

**Letter of Findings: 10-0425
Gross Retail Tax
For the Years 2007 and 2008**

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ISSUES

I. Computation Error – Gross Retail Tax.

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

Taxpayer argues that the Department of Revenue's audit "double-counted" payments on the purchase of tangible personal property.

II. Bad Debt Write-Off – Gross Retail Tax.

Authority: IC § 6-2.5-1-5(a); IC § 6-2.5-6-9(a).

Taxpayer maintains that the purchase by one of its customers should not have been included in the "sample" because that customer never paid for the items purchased.

III. Internal Customer – Gross Retail Tax.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-2(a).

Taxpayer states that the sale of an item to "KMC" should not have been included in the "sample" because KMC is an "internal customer."

IV. Exemption Certificates – Gross Retail Tax.

Authority: IC § 6-2.5-8-8(a).

Taxpayer explains that it has discovered four additional customer exemption certificates and that – as a result – the amount of additional sales/use tax should be adjusted.

V. Computer Based Information Technologies – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-2(a); IC § 6-8.1-5-1(c); Sales Tax Information Bulletin 8 (May 2002); Letter of Findings 05-0438 (August 11, 2006).

Taxpayer argues that purchases of certain information related technologies from three different vendors were not subject to sales tax.

STATEMENT OF FACTS

Taxpayer is an Indiana wholesale distributor of lawn care equipment, irrigation equipment, and related supplies. Taxpayer sells its products to golf courses, retailers, government entities, and contractors. Taxpayer also sells replacement parts and provides related services. The Department of Revenue (Department) conducted an audit review of Taxpayer's business records and found that Taxpayer owed additional sales/use tax. Taxpayer disagreed with a portion of the assessment. An administrative hearing was conducted during which Taxpayer's representative explained the basis for its protest. This Letter of Findings results.

I. Computation Error – Gross Retail Tax.

DISCUSSION

Taxpayer purchased an item of computer equipment which cost approximately \$146,000. Taxpayer paid for the equipment over 36 months. Taxpayer reported and paid tax on an amount and that amount was acknowledged in the audit report. However, this corresponding amount in the audit report was approximately \$132,000 because – according to Taxpayer – this lesser amount represented the "amortized" price. According to Taxpayer, this "amortized price" was the actual value of the item purchased minus the interest payments. Taxpayer believes the \$132,000 amount contained in the audit report is correct but objects to an additional amount of sales tax in "the amount of \$9,481" stating that this charge represents a duplicate of the \$132,000 amount already billed.

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-5-1. A complementary 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. IC § 6-2.5-3-2.

Taxpayer purchased computer equipment over 36 months and paid approximately \$146,000 for that equipment. The audit indicated that the equipment cost about \$132,000 and that tax should be assessed based upon that lesser amount. Taxpayer indicates that the audit "double counted" a portion of the assessment on this transaction counting both the \$132,000 as taxable and a separate listed amount of \$9,481 as also taxable. In other words, the \$9,481 was included in the \$132,000.

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."

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

In this case, there are actually two errors to address. The first relates to the purchase price of this particular item. On its face, Taxpayer made 36 payments of \$4,055 to buy the equipment; simple arithmetic leads one to the conclusion that this equipment cost \$145,980. Taxpayer has not provided anything which would justify a conclusion that this equipment cost less than \$145,980. Nonetheless, Taxpayer argues that the item actually should be taxed based upon a purchase price \$132,000 because this lesser amount was the "amortized" cost of the item as entered into their records and because a portion of the 36 monthly payments consisted of interest charges.

Taxpayer errs because – for purposes of determining tax liability – "gross retail income" – means the total gross receipts of any kind or character, received in a retail transaction, including cash, credit, property, and services, for which tangible personal property is sold, leased, or rented, valued in money, whether received in money or otherwise.... IC § 6-2.5-1-5(a). The audit report should be corrected to reflect the total amount of money Taxpayer paid for this particular item.

