DEPARTMENT OF STATE REVENUE

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04-20120271.LOF

Letter of Findings: 04-20110564; 04-20120271
Gross Retail Tax
For the Years 2007, 2008, and 2009

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ISSUE

I. Dealer Buyout Payments – Gross Retail Tax.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b); IC § 6-2.5-4-10; IC § 6-2.5-5-8(b); IC § 6-8.1-5-1(c); Meridian Mut. Ins. Co. v. Richie, 540 N.E.2d 27 (Ind. 1989); Dep't of Treasury of Indiana v. Dietzen's Estate, 21 N.E.2d 137 (1939); Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Ruff v. Charter Behavioral Health System of Northwest Indiana, Inc., 699 N.E.2d 1171 (Ind. Ct. App. 1998); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Fell v. West, 73 N.E. 719 (Ind. App. 1905); 45 IAC 2.2-4-27(d); Sales Tax Information Bulletin 28L (July 2007); Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that it was not required to collect sales tax on money received from Third-Party automobile dealers and attributable to lease agreements Taxpayer had previously entered into with its Indiana customers.

STATEMENT OF FACTS

Taxpayer is an out-of-state business trust which "holds" automobile leases generated by its parent banking corporation and entered into with leasing customers in Indiana and other states. Taxpayer receives auto lease revenue in the form of down payments, lease stream payments, "gap" insurance, late fees, termination fees, and end-of-term fees such as excess mileage fees and wear-and-tear fees. Taxpayer is registered in Indiana as a "retail merchant" and collects sales tax from its leasing customers.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's tax returns and business records and concluded that Taxpayer incorrectly failed to collect sales tax on certain payments received from Third-Party car dealers and attributable to lease agreements it had entered into with its Indiana customers. As a result, the Department assessed Taxpayer additional gross retail (sales) tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An initial administrative hearing and a series of follow-up discussions were conducted during which Taxpayer explained the basis for the protest. This Letter of Findings ("LOF") results.

I. Dealer Buyout Payments – Gross Retail Tax.

DISCUSSION

Taxpayer leased automobiles to customers ("Lessees"). Taxpayer held title (owned) to the vehicle during the lease period. The lease terms were defined in a written contract between Taxpayer and its Lessees. Among other provisions contained in the standardized, written contract, the lease agreement defined the length of the lease. For example, a Lessee might agree to lease an automobile for 60 months and pay 60 monthly taxable lease payments to Taxpayer. Taxpayer collected and remitted sales tax as lease payments were received from the Lessees. At the conclusion of the lease period the Lessee's obligation to Taxpayer was complete, the vehicle was ordinarily surrendered to Taxpayer, and Taxpayer would typically sell the vehicle either to the original Lessee or on the wholesale car market.

A. Audit Conclusion:

The disputed issue here arises when Lessees decide to purchase – or lease – a different car before the conclusion of the pending lease. According to Taxpayer, the Lessees are exercising an "option to terminate the lease... before the expiration of the contractual lease term...." Taxpayer characterizes this as an "Early Termination."

An "Early Termination" can occur under a number of circumstances. For example, a Lessee can communicate with Taxpayer his or her desire to terminate the lease agreement. The Lessee will be directed by Taxpayer to deliver the vehicle to a designated auction house. Taxpayer will then sell the vehicle at wholesale. In these circumstances, the lease agreement provides a specific formula for determining the amount the Lessee must pay Taxpayer to rid himself or herself of the remaining lease obligation.

An "Early Termination" can also occur when the Lessee enters into a new purchase or lease agreement with a car dealer before the end of the current lease agreement with Taxpayer. For example, Lessee – who originally agreed to pay Taxpayer 60 monthly payments – decides after 48 months that he or she wants to purchase or lease another car from a Third-Party. (This LOF designates the secondary vendor here as "Third-Party" to differentiate it from the dealer who leased the original vehicle.) The Lessee can be accommodated, but the Lessee must be extricated from the remainder of the original 60 month lease obligation and the obligation to pay

the 12 remaining lease payments.

