DEPARTMENT OF STATE REVENUE

04-20100311.LOF

Letter of Findings: 04-20100311
Sales and Use Tax
For the Years 2007 and 2008

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ISSUES

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-8.1-5-1; IC § 6-8.1-5-4; 45 IAC 2.2-1-1; 45 IAC 2.2-4-1; 45 IAC 2.2-4-2; 45 IAC 15-3-2; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Sales Tax Information Bulletin 2 (May 2002); Sales Tax Information Bulletin 2 (December 2006).

Taxpayer protests the imposition of sales/use tax on its purchases of certain tangible personal property.

II. Tax Administration – Negligence Penalty.

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

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, an Indiana company, sells residential and commercial heating and cooling systems and also provides installation and maintenance services. The Indiana Department of Revenue ("Department") conducted a sales/use tax audit for tax years 2007 and 2008. Pursuant to the audit, the Department determined that Taxpayer did not pay sales tax at the time of the retail transactions, nor did Taxpayer self-assess and remit the use tax due to the Department. Thus, the Department's audit assessed additional sales/use tax, interest, and penalty.

Taxpayer timely protests the imposition of sales/use tax and negligence penalty. To support its protest, Taxpayer submitted pertinent documentation and directed the Department's attention to an itemized list. Taxpayer states that these protested items are exempt from sales/use tax for several reasons. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales and Use Tax – Imposition.

DISCUSSION

The Department's audit assessed sales/use tax in two instances which Taxpayer's vendor ("Sign Company") applied lettering to Taxpayer's vehicles. The Department also assessed sales/use tax on charges for automobile parts which Taxpayer paid to a vendor ("Auto Repair Company") for maintenance of the company's vehicles because Taxpayer did not pay sales tax. Additionally, the Department determined that Taxpayer purchased optional extended warranties for its own use or on behalf of its customers without paying sales/use tax.

Taxpayer, to the contrary, claims that Sign Company's charges were labor for lettering the company's vehicles and, therefore, were not subject to sales/use tax. Taxpayer also maintains that Auto Repair Company had discounted its charges, which was stated in the invoices. Taxpayer further asserts that "when discounted the [amount] is taken off the parts" and that Auto Repair Company pays sales tax when it purchases the parts. Additionally, Taxpayer states that its purchases of optional extended warranties were not subject to sales/use tax because they are services.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dept of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. "Tangible personal property," as defined in IC § 6-2.5-1-27, "means personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses," including "electricity, water, gas, steam, and **prewritten computer software**." (**Emphasis added**).

IC § 6-2.5-2-1 provides:

(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) states:

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.

45 IAC 2.2-4-1(a) explains:

Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant".

A. Retail Transactions.

The Department's audit determined that Taxpayer failed to pay sales tax or self-assess use tax and remit to the Department for two unitary transactions in which Sign Company lettered Taxpayer's vehicles. The Department's audit also determined that Taxpayer failed to pay sales tax/use tax on charges for automobile parts which Taxpayer paid to Auto Repair Company. Additionally, the Department's audit concluded that Taxpayer failed to pay sales/use tax when it purchased "Quick Start Up: FD Quickstart," tangible personal property.

Taxpayer, to the contrary, claims that the charges from Sign Company were "labor" for lettering the company's vehicles and, therefore, were not subject to sales/use tax. Taxpayer also maintains that Auto Repair Company discounted its total charges stated in the invoices. Thus, Taxpayer asserted that the discounted amounts were for the parts (tangible personal property) and Auto Repair Company paid sales tax when it purchased the parts and, thus, Taxpayer believes that it was not responsible for sales/use tax. Taxpayer further claims that "Quick Start Up: FD Quickstart" is a service for computer diagnosis and not a purchase of tangible personal property.

A unitary transaction is defined in IC § 6-2.5-1-1, which states:

(a) Except as provided in subsection (b), "unitary transaction" includes all items 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.

(b) "Unitary transaction" as it applies to the furnishing of public utility commodities or services means the public utility commodities and services which are invoiced in a single bill or statement for payment by the consumer.

45 IAC 2.2-1-1(a) further explains:

Unitary Transaction. For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. **A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.** (**Emphasis added**).

Thus, when a retail merchant includes the charge for services and the charge for tangible personal property in one price in respect to a retail transaction, the charge is a unitary transaction and the retail merchant is responsible for collecting sales tax on the entire combined price it bills its customer and the customer is obligated to pay the sales tax on that price or is responsible for self-assessing and remitting to the Department the use tax.

