

Letter of Findings: 04-20120332
Sales and Use Tax
For the Years 2008, 2009, and 2010

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ISSUE

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-8.1-5-1; [45 IAC 2.2-5-36](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993).

Taxpayer protests the assessment of use tax on purchases of tangible personal property – "procedure cards."

STATEMENT OF FACTS

Taxpayer is an Indiana company which offers full optical services. Taxpayer employs doctors who specialize in various types of eye surgeries including cataract, refractive, glaucoma, laser, and specialty and corneal implants. From late 2011 through early 2012, the Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer's business records. Pursuant to the audit, the Department determined that Taxpayer purchased certain tangible personal property, including office supplies and medical supplies, to be used in the course of its business activities but did not pay sales tax or use tax on those items. As a result, the Department assessed additional use tax and interest.

Taxpayer only protested the Department's assessments on its purchases of "procedure cards" ("Cards"). An administrative hearing was held by phone. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

The Department's audit found that Taxpayer purchased the Cards without paying sales or use tax; the Cards were used to operate laser equipment to perform the LASIK surgical treatments on individual patients. The Department's audit noted, in relevant part, that:

[Taxpayer] performs Lasik surgery using laser equipment.... [T]axpayer also purchased procedure cards [without paying sales tax]. The cards are used to provide Lasik eye surgery to its patients and are similar in size to credit cards.

The procedure cards are inserted into the equipment which allows the doctor to gain access to the laser equipment which is used by the doctor to perform laser eye surgery on the patients.... Taxpayer paid for the [Cards] upon purchase and 10 procedures are on one [Card]. The equipment can be turned on by the doctor without a [Card] but it cannot be utilized for laser until the [Card] is inserted into the equipment. (Page 4 of the Audit Summary).

Since Taxpayer did not pay sales tax on its purchases of the Cards, the Department's audit assessed Taxpayer use tax as a result. Taxpayer argued that it was not responsible for the sales/use tax because its purchases of the Cards were "non-taxable... royalty fee."

As a threshold issue, all tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

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 Rhoades 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. Id. 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).

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, in relevant part, states:

(a) 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.

(b) The use tax is also imposed on the storage, use, or consumption of a vehicle, an aircraft, or a watercraft, if the vehicle, aircraft, or watercraft:

- (1) is acquired in a transaction that is an isolated or occasional sale; and
- (2) is required to be titled, licensed, or registered by this state for use in Indiana.

[45 IAC 2.2-5-36](#) further states:

(a) The gross retail tax shall apply to the following purchase transactions made by licensed practitioners:

- (1) All office furniture, equipment and supplies.
- (2) Drugs of a type not requiring a prescription, when not purchased for resale.
- (3) **Surgical instruments, equipment and supplies.**
- (4) Bandages, splints, and all other medical supplies consumed in professional use.
- (5) X-Ray, diathermy, diagnostic equipment, or any other apparatus used in the practice of surgery or medicine.

(b) The purchase of items for resale by the physician or surgeon. In order to resell items the practitioner must be licensed as a retail merchant, and must quote the selling price of any items separately from the charge for professional service. (**Emphasis added**).

Taxpayer, in its protest letter, stated that it purchased the refractive laser (the "surgical equipment") from its predecessor, the owner of that surgical equipment, pursuant to a lease-to-own arrangement with the manufacturer. Taxpayer also stated that it purchased the Cards from the manufacturer of that surgical equipment to operate the surgical equipment to perform the eye surgery. Taxpayer explained that each of the Cards is "approved for up to 10 treatments with a small chip that records the treatment, and then deactivates the [Card]. The chip is for counting treatments only and does not otherwise interface or control the mechanics of the actual [surgical equipment]." Thus, Taxpayer asserted that its purchase of each Card "should not be taxed and [should] not be subject to Indiana sales tax because it is the payment of royalties to a patented surgical process." Taxpayer further maintained that "the value of each treatment card should not be subject to sales tax as the value of each card is de minimus [*sic*] in relation to the value of each per procedure fee for the right to use an intangible patented surgical process." To support its protest, Taxpayer submitted additional documentation, which includes a statement from the manufacturer of the surgical equipment and a copy of the registered patent concerning the "Laser Surgery Method." Taxpayer also provided an excerpt of the surgical equipment Operator's Manual and an excerpt of the manufacturer's device description of the surgical equipment.