According to Taxpayer, Third-Party dealer contacts Taxpayer and is informed of the price Taxpayer will sell the vehicle to Third-Party dealer and the cost of extricating the Lessee from the remainder of the lease obligation. Thereafter, Taxpayer accommodates the Lessee by agreeing to sell the existing vehicle to the Third-Party car dealer. The Lessee's existing obligation is paid off by the Third-Party car dealer, and the existing vehicle becomes the Lessee's "trade-in."

Under the "Early Terminations" here at issue, the Lessee negotiates with the Third-Party new car dealer to "wind down" the remainder of the 60 month original lease cited above with the aim of ridding himself or herself of the original vehicle and acquiring a new vehicle. The audit report describes this secondary transaction as follows:

This type of transaction occurred when the lessee entered into a new purchase or new leased vehicle transaction with a car dealer prior to the end of its current lease obligation with the [T]axpayer. In substance the lessee used its leased vehicle as a trade-in on a new vehicle with the dealer, although in form the leased vehicle was never titled to the lessee. In facilitating the deal, the [T]axpayer provided the amount of the payment required from the dealer to pay off the lessee's contractual lease obligation and exercise its option to buy the leased vehicle. (Emphasis added).

According to Taxpayer:

> Upon receipt of the payment of the purchase price, Taxpayer transfers the certificate of title to the vehicle to the Third-Party dealer. The Third-Party dealer may agree to make an adjustment to the purchase price of the new vehicle to account for the "trade-in" of the leased vehicle. If there is "positive equity" in the leased vehicle, i.e. the market value of the vehicle exceeds the price at which it may be purchased from Taxpayer, the positive equity may be shown as a trade-in credit reducing the purchase price of the new vehicle. If there is "negative equity" in the leased vehicle, i.e. the market value of the vehicle is less than the price to purchase it from Taxpayer, the negative equity may be added to the amount financed in connection with the customer's acquisition of the new vehicle.

In those instances in which the Lessee decides to acquire a new vehicle from a Third-Party car dealer and negotiate with Third-Party car dealer to satisfy the existing lease agreement, the audit report described the process as follows:

> The [T]axpayer records the dealer payments on its internal books as a two-fold payment, a satisfaction of the lease and a purchase of the vehicle. The reviewed dealer pay-offs to the [T]axpayer referenced the lessee by name and by lease number. The reviewed payments received from the car dealers equaled the lease termination fees and the contractual amount (as specified in the lease contract) needed to buy the vehicle.

The audit found that a portion of the Third-Party car dealer payoff amounts – lease payments and/or lease termination fees – was subject to sales tax because the payments "[were] part of the lease consideration in the lease agreement that was executed with the lessee." As further explained in the audit report:

> The payments by the dealers relieve the lessees from liability to the extent that the lease obligation is satisfied. All consideration received and provided for in the lease contract for the rental of property is subject to tax. As a result the audit taxes the dealer payments to the extent they are attributable to satisfying the lease obligation between the [T]axpayer and the lessee.

In effect, the audit treated the Early Termination including, "lease payments and/or lease termination fees," as relieving the Lessee from his or her liability under the tax and treated those amounts as substitute lease payments by the Lessee which were subject to sales/use tax. It should be noted that the audit did not tax that portion of the Third-Party dealer's payment that equaled the residual value of the vehicle.

Under the parties' Lease agreement, the Lessee had options other than the "Early Termination" scenarios listed above. At all times during the pendency of the lease agreement, the Lessee retained the right to simply purchase the automobile from Taxpayer at a price defined under the terms of the lease agreement. Whether paid by the Third-Party dealer as a "buyout" or by the Lessee, the outright purchase of the vehicle terminated the Lessee's obligation to make further lease payments. However, it is not disputed that the Lessee's purchase of the original vehicle would have been subject to sales tax and that Taxpayer would have been required to collect that tax as an agent for Indiana.