However, to the extent that the audit report indicated an initial tax payment of \$9,481 based on the "Sales/Use Tax Addendum," that amount should be deleted as duplicative of the gross amount as referenced above. The equipment cost no more and no less than \$145,980 and use tax should be based on that entire amount.

FINDING

Taxpayer's protest is denied in part and sustained in part; the gross retail price for the equipment at issue should be corrected to reflect the gross amount paid for the item but the duplicate entry should be deleted.

II. Bad Debt Write-Off – Gross Retail Tax

DISCUSSION

Taxpayer asks that amounts sold to "Outdoor Management" be removed from the audit because Taxpayer was never paid for the items sold to this company and the amounts were "written off" as bad debt.

As noted above, sales/use tax is based on the "total gross receipts of any kind or character, received in a retail transaction...." IC § 6-2.5-1-5(a). In this particular case, Taxpayer has met its burden of demonstrating that the taxable transactions were never completed because Taxpayer did not receive payment for this amount. The \$4,157.63 cost attributable to the incomplete sale should be removed from the audit report; Taxpayer has provided specific documentation establishing that the cited cost was "written off as an uncollectible debt for federal tax purposed under Section 166 of the Internal Revenue Code during the particular reporting period." IC § 6-2.5-6-9(a).

FINDING

Taxpayer's protest is sustained.

III. Internal Customer – Gross Retail Tax.

DISCUSSION

Taxpayer asks that an amount of \$227.39 should be removed from the audit report because Taxpayer sold the item to an "internal customer." Taxpayer explains, "This is a piece of equipment that was removed from inventory for internal use, but shortly afterward a customer wanted to purchase it. We then sold it to [the customer] a few months later." According to Taxpayer, "The taxable portion should only be the reduction in value due to our use of that product and not the full amount."

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 that transaction."

Taxpayer acquired this item in a retail transaction and then decided to make use of it for Taxpayer's own business purpose. Therefore, Taxpayer owes use tax on this item. See IC § 6-2.5-3-2 (Imposing a complementary "excise tax" on the "storage use or consumption of tangible personal property....")

Thereafter, Taxpayer sold the same item to one of its customers. IC § 6-2.5-2-1(a) states that, "An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana." Taxpayer sold the item to one of its own customers. Taxpayer was required to collect sales tax on that transaction in Taxpayer's capacity as "agent for the state." IC § 6-2.5-2-1(b).

Taxpayer apparently misconstrues the nature of the tax thinking of the tax as being imposed on the object and not the transaction. In this case, there were two transactions. Taxpayer "used" the item and then later sold it to one of Taxpayer's customers; there is a "use" transaction and a "sales" transaction. Taxpayer's suggestion that one tax be used to offset the other is not supported in law.

FINDING

Taxpayer's protest is respectfully denied.

IV. Exemption Certificates – Gross Retail Tax.**DISCUSSION**

Taxpayer believes that some of the items it sold are exempt because Taxpayer has obtained additional exemption certificates from a number of buyers. Taxpayer apparently references IC § 6-2.5-8-8(a), which states: A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax.

The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

Taxpayer has provided copies of additional exemption certificates. Taxpayer indicates that these particular certificates were not considered during the original audit and that they should be reviewed now.

The audit division is requested to review the late-filed exemption certificates and to make whatever adjustments it deems appropriate.

FINDING

Taxpayer's protest on this issue is neither sustained nor denied; the audit division will review the four exemption certificates and make whatever adjustments that are warranted.

V. Computer Based Information Technologies – Gross Retail Tax.**DISCUSSION**

Taxpayer paid for costs charged by three different vendors. The first vendor is Adventnet which sold Taxpayer "Annual Sub Fee AdventNet Manage Engine." The second vendor is ARI Network Services, Inc. which sold Taxpayer a license renewal and "annual support fee." The third vendor is McGraw-Hill Dodge which was paid for "Construction Network Access" along with "Network News & Plans." The Department's audit concluded that expenditures paid to these three entities were subject to sales/use tax. Taxpayer disagrees stating that, "These payments are for software subscription fees for software that we do not own." Taxpayer concludes that the three vendors were not paid for "tangible personal property."

