DEPARTMENT OF STATE REVENUE

04-20110604.LOF

Letter of Findings Number: 04-20110604
Sales/Use Tax
For Tax Years 2008-2010

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ISSUE

I. Sales/Use Tax–Service Agreements.

Authority: IC § 6-8.1-5-1(c); IC § 6-2.5-2-1; IC § 6-2.5-3-2; Letter of Findings 05-0438 (August 11, 2006).

Taxpayer protests the imposition of sales tax on service agreements.

STATEMENT OF FACTS

Taxpayer, a registered retail merchant, is an Indiana business that sells audio and visual equipment. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for the years 2008 through 2010. Taxpayer protested a portion of the audit. An administrative hearing was held. Further facts will be supplied as required below.

I. Sales/Use Tax–Service Agreements.

DISCUSSION

The Department initially 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).

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 § 6-2.5-2-1; IC § 6-2.5-3-2.

The Department's audit report states in part:

> [S]ervice agreements were sold and no signed agreements were provided. The service agreements include annual preventive maintenance and software updates and there is a reasonable expectation that tangible personal property will be provided.

Taxpayer, in a letter to the Department, states:

> [Taxpayer] is a retailer of audio-visual equipment. [Taxpayer] also sells service agreements to provide repair services and telephone support services for equipment [Taxpayer] sells. [Taxpayer] does not have a written service agreement contract that each customer signs. Rather [Taxpayer] has a specification sheet that describes the services provided under a standard service agreement.

Taxpayer then states that it is protesting the "Nontaxable Sales of Service Agreements Where No Tangible Personal Property Transfers to Purchaser." To that end, Taxpayer states:

> The auditor has assessed tax on [Taxpayer] for failure to collect sales tax on separately stated charges for [Taxpayer's] service agreements and service agreement renewals. All of the service agreements cover equipment that [Taxpayer] sells. The service agreements are not software maintenance agreements.

Taxpayer also states:

> If the customer needs additional parts, repair parts, or any other property [Taxpayer] bills the customer for that property separately. The agreement does specify that [Taxpayer] will install updates as needed to the equipment software. [Taxpayer] does not provide any updates to equipment software. [Taxpayer] only provides the labor of a technician to assist the customer in applying any updates that may be available.

At the hearing, Taxpayer stated that the agreements that it enters into with its customers are verbal agreements, and that the annual preventative maintenance referenced in the audit report is all labor–and that when Taxpayer does provide parts, Taxpayer separately invoices.

After the hearing date, Taxpayer provided to the Department a copy of a written statement by the Chief Financial Officer ("CFO"). In it the CFO states:

> [T]he service agreements listed on the protest listing for [Taxpayer's] audit protest do not involve any transfer of tangible personal property. If the customers with service agreements require any tangible personal property as a result of a service call, [Taxpayer] bills the customer separately for the tangible personal property and charges the customer sales tax appropriately.

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."

The presumption in Indiana is that all retail sales are subject to sales or use tax, unless expressly exempted by statute. IC § 6-2.5-2-1 ("An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana... except as otherwise provided in this chapter..."). Taxpayer conducted its business by way of verbal agreements, and thus there are no written service agreements for the Department to examine.

Regarding software maintenance agreements, in 2006 the Department stated in Letter of Findings 05-0438 (August 11, 2006), 20061101 Ind. Reg. 045060474NRA, that:

> There is no regulation that sets out the department's position regarding the application of sales and use tax to optional warranties. The department first issued Sales Tax Information Bulletin [] 2 concerning Optional Warranties... on May 2, 1983. In that Information Bulletin, the department explained that if there was a possibility that no tangible personal property would be transferred with the warranty, then there was no certainty that there would be a retail sale and the sales and related use tax did not apply. This position was restated in the revised Sales Tax Division Information Bulletins issued in August 1991, November 2000, and May 2002. Each of the revisions restated the general rule. In the May 2002 revision, it was stated "[o]ptional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax." Each of the revisions also gave a specific example concerning computer software situations. The examples stated that sales and use tax would apply to the sale of an optional warranty or maintenance agreement in the software situation only if there was a guarantee of the transfer of tangible personal property (updates) pursuant to the agreement.
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> Computer technology and use has evolved since the issuance of the first Sales Tax Information Bulletin [] 2 on May 2, 1983. Almost all software optional warranties and software maintenance agreements sold today include the automatic provision of updates-sometimes on a day-by-day or week-by-week basis. Purchasers of these agreements have a reasonable expectation that they will receive the updates whether or not the actual contract couches the provision of updates as "optional." The substance of the agreements is that tangible personal property in the form of software updates will be provided no matter what the language of the contract says. The department determines tax consequences by construing the substance of the agreement over the form. Wholesalers, Inc. v. Indiana Department of State Revenue, 597 N.E.2d 1339 (Ind. Tax 1992). In the case of software maintenance agreements or optional warranties, it is clear that the parties presume that tangible personal property in the form of updates will be transferred. Therefore, **the 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.
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> In this particular taxpayer's situation, the department will apply this interpretation prospectively. (Published in the Indiana Register and available at http://www.in.gov/legislative/iac/20061101-IR-045060474NRA.xml.html) (**Emphasis added**).

Taxpayer is unable to rebut the presumption discussed in Letter of Findings 05-0438, since Taxpayer does not have written service agreements. Taxpayer tried to rebut the presumption by providing the Department with a written statement from the CFO that the service agreements "do not involve any transfer of property[.]" The statement, in effect, simply reiterates the assertions made in Taxpayer's protest letter. It does not provide any substantial evidence to demonstrate what it asserts. Additionally, Taxpayer provided the Department with a document titled "General Support." That document says, "Software upgrades–install updated versions of system software when suggested by manufacturers[.]" The Department notes that the language of the printout indicates that the parties anticipate software updates ("install updated versions...."). Finally, Taxpayer provided the Department with a few sample invoices. The invoices, however, are not dispositive for the protested issue.

As noted, the Department's assessment is prima facie evidence that the claim for unpaid tax is valid. Taxpayer has failed to meet its burden of proof.

FINDING

Taxpayer's protest is denied.

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