The original parties' lease agreement also contemplated instances in which the Lessee would default on the lease obligation. In those instances, Taxpayer reserved the right to terminate the lease. Upon termination, the contract required the Lessee to return the vehicle, reserved to Taxpayer the right to "enter any premises" to regain possession of the vehicle, permitted Taxpayer to apply the Lessee's security payment to any unpaid amounts due on the lease, required the Lessee to pay a "termination charge," required the Lessee to pay the "residual value" of the vehicle, required the Lessee to pay all the remaining monthly payments, and required the Lessee to pay various miscellaneous costs such as taxes, fees, liens, and rents.

B. Taxpayer's Argument:

It is the Taxpayer's contention that it directly sold the leased vehicles to Third-Party car dealers who purchased those vehicles for resale purposes. Taxpayer contends that, in both substance and form, the transactions "were exempt from sales tax" as a "sale for resale." Taxpayer argues that the Third-Party car dealer's buyout payment is not made by the Lessee, is not made on behalf of the Lessee, and is not made to satisfy the

Lessee's lease obligation. "Rather the entire payment is the consideration paid by the Third-Party dealer for the purchase of the vehicle from [Taxpayer]."

Taxpayer disagrees with the audit's contention that the "payments made by the dealers relieve the lessees from liability to the extent that the lease obligation is satisfied" and that the Third-Party car dealer's payment satisfied the Lessee's liability under the agreement between the Lessee and Taxpayer. Specifically, Taxpayer disputes the audit's conclusion set out as following:

> The payments made by the dealers relieve the lessees from liability to the extent that the lease obligation is satisfied. All consideration received and provided for in the lease contract for the rental of property is subject to tax. As a result the audit taxes the [Third-Party] dealer payments to the extent they are attributable to satisfying the lease obligation between the [T]axpayer and the lessee.

Taxpayer asserts that the "lease payments and/or lease termination fees" are not made by or on behalf of the Lessee and are not payments intended to satisfy the Lessee's obligations. Specifically, Taxpayer argues that the audit's conclusion and methodology are inherently flawed:

> The quoted purchase price is not broken down among different lease components, and Taxpayer asserts that the audit erred in taxing part of the dealer payment while exempting part of it. If the Third-Party dealer's purchase was actually made on behalf of the Lessee, Taxpayer points out that the entire transaction should have been subject to sales tax. Taxpayer claims that there are no other instances in which a transaction subject to the resale exemption is bifurcated into a taxable portion and an exempt portion.
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> As further explained by Taxpayer:
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> The auditor's characterization of the transaction fails to recognize a key distinction. When the [Third-Party] dealer purchases the vehicle from [Taxpayer], the lease terminates at that point. The lessee no longer has the use of vehicle, and there are no future rental payments due. Therefore, the dealer cannot satisfy future rental obligations because there are no further rental obligations when the lease is terminated by agreement of the parties.
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> In Taxpayer's protest, Taxpayer provides its own example and explanation of one of the transactions at issue:
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> [A]ssume that a [Taxpayer] leasing customer wants to purchase a new vehicle from a dealer at a purchase price of $27,000. The [Third-Party] dealer contacts [Taxpayer] and is informed that [Taxpayer] will sell the customer's leased vehicle to the dealer for $10,000. The dealer determines that it can resell the vehicle for $15,000. The dealer purchases the vehicle from [Taxpayer] and gives the customer a credit of $5,000 (the positive equity) toward the $27,000 purchase price. The customer must pay or finance an additional $22,000 to complete the purchase of the vehicle. The dealer resells the trade-in vehicle for $15,000 realizing a $5,000 gain.

Taxpayer also cites to a second possible scenario in which the Lessee is "upside down;" the Lessee owes more on the remaining lease agreement than the value of vehicle. In those instances, the Third-Party dealer acquires the leased vehicle, but adds a "negative equity" to the loan balance that the Lessee customer would be required to finance to purchase the new vehicle.