As noted in Part I above, it is the Taxpayer's responsibility to establish that the proposed 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."

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-3-2(a). A complementary 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. IC § 6-2.5-3-2.

Specifically, IC § 6-2.5-2-1 provides as follows:

(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 § 6-2.5-3-2(a) provides for the complementary use tax:

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.

In this case, the audit found that Taxpayer had made purchases which were subject to sales tax but failed to pay that tax. Therefore, the audit assessed the complementary use tax.

A. Adventnet

Taxpayer maintains that the payment to this particular vendor represents the purchase of an intangible service. As stated by Taxpayer, "These payments are for software subscription fees for software that we do not own." Based upon the information supplied by Taxpayer following the administrative hearing, the payment appears to represent a charge for a maintenance contract which – among other features – provides "canned reports," "customizable reports," "scheduled reports," and "custom request form templates." The purchase of computer-based reports is subject to sales tax as addressed in Sales Tax Information Bulletin 8 (May 2002) (25 Ind. Reg. 3934) which states as follows:

The sale of statistical reports, graphs, diagrams or any other information produced or compiled by a computer and sold or reproduced for sale in substantially the same form as it is so produced is considered to be the sale of tangible personal property unless the information from which such reports was compiled was furnished by the same person to whom the finished report is sold.

Based upon the information provided, Adventnet also appears to offer a maintenance service starting – as noted on the invoice – for a term beginning "01/Sept/2008" and concluding on "31/Aug/2009." The Department has addressed the question of whether software maintenance contracts are subject to sales tax. As stated in Letter of Findings 05-0438 (August 11, 2006), "[T]he department will construe software maintenance agreements

and optional agreements as presumed to be subject to the sales and use tax. A taxpayer could rebut this presumption by demonstrating that no updates were actually received pursuant to a particular maintenance agreement or optional warranty."

The agreement with Adventnet provides for the "maintenance" of certain computer software and provides taxpayer with access to related reports. The audit correctly determined that the sale was subject to tax.

B. ARI Network Services, Inc.

Taxpayer was unable to provide information specific to its purchase from ARI Network Services, Inc. Without more, it is not possible to determine whether the transaction involved the sale of tangible personal property, whether Taxpayer paid for a software maintenance contract, or whether Taxpayer paid for a purely intangible service. The Department is unable to agree that the transaction should be removed from the audit report.

C. McGraw-Hill Dodge.

Following the administrative hearing, Taxpayer supplied additional information relevant to the transaction with McGraw-Hill. The information stated that Taxpayer paid for "Network Access" and "Network News." Based on Taxpayer's information, Taxpayer purchased the right to "Download and print plans and specs," paid for "Access to Dodge Reports, Plans & Specs," and paid for the right to "Access product and equipment information, supplier directories and industry news." Based upon the information provided by Taxpayer, it is not possible to determine with any certainty what exactly it was that McGraw-Hill provided to Taxpayer although there clearly is one aspect of the transaction which involved the right to download both news and certain professional reports. The audit was entitled to reasonably conclude that the transaction was taxable and the Department will not second-guess that determination here based upon the scanty information now provided.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Taxpayer's challenge of the "computational error" is sustained in part and denied in part. A supplemental audit will be conducted to assure that no portion of the base price is "double counted" but will also assure that the entire price of the item is subject to the tax.

Taxpayer's request to remove the cost of items sold to "Outdoor Management" is granted.

The audit division is requested to review the additional exemption certificates and to make the appropriate adjustments to the assessment.

In all other respects, Taxpayer's protest is denied.

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