Taxpayer's documentation contained an excerpt of a document prepared by the manufacturer for the approval of the Federal Drug and Food Administration (the "FDA") to sell the surgical equipment to the public. The manufacturer, in that document, described that a LASIK eye surgery consists of several steps: "Wavefront Aberrometer," "Microkeratome," "Laser System with Active Tracker," and "Tracking System." Among those steps, the "Laser System with Active Tracker" step is the most relevant to Taxpayer's protest. Taxpayer's documentation demonstrated that, the surgical equipment it used had several components, which included a laser unit, a control unit, a tower unit, a Card, a robotic arm, an active eye tracker, an operating elements, a bed unit and a chair. Taxpayer's documentation further showed that the surgical equipment contained a Card reader, which "is located behind the black flap in the optics tower." The surgical equipment, which contained certain software, prompted Taxpayer to insert the Card into the card reader to start its surgery and without the Card the surgical equipment would not be operable. Taxpayer's documentation further demonstrated that it subsequently purchased an upgrade kit from the manufacturer to be installed in the surgical equipment. The "Purchase Price" section, in relevant part, stated:

- [A] down payment towards equipment, plus applicable tax.
- The [] remaining balance will be payable as [an] equipment fee per each procedure purchased. Taxes will be applied to this fee....
- The equipment fee will be removed once 165 procedures are purchased.

Thus, Taxpayer's documentation clearly showed that it was required to purchase the Card in order to operate the surgical equipment, and the Card was one component of the surgical equipment. Thus, Taxpayer's purchases of the Cards were subject to Indiana sales/use tax pursuant to [45 IAC 2.2-5-36\(a\)\(3\)](#).

Taxpayer argued that the payments of the Cards constitute royalty payments. The Department disagrees. Taxpayer's documentation showed that a patent named "Laser Surgery Method" was filed in 1987 and registered in 1992. However, neither the inventor nor the assignee of that patent was the manufacturer. Additionally, the abstract of that patent did not contain any information as to the operation of the surgical equipment and the Card which Taxpayer was required to use to perform the surgery in that patented surgical process. Thus, given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer's payments of the Cards represented a fee for "a right to perform a patented surgical process resulting from patented intangible intellectual property."

Taxpayer further argued that "the value of each treatment card should not be subject to sales tax as the value of each card is de minimus [*sic*] in relation to the value of each per procedure fee for the right to use an intangible patented surgical process." Specifically, Taxpayer claimed that it paid the manufacturer of the surgical equipment "\$1,300 or \$2,000" per Card, when "the value for each card is \$10." The Department also disagrees. As mentioned above, Indiana imposes sales tax "on retail transactions made in Indiana," and use tax on "storage, use, or consumption of tangible personal property in Indiana." The Indiana General Assembly does not intend to exclude or exempt certain sales from the sales/use tax based on the cost of producing the item for sale. Rather, the sales/use tax is imposed at the time of the retail transaction based on the price of the sale. Whether the value of the tangible personal property is de minimus [*sic*] is irrelevant. The manufacturer and/or retail seller often include their costs of doing business in the sale price of their products to be sold—which, in this instance, may well include the cost of developing certain intellectual property. Thus, what the manufacturer of the surgery equipment's cost in producing the Cards for sales was beyond the scope of this protest. In this instance, the Card is a component part of the surgical equipment and is required to be inserted into the surgical equipment so it can be operable. The manufacturer sold the Cards for \$1,300 or \$2,000 and Taxpayer paid the manufacturer \$1,300 or \$2,000 per Card. Taxpayer acquired the Cards in retail transactions, and thus was liable for the sales tax.

In conclusion, Taxpayer's documentation demonstrated that the Card, tangible personal property, is one of the components of the surgical equipment and Taxpayer is required to insert the Cards to operate that surgical equipment. Thus, Taxpayer's purchases of the Cards were subject to sales/use tax pursuant to [45 IAC 2.2-5-36\(a\)\(3\)](#). Since Taxpayer did not pay sales tax at the time of its purchases, use tax is properly imposed.

FINDING

Taxpayer's protest is respectfully denied.

Posted: 02/27/2013 by Legislative Services Agency
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