Whether "upside down" or not, in either circumstance: (1) the Third-Party car dealer obtained ownership of the vehicle from Taxpayer; (2) Third-Party car dealer paid Taxpayer to obtain that ownership; (3) Lessee purchased or financed the expenses incurred by the Third-Party car dealer in obtaining the vehicle; (4) the original agreement between Taxpayer and Lessee was terminated; and (5) former Lessee obtained a substitute vehicle from Third-Party car dealer.

The significance of the differing interpretations lies in the tax consequences. Taxpayer concludes that the transaction is between itself and the Third-Party car dealer and that the transfer of the vehicle to the Third-Party car dealer is exempt from sales tax as a "sale for resale" pursuant to IC § 6-2.5-5-8(b). That statute provides:

> 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 reasons that the lease agreement is first terminated and after termination Taxpayer sells the car to Third-Party car dealer. Taxpayer indicates that the taxable lease agreement terminates upon sale of the vehicle to the Third-Party car dealer, that the Lessee no longer has control or use of the vehicle, and that no further rental payments are due from Lessee. In making its argument, Taxpayer postulates a hypothetical "rich uncle" scenario. If Lessee were fortunate enough to have a rich uncle intervene in the lease agreement between Lessee/nephew and Taxpayer and if the rich uncle provided a buyout or payoff of the lease agreement, the payments rich uncle made on behalf of Lessee/nephew would be taxable because Lessee/nephew would continue to enjoy continued possession and use of the vehicle. According to Taxpayer, when a Third-Party car dealer intervenes in the on-going lease arrangement, Lessee no longer enjoys possession and use of the vehicle, and "leasing stops because of an early lease termination [and] taxable transactions stop."

Taxpayer further claims that there is nothing in the lease agreement which precludes it from unilaterally selling the leased vehicle to a third-party during the lease term or at the end of the lease term. Taxpayer points to a specific provision in the lease agreement which contemplates the sale of the vehicle by Taxpayer in the event of a "default."

In addition, Taxpayer believes the Department's treatment of the Third-Party car dealer's payments is at odds with previously published Departmental directives. Taxpayer cites to Sales Tax Information Bulletin 28L (July 2007), 20070801 Ind. Reg. 045070433NRA, which according to Taxpayer:

> [E]xpressly recognizes that in a transaction of this type, it is the dealer that purchases the leased vehicle from the leasing company, not the lessee. Because a lessee does not acquire ownership of the vehicle, the lessee is not entitled to any trade-in exemption on the transaction with the dealer.

Taxpayer contends that the audit conclusion directly contradicts Sales Tax Information Bulletin 28L. Taxpayer contends that if the lessee does not acquire ownership of the vehicle, the lessee cannot be subject to sales tax on the transaction.

C. Statement of Law:

(1) Imposition:

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" 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." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Id.; USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466, 468–69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. Rhoade, 774 N.E.2d at 1048. A taxable retail transaction occurs when; (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

(2) Lease Income:

Lease payments – such as that made by Lessees to Taxpayer – are subject to the state's sales tax. Specifically, the audit cites to 45 IAC 2.2-4-27(d)(1) as authority for subjecting the "lease payments and/or lease termination fees" to the tax.

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction is taxable.
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> (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include the consideration received from the exercise of an option contained in the rental [or] lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property and any receipts held by the lessor or some future time be applied by the lessor as rentals.

(3) Presumption and Burden of Proof:

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing sales 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 this case, Taxpayer has the obligation of establishing that the assessment of sales/use tax on the payments made by Third-Party car dealers was "wrong."

The presumption in Indiana is that all retail sales – such as the automobile lease payments at issue – 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....").

In addition, it is a long held rule in Indiana that "[t]he statutes of this state relating to the assessment and collection of taxes are liberally construed in favor of the taxing powers." Fell v. West, 73 N.E. 719, 722 (Ind. App. 1905). See also Dep't of Treasury of Indiana v. Dietzen's Estate, 215 Ind. 528, 532, 21 N.E.2d 137, 139 (1939) ("In construing tax statutes a liberal rule of interpretation must be indulged in order to aid the taxing power of the state.").

