DEPARTMENT OF STATE REVENUE

04-20100492.LOF

Letter of Findings Number: 04-20100492
Use Tax
For Tax Years 2007-09

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ISSUE

I. Use Tax–Fiber Optic Equipment.

Authority: Miles, Inc. v. Indiana Dept. of State Revenue, 659 N.E.2d 1158 (Ind.Tax Ct. 1995); IC § 6-2.5-5-8; IC § 6-2.5-5-13; IC § 6-8.1-5-1; 45 IAC 2.2-3-20.

Taxpayer protests the imposition of use tax on purchases of fiber optic equipment which it believes are exempt from use tax.

STATEMENT OF FACTS

Taxpayer is an Indiana business operating as an Internet service provider. During the audit period, Taxpayer merged with another entity and was the surviving entity. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had made purchases of tangible personal property in the audit years of 2007, 2008, and 2009, without paying sales tax at the time of purchase. The Department therefore issued proposed assessments for use tax and interest on those purchases for 2007, 2008, and the first half of 2009. Effective July 1, 2009, the Taxpayer protests that some of the items are exempt from sales and use taxes and that it does not owe use tax on the purchase of those items. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Fiber Optic Equipment.

DISCUSSION

Taxpayer protests the imposition of use tax on its purchases of reconfigurable optical add-drop multiplexer ("ROADM") equipment during the years 2007-09. Taxpayer states that the ROADM equipment is leased to a related entity ("Related") which is an exempt public service company as defined by IC § 6-2.5-5-13. The Department notes that the proposed use tax in this case is imposed on Taxpayer's purchase of the ROADM equipment, not on the lease stream between Taxpayer and its customer. Taxpayer also protests that the equipment is exempt under the resale/leasing exemption found at IC § 6-2.5-5-8. 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).

First, the Department refers to 45 IAC 2.2-3-20, which provides:

> All purchases of tangible personal property which are delivered to the purchaser for storage, use, or consumption in the state of Indiana are subject to the use tax. The use tax must be collected by the seller if he is a retail merchant described in Reg. 6-2.5-3-6(b)(010) [45 IAC 2.2-3-19] or if he has Departmental permission to collect the tax. If the seller is not required to collect the tax or fails to collect the tax when required to do so, the purchaser must remit the use tax directly to the Indiana Department of Revenue. (Emphasis added).

The Department considered the purchase of the ROADM equipment to be for Taxpayer's storage, use, or consumption in the state of Indiana. Since the ROADMs are used in the provision of Internet access services, the Department took into account the statutory change which took effect on July 1, 2009. That statutory change occurred with the amendment of IC § 6-2.5-5-13, which prior to July 1, 2009 stated:

> Transactions involving tangible personal property are exempt from the state gross retail tax, if:
> (1) the property is:
> (A) classified as central office equipment, station equipment or apparatus, station connection, wiring, or large private branch exchanges according to the uniform system of accounts which was adopted and prescribed by the Indiana utility regulatory commission; or
> (B) mobile telecommunications switching office equipment, radio or microwave transmitting or receiving equipment, including, without limitation, towers, antennae, and property that perform a function similar to the function performed by any of the property described in clause (A); and
> (2) the person acquiring the property furnishes or sells intrastate telecommunication service in a retail transaction described in IC 6-2.5-4-6.

Effective July 1, 2009, IC § 6-2.5-5-13 states:

> Transactions involving tangible personal property are exempt from the state gross retail tax, if:
> (1) the property is:
> (A) classified as central office equipment, station equipment or apparatus, station connection, wiring, or large private branch exchanges according to the uniform system of accounts which was adopted and

prescribed for the utility by the Indiana utility regulatory commission;
(B) mobile telecommunications switching office equipment, radio or microwave transmitting or receiving equipment, including, without limitation, towers, antennae, and property that perform a function similar to the function performed by any of the property described in clause (A); or
(C) a part of a national, regional, or local headend or similar facility operated by a person furnishing video services, cable radio services, satellite television or radio services, or Internet access services; and
(2) the person acquiring the property:
(A) furnishes or sells intrastate telecommunication service in a retail transaction described in IC 6-2.5-4-6; or
(B) uses the property to furnish:
(i) video services or Internet access services; or
(ii) VOIP services.

(Emphasis added).

Therefore, the Department did not impose use tax on Taxpayer's purchases of ROADMs after July 1, 2009.

The rental and leasing exemption is found at IC § 6-2.5-5-8(b), which states:

(b) Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.

Taxpayer provided copies of the leases between itself and the related entity. Taxpayer believes that the leases are for the leasing of the ROADMs and therefore its purchases of the equipment qualify for the exemption found at IC § 6-2.5-5-8(b).

The Department refers to Miles, Inc. v. Indiana Dept. of State Revenue, 659 N.E.2d 1158, 1164 (Ind.Tax Ct. 1995), in which the Indiana Tax Court provided:

Finally, Miles claims that its discount coupons are exempt from use tax under the incorporation exemption in I.C. 6-2.5-5-6, or in the alternative, under the resale exemption in I.C. 6-2.5-5-8. It is well-settled that tax exemptions are strictly construed against the taxpayer. Thus, Miles bears the burden of showing that the terms of these exemptions are met.

(Emphasis added).

(Internal citation omitted).

Therefore, Taxpayer in the instant case bears the burden of showing that its leases qualify for the exemption found at IC § 6-2.5-5-8(b).

A review of the contracts shows that Taxpayer was "leasing" internet access service to the related entity. Sections 1(a) of both contracts provide:

[Taxpayer] hereby leases to [Related Entity] and [Related Entity] hereby leases from [Taxpayer] [10 or 20] Gbps service (hereafter the "Leased Circuits").

(Emphasis added).

It is therefore clear that what Taxpayer was "leasing" was its Internet access service, not the tangible personal property which Taxpayer used to provide such service. Since Taxpayer was not leasing the tangible personal property it purchased during these years, those purchases do not meet the requirements of IC § 6-2.5-5-8(b) and are not eligible for the resale/leasing exemption. Also, since the amendment to IC § 6-2.5-5-13 did not take effect until July 1, 2009, Taxpayer's purchases of tangible personal property in 2007, 2008, and January through June 2009, used in the provision of Internet access services were not exempt under that statute either. Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

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