45 IAC 2.2-4-2 provides an exception to the unitary transaction. 45 IAC 2.2-4-2, in relevant part, states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. **Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless**:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10 [percent]) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition. (**Emphasis added**).

1. Payments for Lettering the Company's Vehicles.

In this instance, Taxpayer claims that the charges from Sign Company were for "labor" involved in lettering Taxpayer's vehicles. To support its position, Taxpayer provides a statement from the vendor simply stating that "[t]he Indiana Department of Revenue told us we did not need to charge sales tax on vehicle lettering because we did not provide a substrate."

"Oral opinions or advice will not be binding upon the department." 45 IAC 15-3-2(e). Nonetheless, a taxpayer may, in writing, seek a revenue ruling or determination based on the facts presented by the taxpayer. While Taxpayer's vendor transferred the tangible personal property during the course of lettering Taxpayer's vehicles, the vendor did not separate the charge of materials from the charge of labor. Neither Taxpayer nor its vendor has provided sufficient documentation demonstrating that the two transactions of lettering Taxpayer's vehicles meet the four requirements outlined in 45 IAC 2.2-4-2(a).

In this instance, the vendor's invoices demonstrated that both transactions were single orders, which included transferring tangible personal property and performing the services. The invoices also showed that a total

combined charge was calculated and stated as one price. The invoices also showed that the vendor did not collect and Taxpayer did not pay the sales tax on both invoices. Thus, the Department is unable to agree that Taxpayer has met its burden demonstrating that the assessment is not correct.

Since Taxpayer did not pay sales tax at the time of the transactions, use tax is properly imposed.

2. Payments for Auto Repair Parts.

After performing the maintenance work on Taxpayer's vehicles, Auto Repair Company's invoices separately stated the charges on labor and parts without collecting sales tax. The audit assessed use tax on the "parts" because Taxpayer did not pay sales tax at the time of the transactions nor did Taxpayer self-assess use tax and remit to the state.

Taxpayer, to the contrary, asserts that it was not responsible for the entire amount of the taxes because the vendor discounted the charges on several invoices. Taxpayer further maintains that when the vendor discounted the charges, "the [amount] is taken off the parts." Taxpayer also claims that "when [the vendor] purchases his parts he pays the sales tax."

Upon reviewing copies of Taxpayer's invoices, in addition to crossing out the original grand total amounts in the invoices, there were hand-written amounts next to the original grand total amounts. However, without other supporting documentation, the invoices, containing hand-written alterations of charges, alone are insufficient to substantiate Taxpayer's claim that when the vendor discounted the charges, "the [amount] is taken off the parts" and that "when [the vendor] purchases his parts he pays the sales tax."

In short, the Department is unable to agree that Taxpayer has met its burden demonstrating that the assessments on the parts were incorrect. Since Taxpayer did not pay sales tax at the time of the retail transaction, use tax is properly imposed on the parts sold to Taxpayer.

3. Payment for Quick Start Up: FD Quickstart.

The Department assessed sales/use tax on Taxpayer's purchase of "Quick Start Up: FD Quickstart."

Taxpayer states that "[t]his company is out of business" and the charge "is for their labor to get laptop loaded and ready to use." Taxpayer's documentation, however, demonstrates otherwise. Taxpayer's purchase receipt demonstrates that, in addition to the purchase of a laptop computer, it purchased several accessories. Taxpayer's purchase of "Quick Start Up" could have been a purchase of a book or pre-written software which the vendor installed for Taxpayer because the receipt also listed a charge of one cent ($0.01) for "PC Checkup," which presumably is the service. Thus, upon reviewing Taxpayer's receipt, given the totality of the circumstances, without other supporting documentation, the Department is unable to agree that Taxpayer has met its burden demonstrating that the charge was for "labor to get laptop loaded and ready to use."

Since Taxpayer did not pay sales tax at the time of the retail transaction, use tax is properly imposed.

B. Optional Extended Warranties.

The Department's audit imposed use tax on Taxpayer's purchase of an optional warranty contract for a laptop computer because Taxpayer did not pay sales tax at the time of the purchase. The audit also imposed sales/use tax on optional extended warranties, which Taxpayer purchased for its customers and were included in the total charge based on the lump sum contracts. Taxpayer, to the contrary, asserts that it was not responsible for sales/use tax on its purchases and sales of the optional and extended warranties.