D. Discussion:

The issue is whether Taxpayer was required to collect sales tax on the money it received from Third-Party car dealers when one of Taxpayer's Lessee/customers decided to terminate a automobile lease agreement, arranged for a Third-Party automobile dealer to acquire the leased vehicle, and where the Third-Party automobile dealer paid the remaining lease obligations due Taxpayer on the leased vehicle.

It is the audit's position that "[l]ease payments and/or lease termination fees that are satisfied by the dealer payments are taxable" because the payments relieved the lessee of its taxable obligations under the parties' agreement, and because "[a]ll consideration received and provided for in the lease contract for the rental of property is subject to tax."

It is the Taxpayer's position that the agreement which allows the Third-Party car dealer to acquire the vehicle is strictly between itself and the Third-Party car dealer because the transaction "does not involve the exercise of the [Lessee's] early termination option," the Third-Party car dealer's payments are not made on behalf of the Lessee, and that the entire Third-Party car dealer's payment constitutes "consideration paid by the [Third-Party] dealer for the purchase of the vehicle from [Taxpayer]."

It is the audit's position that the Third-Party car dealer pays off the Lessee's obligation under the lease agreement, that there is nothing in the agreement which permits the Third-Party car dealer and Taxpayer to deal directly with each other ignoring the rights and obligations of the Lessee, and that the payment made by Third-Party car dealer is subject to tax because Third-Party car dealer "stands in the shoes" of the Lessee when it makes the payment. In other words – adopting Taxpayer's own analogy – Third-Party car dealer acts as the Lessee's "rich uncle."

In reviewing the audit's position and the Taxpayer's argument, it is appropriate to understand fully the nature and extent of the obligations, rights, and responsibilities of both Taxpayer and the Lessees spelled out under their written agreement; it is those "obligations, rights, and responsibilities" which determine the tax consequences of the transactions here at issue.

As stated above, the parties' agreement contemplates circumstances in which the Lessee may decide to accelerate the remaining term of the lease, shed responsibility for the remaining payments due under the lease, and surrender possession of the vehicle. In those instances, the contract requires that the Lessee make a series of payments. Lessee is required to pay (1) "unpaid monthly payments." These charges are the value of the remaining lease payments. For example, if – after 36 months of a 48 month lease – the Lessee wants to rid himself of the responsibilities under the remaining lease term, the Lessee is required to pay the "unpaid monthly charges" equal – in this example – to the value of the 12 months remaining on the lease. In addition, the Lessee will be required to pay a contractually defined (2) "termination charge" which is composed of a flat fee and an amount equal to 50 percent and up to 250 percent of a single monthly lease payment. The "termination charge" acts as a penalty imposed in exchange for allowing the Lessee to avoid the remainder of the lease. The Lessee would also be required to pay the (3) "residual value" of the vehicle. The residual value is the remaining value of the vehicle at the conclusion of the contemplated 48 month lease. In addition, the Lessee may be required to pay "excess damages fees" which is the amount due if the Lessee exceeded the mileage limits set out under the lease agreement or if the vehicle was somehow damaged during the course of the lease. After paying the "unpaid monthly payments," the termination charge, and the residual value, the Lessee is free to "walk away" from his or her obligations under the lease but – in this admittedly unlikely scenario – does not acquire ownership of the vehicle.

The agreement also contemplates circumstances in which a Lessee may decide to accelerate the remaining term of the lease and acquire full ownership of the vehicle. In those instances, the contract requires that the Lessee pay the (1) "unpaid monthly payments," the (2) "termination charges" along with the (3) "residual value" of the vehicle. As noted above, the "residual value" is the value the car would have at the end of the original lease. In effect, the Lessee accomplishes two things; the Lessee concludes the lease and acquires full ownership of the vehicle. Under this scenario, the lessee pays tax on the unpaid monthly payments and the residual value. The Lessee does so because the lease payments are subject to sales tax and the payment of the "residual value" is treated as a purchase of the vehicle. See IC § 6-2.5-2-1; See also IC § 6-2.5-4-10 ("[a] person is a retail merchant making a retail transaction when the person sells any tangible personal property which has been rented or leased in the regular course of the person's rental or leasing business.")

