. at 13.

As indicated above, the Indiana legislature enacted legislation to address the Ameritech situation. The Tax Court noted in API, "the Indiana legislature has closed th[is] loophole" with the enactment of IC § 6-2.5-3-2(d). See API slip op. at 13 n. 12. IC § 6-2.5-3-2(d) (effective July 1, 2006), provides:

The use tax is imposed on a person who:

- (1) manufactures, fabricates, or assembles tangible personal property from materials either within or outside Indiana; and
- (2) uses, stores, distributes, or consumes tangible personal property in Indiana.

Taxpayers have provided sufficient documentation to demonstrate that their facts comport almost precisely with the facts of Ameritech, as embodied in AP I and AP II, as described above, and, therefore, Taxpayers' protest of the assessments for the periods prior to July 1, 2006, is sustained.

B. Appropriate Base for Calculation.

As stated above, Taxpayers concede that their distribution of catalogs in Indiana is subject to use tax for periods after July 1, 2006. However, Taxpayers protest the base on which the Department measured the use tax due. Taxpayers argue that the appropriate measure of use tax is the cost of the paper used to produce the catalogs distributed in Indiana, and not the total cost of producing the catalogs, paid to the printers, on which the Department calculated the use tax owed.

Taxpayers argue that the central determinant of the measure of the use tax is the gross income received in a unitary transaction. IC § 6-2.5-2-2(a). Taxpayers then state that "unitary transaction" is defined as "all terms 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." IC § 6-2.5-1-1. Taxpayers insist that here there are two transactions involving two different vendors, two different orders, and two different charges or prices – one for the purchase of the paper and one for the purchase of the printing services to produce the catalogs. Taxpayers cite to *Cowden & Sons Trucking, Inc. v. Indiana Dep't of State Revenue*, 575 N.E.2d 718 (Ind. Tax Ct. 1991), for the proposition that services rendered in a retail unitary transaction are taxable only if the transfer of property and rendition of services is "inextricable and indivisible" and services and property are determined "inextricable and indivisible" when the services are performed before the property is transferred to the transferee. Taxpayers conclude that use tax cannot be applied to a combination of the charge for the paper and the charge for the printing because it is not a single order or agreement for which a combined price is charged.

Indeed, pursuant to IC § 6-2.5-4-1(e) the amount of the retail transaction that is subject to sales tax includes "the price of the property transferred" and "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." Further, [45 IAC 2.2-4-1\(b\)\(3\)](#) provides that the amount of the retail transaction which is subject to tax includes the amounts collected for "services performed or work done on behalf of the seller prior to transfer of such property at retail." (Emphasis Added).

IC § 6-2.5-4-1 states in relevant part:

- (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.
 - (d) Notwithstanding subsection (b), a person is not selling at retail if he is making a wholesale sale as described in section 2 of this chapter.
 - (e) The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:
 - (1) the price of the property transferred, without the rendition of any service; and
 - (2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.
- For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.
- (Emphasis added)

In *Frame Station, Inc. vs. Indiana Dep't of Revenue*, 771 N.E.2d 129 (Ind. Tax Ct. 2002), the Tax Court held that when customers were charged separate amounts for labor and materials for custom framing services, the labor charges were subject to sales tax. *Id.* at 131. In arriving at that decision, the court reasoned that the issue is "whether [Taxpayers'] services were performed before or after it transferred property to its customers." *Id.* The court found that services that are performed prior to the transfer of the property are taxable, and services that are performed after the transfer of the property are taxable to the extent that the services represent a "unitary transaction" and are "inextricable and indivisible" from the property being transferred. *Id.* Accordingly, the determinative fact is when the services were performed.

In this instance the printing production process was obviously performed prior to the transfer of the catalogs and therefore the associated billings are, in addition to the paper transactions, taxable under the authority cited above and notably as interpreted by *Frame Station*. The total cost of the catalogs – which is the tangible personal property used in Indiana – includes both the costs of the tangible personal property used in producing the catalogs as well as the services performed to produce the catalogs prior to their transfer. After all, what was used in Indiana were catalogs, not just paper.

Taxpayers' protest of the base amount on which use tax was calculated is respectfully denied.

FINDING

Taxpayers' protest of the assessment of the use tax on their distribution of catalogs in Indiana for the period prior to July 1, 2006, is sustained. Taxpayers' protest of the base amount on which use tax is calculated is denied.

II. Tax Administration – Negligence Penalty.

DISCUSSION

The Taxpayers also protested 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. 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.

Taxpayers have not affirmatively established, as required by [45 IAC 15-11-2](#)(c), that their failure to pay use tax on the remaining items was due to reasonable cause and not due to negligence.

FINDING

Taxpayers' protest is respectfully denied.

CONCLUSION

Taxpayers' protest of the assessment of the use tax on their distribution of catalogs in Indiana for the period prior to July 1, 2006, is sustained. Taxpayers' protest of the base amount on which use tax is calculated is denied. Taxpayers' protest of the assessment of the negligence penalty on the remaining items is respectfully denied.

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