DEPARTMENT OF STATE REVENUE

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Letter of Findings: 04-20110098
Sales and Use Tax
For the Year 2009

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ISSUE

I. Sales and Use Tax – Public Transportation Exemption.

Authority: IC § 6-8.1-5-1; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-27; 45 IAC 2.2-5-61; Sales Tax Information Bulletin 12 (July 2010); Indiana Dept. of State Rev. v. Kimball Int'l, 520 N.E.2d 454 (Ind. Ct. App. 1988).

Taxpayer protests the imposition of use tax on a variety of transportation equipment purchases.

STATEMENT OF FACTS

Taxpayer is an Indiana LLC formed in 2009. Taxpayer provides transportation services to its related company ("Related"). Related sells, installs, and repairs fire prevention and security solutions to several regions in the United States. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for 2009. The Department's audit found that Taxpayer had not paid sales tax on any purchases used in its business on the premise that it qualified for the public transportation exemption. The Department's audit did not agree that Taxpayer qualified for the exemption and therefore assessed Taxpayer use tax on those items. Taxpayer protested the assessment of tax. Taxpayer waived its right to a hearing but provided additional requisite documentation and asked that the Department makes its final determination based on the information in Taxpayer's file, therefore this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Public Transportation Exemption.

DISCUSSION

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."

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.

The exemption sought is found at IC § 6-2.5-5-27, which states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

45 IAC 2.2-5-61 elaborates on the public transportation exemption. The regulation states in relevant part:

(a) The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property.

(b) Definition: Public Transportation. Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation unless it is in fact engaged in the

transportation of persons or property for consideration as defined above.

(c) In order to qualify for exemption, the tangible personal property must be reasonably necessary to the rendering of public transportation. The tangible personal property must be indispensable and essential in directly transporting persons or property.

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 Rev. v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

The Department's audit specifically referenced Sales Tax Information Bulletin 12 (July 1, 2010), 20100623 Ind. Reg. 045100390NRA and found that while Taxpayer satisfied several of the critical requirements listed in the Information Bulletin it nonetheless did not qualify based on the following:

The drivers of [Taxpayer]'s trucks are leased from their related company-[Related]. These employees perform a dual role as a driver and as a service technician or installer. [Related]'s primary business is the repair and installation of fire sprinkler systems and security systems. Therefore, the use of the trucks is to transport the technicians to their customer's location with their tools and supplies in order to perform their service and installation. The primary purpose is not to haul the good[s] or people of others. The taxpayer provided documentation which determined how much [Taxpayer] pays for the leased employees, This documentation was based on driving hours versus total hours worked. This showed that the employees were used less than 25[percent] of their time driving.

Taxpayer argues in its November 29, 2010 protest letter that the issue is not how much time these employees spent driving the trucks versus their total hours working, but that the Taxpayer and Related properly separated these employee's roles as drivers and technicians. Taxpayer explains:

[Taxpayer] leases the employees from [Related], but does so only for the period of time the individual is performing his role as a driver. The percentage of time spent in each role is not relevant because [Taxpayer] is only leasing the individual for his role as a driver and the individual spends 100[percent] of his time in that role for the hours he is being leased to [Taxpayer]. Moreover, the tangible personal property here in question is used exclusively to transport the property of another for consideration. Therefore, [Taxpayer]'s purchases qualify for the public transportation exemption.

The Department released Sales Tax Information Bulletin 12 (July 2010) (replacing an earlier version dated December 2009) which sets out the factors the Department will weigh in determining whether a transportation company qualified for the sales and use tax public transportation exemption. While the revised information bulletin was not in effect during the audit year, nonetheless the Department's audit used it as a guideline to review Taxpayer's qualification for the public transportation exemption. A review of the factors stated in the revised bulletin is useful. Some of the factors are more critical to the determination than others and are designated with an asterisk (*):

II. Public Transportation Requirements

The following requirements are factors the Department weighs in determining whether a transportation company is engaged in public transportation. An asterisk (*) indicates a requirement that is considered by the Department to be a critical factor in determining whether a transportation company qualifies for the public transportation exemption. A transportation company fails to qualify for the exemption if it does not, at a minimum, adhere to all the critical requirements. However, failure to adhere to one or more of the "noncritical" requirements can also result in a transportation company's failure to qualify for the exemption. The requirements are:

• The transportation company must transport the persons or property of another.*

• The transportation company must maintain all shipping/transporting documents for all transactions (e.g., trip reports, truck logs, and invoices).*

• The transportation company must receive compensation for the services it provides.*

• The transportation company must hold and pay for appropriate public transportation insurance.*

• The transportation company must be fully and independently authorized by federal and/or state authorities to provide public transportation services.*

• If an employee of the parent company performs duties for the parent company and also performs "leased" duties for the transportation company, the parent company must maintain detailed records of when and what duties that employee is performing for the parent company and when and what duties that employee is performing under the lease.*

• If the parent company makes a capital contribution of the vehicles to the transportation company, titles to the vehicles must be transferred to the transportation company.*

• The transportation company and the parent company must maintain separate books and records, including separate charts of accounts for each company.

• Transactions between the parent company and the transportation company must evidence a commercially reasonable, arms-length relationship between the parties.

• Transactions between the parent company and the transportation company must be evidenced by actual invoicing and payments for all transactions.*

- The parent company and the transportation company must segregate and account for each entity's purchases and expenses.*
- The parent company and the transportation company must maintain separate bank accounts.
- The parent company and the transportation company must issue separate W2 forms to their employees.
- The parent company and the transportation company must maintain separate federal depreciation schedules pursuant to generally accepted accounting standards.
- Any income earned by the transportation company for transporting for a third party is to be recognized by the transportation company.
- Because the transportation company and the parent company must have a distinct, arms-length business relationship, their separate incomes and expenses must be reflected on the taxpayers' federal income tax filings, all of which must be reconciled with the taxpayers' own records; when transactions are eliminated as intercompany transactions, the taxpayers must file the appropriate schedules with their federal returns.*

• If the parent company owns and holds titles to the vehicles, the parent company may lease those vehicles to the transportation company. However:

- The lease must be documented as a commercially reasonable, arms-length transaction; and
- The lease must be evidenced by actual payments to the parent company.

• If the transportation company owns the vehicles, titles to the vehicles must be held by the transportation company.

• The parent company and transportation company must have separate employees, or, if the transportation company leases its employees from the parent company, there must be a meaningful, arms-length charge for the leased employees.

(**Emphasis added**).

Taxpayer is correct that the percentage of time Related's employees were leased to Taxpayer as drivers is not relevant to the inquiry of qualification for the exemption. The Information Bulletin the Department's audit relied on for guidance in evaluating Taxpayer's qualification for the exemption contemplates an arrangement similar to that between Taxpayer and Related (see bolded language above), but stipulates that "the parent company must maintain detailed records of when and what duties that employee is performing for the parent company and when and what duties that employee is performing under the lease."

Taxpayer has demonstrated two things. First, Taxpayer has demonstrated that Related sufficiently documents the time that Related's employees spend as drivers leased to Taxpayer. Secondly, Taxpayer has demonstrated that it pays Related for that time.

FINDING

Taxpayer's protest is sustained.

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