The parties' agreement anticipates circumstances under which the Taxpayer – and not the Lessee – may terminate the lease agreement under certain, contractually specified circumstances under which the Lessee has gone into default. Those circumstances may include: (1) the Lessee fails to make any monthly payment by the due date; (2) the Lessee dies, is disabled, or becomes incompetent; (3) the Lessee fails to acquire and/or maintain insurance on the leased vehicle; (4) the Lessee provides incomplete or inaccurate information on a credit application, financial statement, or on the lease application; (5) if an outside party attempts to seize, levy, impound, confiscate the vehicle or if a forfeiture is brought against the Lessee or the vehicle; (6) the Lessee becomes insolvent, enters into bankruptcy, enters into receivership, or makes any assignment for the benefit of creditors; (7) Taxpayer, "in its reasonable commercial discretion," decides that it is "insecure;" (8) Lessee defaults or fails to perform any promise or agreement with either Taxpayer or any affiliate of Taxpayer; (9) the vehicle is lost, destroyed, or stolen.

If the Lessee defaults on the lease agreement, Taxpayer is entitled to collect: (1) a fixed amount based on the percentage of the completed monthly lease payments; (2) the residual value of the vehicle as defined under the agreement; (3) the total of all unpaid monthly lease payments; (4) all collection costs, collection agency costs, and attorney fees; (5) taxes, fees, fines, citations, and any other amounts due under the terms; (6) minus any

"unearned rent charges" as computed under a "constant yield" method, deprecation amounts accrued during the previous months, and the first base monthly payments and (7) minus any amount received by Taxpayer from insurance payments, salvage sale, sale or re-lease of the vehicle.

None of the aforementioned contract provisions are specifically at issue here. The issue centers on those circumstances in which the Lessee decides to acquire an entirely different vehicle from a Third-Party car dealer before the lease on the original vehicle has fully run its course. In those instances, the Third-Party car dealer intervenes in the lease, deals directly with Taxpayer and – on behalf of the Lessee – agrees to pay the (1) "unpaid monthly payments," the (2) "termination charges" along with the (3) "residual value." It is important to note that this transaction is initiated by the Lessee because it is Lessee's decision which triggers the subsequent series of events. At the conclusion of the transaction, the Lessee has shed his or her responsibility for the original lease, Third-Party car dealer has acquired ownership of the original leased vehicle, and Taxpayer has been "made whole" pursuant to the terms of the original lease agreement. Taxpayer maintains that none of the charges listed above are subject to sales or use tax because the Taxpayer treats the events as if the Lessee went into default while the Department maintains that the "unpaid monthly payments" and the "amount received by [Taxpayer] over and above the residual value" were subject to tax because that amount was always the Lessee's liability whether the lease went full term or was terminated early and because Third-Party car dealer assumed the contractual responsibilities owed by the Lessee. In effect, the Department treated the transaction between the Third-Party car dealer and Taxpayer the same as if the transaction were between the original Lessee and Taxpayer.

There are two parties to each of the lease agreements at issue. Both parties have certain specifically enumerated rights and obligations. Both parties have the right to terminate the agreement, both parties have the right to acquire ownership of the vehicles, and both parties can become obligated to the other for certain defined costs and responsibilities under the specific terms of the agreement. However, there is nothing in the contract which expressly anticipates circumstances in which a Third-Party car dealer intervenes to purchase the leased vehicle directly from Taxpayer; conversely there is nothing in the agreement which expressly anticipates circumstances in which Taxpayer has the authority to sell the leased vehicle to Third-Party car dealer unless the Lessee has gone into default. Under the terms of the parties' agreement, only the Lessee has the enumerated right to purchase the vehicle and – under those enumerated rights – would become obligated to pay sales tax. Although the Taxpayer has the right under certain circumstances to declare that the Lessee is in default and regain possession of the vehicle – and thereafter sell or dispose of the vehicle in any manner it sees fit – the Lessee is nonetheless obligated to pay the sales tax on all the amounts contractually owed by the Lessee as if the lease ran full term.