The prior version of Sales Tax Information Bulletin 2 stated as follows:

> Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax. Any parts or tangible personal property supplied pursuant to this type of agreement are subject to use tax. Sales Tax Information Bulletin 2 (May 2002), 25 Ind. Reg. 3595 (Emphasis added).

However, the current version of Sales Tax Information Bulletin 2 states as follows:

> Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are subject to sales tax if there is a reasonable expectation that tangible personal property will be provided. Any parts or tangible personal property supplied pursuant to this type of agreement are not subject to sales or use tax. Sales Tax Information Bulletin 2 (December 2006) (20100804 Ind. Reg. 045100497NRA)(Effective August, 4, 2010) (Emphasis added).

The Department's guidance and interpretation on this issue relevant to the years for which Taxpayer was audited is found in Sales Tax Information Bulletin 2 (May 2002) which states that "Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax." Id. Therefore, Taxpayer was not required to collect sales tax on the warranties/maintenance agreements it sold its customers prior to August 4, 2010. However, it should be noted that during this same period, Taxpayer was required to self-assess use tax on any of the parts or supplies it provided its customers pursuant to those same agreements.

Taxpayer is on notice that as of August, 4, 2010, Taxpayer is required to collect sales tax on the warranties/maintenance agreements it sells to its customers. The corollary remains true; under this regime, Taxpayer is not required to self-assess use tax on parts and supplies furnished pursuant to those later agreements.

The audit division is requested to review the original assessment of tax on the sale of

warranties/maintenance agreements to its customers based on Sales Tax Information Bulletin 2 (May 2002) in effect during the audited years and to make whatever adjustment is appropriate.

C. No Invoices.

The Department's audit examined Taxpayer's records and determined that Taxpayer made four (4) purchases without paying sales tax or remitting use tax to the Department. Taxpayer claimed that it could not find its invoices, which the Department's audit referred in the Audit Summary. Thus, Taxpayer believes that it was not responsible for the tax imposed by the audit.

The Department must respectfully disagree. IC § 6-8.1-5-4(a), in pertinent part, provides:

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

In this instance, Taxpayer failed to maintain proper invoices, i.e., the source documents, necessary for the Department to determine the tax. Thus, the Department is unable to agree that Taxpayer has met its burden demonstrating that the assessment is wrong.

D. Double Entries/ Duplicate Invoice.

Taxpayer also asserts that the Department's audit mistakenly assessed the same invoice twice. Upon reviewing the Audit Summary, the Department agrees that the same invoice was listed twice in the same report. Although the dates and references in the Audit Summary were essentially the same, the amounts listed in the Audit Summary were different. Based on Taxpayer's documentation, the Department will remove the following item from the assessment.

Date	Reference	Vendor	Item Description	Amount
07/22/2008	896256	XXX System-XXX	Generator Equipment	$801.83

In conclusion, Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest of Part B and Part D is sustained. However, Taxpayer failed to provide sufficient documentation in supporting its protest of Part A and Part C. The Department will recalculate Taxpayer's tax liability in a supplemental audit review.

FINDING

Taxpayer's protest of the imposition of sales/use tax is sustained in part and denied in part. Taxpayer's protest of Part B and Part D is sustained. However, Taxpayer's protest of Part A and Part C is respectfully denied. The Department will recalculate Taxpayer's liability in a supplemental audit review.

II. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

(1) fails to file a return for any of the listed taxes;
(2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
(3) incurs, upon examination by the department, a deficiency that is due to negligence;
(4) fails to timely remit any tax held in trust for the state; or
(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

45 IAC 15-11-2(b) further 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.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), in part, 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:
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> (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.

The audit imposed the negligence penalty because Taxpayer made numerous purchases without paying sales tax. The audit also noted that Taxpayer failed to establish a use tax accrual system and remit the use tax accordingly. Upon reviewing Taxpayer's documentation, the Department is unable to agree that Taxpayer has met its burden and that its failure to pay tax or timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of the negligence penalty is respectfully denied.

SUMMARY

For the reasons discussed above, on Issue I, Taxpayer's protest of the imposition of use tax is sustained in part and denied in part. Taxpayer's protest of Part B and Part D is sustained. However, Taxpayer's protest of Part A and Part C is respectfully denied.

On Issue II, Taxpayer's protest on the imposition of the negligence penalty is also respectfully denied.

The Department will recalculate Taxpayer's liability in a supplemental audit review.

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