What is evident is that the Lessee is not purchasing the vehicle, and the Taxpayer is not declaring that the Lessee is in default. That being said, the Lease agreement is entirely silent on the subject transactions here in dispute. Under circumstances in which a contract is silent, it is appropriate to review the supplementary documentation exchanged between Third-Party car dealer, Taxpayer, and the affected Lessee along with the circumstances surrounding the transaction. Meridian Mut. Ins. Co. v. Richie, 540 N.E.2d 27, 28 (Ind. 1989) ("Only when ambiguities cannot be resolved within the four corners of the contract is a fact finder needed to determine those extrinsic facts upon which interpretation of the contract may rest.")

The Department's audit reviewed the payments and documentation sent and received by Taxpayer (or its designated payee) from the Third-Party car dealers. The payments received by Taxpayer from the Third-Party car dealer referenced the "payoff" of a specified lease account which was identified by lease number and Lessee name. Taxpayer's internal lease accounting system recorded the transactions as a "PAID OFF LEASE." Entries in Taxpayer's accounting system included a payoff receipt amount equaling the total payment and an allocation of the payment to various charges such as "term charges," late charges, and satisfaction of various contractual obligations. (It should be noted that during the course of the administrative hearing process, Taxpayer was asked to provide examples of the documentation defining the obligations between typical lessee/customer and typical Third-Party car dealer but Taxpayer was unable to provide that documentation.)

The audit report indicated that Taxpayer believed it had the right to sell the vehicle to Third-Party car dealers under the "default" provisions of the lease agreement. Under the terms of the agreement, if the Lessee defaulted on the agreement, the Lessee lost the right to use the vehicle and the Lessee was obligated to return the vehicle to Taxpayer. If the Lessee did not willingly surrender the vehicle, Taxpayer had the right to repossess the vehicle and then to sell or lease that vehicle to another person. Presumably such a sale would be exempt under IC § 6-2.5-5-8(b) as a "sale for resale" because the sale is simply a straight-forward transaction between Taxpayer and a car dealer. However, the facts surrounding the transactions at issue do not indicate that the Lessees failed to live up to the terms of the agreement, that any of the contractual pre-conditions to finding the Lessee in default existed, that Taxpayer ever took any actions which would establish that the Lessees were in either actual or technical default, or that there is anything in the lease agreement allowing a sale to a Third-Party car dealer unless the Lessee was in default. "Default" is defined as, "The omission or failure to perform a legal or contractual duty." Black's Law Dictionary 428 (7th ed. 1999). In the transactions at issue, there is no indication that the Lessees failed to perform their contractual duties under the lease agreement.

In actual practice, it was the Lessees who initiated these transactions when it contacted the Third-Party car

dealers seeking to terminate the pending lease agreement, acquire a substitute vehicle, and rid themselves of the original leased vehicle. The Third-Party dealer did not contact Taxpayer to determine what the Lessee's vehicle was worth but to determine the amount necessary to free the Lessee from the contract and allow the Lessee to trade in the leased vehicle. The Department is unable to conclude that in the circumstances here at issue – where Third-Party car dealer acquired formerly leased vehicles – the Lessees ever either omitted or failed to perform a duty under the parties' agreement.

The Department is unable to agree that the example cited in Sales Tax Information Bulletin 28L (July 2007) is dispositive of the issue because the issue is not who does or who does not own the vehicle at the time of the transaction but the nature of the payment made by Third-Party car dealer. Is the payment made satisfy the obligations owed by Lessee or is the payment made to simply purchase the car from Taxpayer? Under the circumstances set out in Taxpayer's own contract, the Lessee is obligated to pay the taxable amounts defined in the parties' agreement and those amounts are owed by Lessee to Taxpayer. The Third-Party car dealer is advancing a payment on behalf of the Lessee to relieve the Lessee of his or her obligation.

Bearing in mind that it was the Lessee that initiated the transactions here at issue and not Taxpayer, the circumstances more closely resemble the provisions under the agreement in which the Lessee decided to accelerate the agreement, exercise the Lessee's option to purchase the vehicle, or exercise the Lessee's option to "wind-down" the lease and rid himself or herself of the vehicle. Whether the Lessee decides to terminate the lease or purchase the vehicle, the Lessee is obligated to pay the remaining lease payments and the taxes associated with those lease payments.

The Department is unable to agree with Taxpayer's assertion that the purchase of the vehicle by a Third-Party car dealer is an "extra-contractual," independent transaction between the Third-Party car dealer and Taxpayer because: (1) there is no provision in the lease agreement which permits or anticipates such a transaction unless the Lessees were in default, and the Lessees here had clearly not defaulted on the agreement; (2) the payments received by Taxpayer from the Third-Party car dealers were designated as "payoffs" of the lease agreement by both Third-Party car dealer and Taxpayer; (3) Taxpayer recorded the payoff amounts, termination charges, late charges, rent payments, and as a payoff of the lease agreement; (4) Taxpayer's payoff form sent to the Third-Party car dealer is designated as a "Lease Payoff" and refers to the "payoff amount."

Taxpayer objects arguing that the audit is attempting to tax future lease payments and that – because the lease was terminated – there could be no future lease payments. However, Taxpayer's assertion begs the questions. The Department agrees with Taxpayer that the leases were indeed terminated, but the issue is whether the "payoff" amounts were subject to sales tax. The audit report does not indicate that the Department is attempting to tax "future lease payments" pursuant to an agreement which has previously been terminated. The audit report is consistent when it defines the issue as whether or not the contractually defined payoff amount – as agreed to at the outset of the parties' relationship – is subject to sales tax. The agreement clearly states that unpaid monthly payments and termination charges are due upon the Lessee's decision to terminate the agreement and either acquire the vehicle or simply extricate himself or herself from the obligations under the lease. Those unpaid monthly payments are derived from the capitalized cost calculation used to determinate the original rental obligation while the termination charges are contingent on the number of payments made through to the date the agreement is terminated. Payments of both these amounts are taxable as provisions of the rental contract for the use of tangible personal property under IC § 6-2.5-2-1.

The Department recognizes that the audit report's conclusion and the conclusion here are likely both unsatisfactory and unanticipated. But the decision is driven by the terms of an agreement which Taxpayer drafted and controlled, and the rule is long held that "ambiguities in a contract are to be strictly construed against the party who employed the language and who prepared the contract." Ruff v. Charter Behavioral Health System of Northwest Indiana, Inc., 699 N.E.2d 1171, 1176 (Ind. Ct. App. 1998). Nonetheless, the Department is unable to agree that Taxpayer entered into exempt, independent extra-contractual agreements with Third-Party car dealers allowing Taxpayer's Lessee customers to avoid fulfilling the terms of the parties' agreement because the Lessees were in constructive "default" of the agreement. The contract between Taxpayer and its customers contains no provision anticipating such an agreement. The only stipulated obligation is between Taxpayer and Lessee and that obligation remains unless the terms of the agreement are fully satisfied. The satisfaction of that obligation by either Third-Party car dealer or Taxpayer's hypothetical "rich uncle" results in the payoff of the amount due Taxpayer by the Lessee and the tax consequences in either case are identical. As set out in 45 IAC 2.2-4-27(d), "The rental or leasing of tangible personal property, by whatever means affected and irrespective of the terms employed by the parties to describe such transaction is taxable," Either paid by "rich uncle" or Third-Party car dealer, the payments are subject to sales tax.

FINDING

Taxpayer's protest is respectfully denied.

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