DEPARTMENT OF STATE REVENUE

04-20120418.LOF

Letter of Findings Number: 04-20120418
Use Tax
For Tax Years 2008-10

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ISSUES

I. Use Tax–Imposition.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-2-2; IC § 6-2.5-2-1; IC § 6-2.5-3-2; 45 IAC 2.2-3-4; 45 IAC 2.2-4-2; Kentucky Rev. Stat. § 138.460; Kentucky Rev. Stat. § 139.200; Kentucky Rev. Stat. § 139.310.

Taxpayer protests the imposition of use tax on some transactions.

II. Tax Administration–Penalty and Interest.

Authority: IC § 6-8.1-10-1; IC § 6-8.1-10-2; 45 IAC 15-11-2.

Taxpayer protests the imposition of negligence penalty and interest.

STATEMENT OF FACTS

Taxpayer is an Indiana business in the medical industry. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not remitted the correct amount of use tax for the tax years 2008, 2009, and 2010. The Department therefore issued proposed assessments for use tax, ten percent negligence penalty, and interest. Taxpayer protests that some of the purchases listed as subject to use tax were not actually subject to use tax. Therefore, Taxpayer protests a portion of the use tax, penalty, and interest found in the proposed assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Imposition.

DISCUSSION

Taxpayer protests the imposition of use tax on certain purchases which the Department had determined were subject to use tax for the tax years 2008, 2009, and 2010. The Department based its determination on its review of Taxpayer's records for 2010. If there was no invoice for a particular transaction or if the invoice did not show sales tax paid at the point of purchase, the Department included that purchase as subject to use tax. The total of expensed purchases without sales tax applied was compared against all purchases to arrive at a sales and use tax error rate. That rate was then applied to all three years under audit. Capital asset purchases were separately and individually reviewed for sales and use tax compliance. Taxpayer protests that some of those purchases had either had sales tax paid at the point of purchase, or were not subject to Indiana use tax at all. 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).

Sales tax is imposed by IC § 6-2.5-2-1, which states:

(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. (Emphasis added).

Use tax is imposed under IC § 6-2.5-3-2(a), which 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 2.2-3-4 further explains:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction.

Taxpayer protests that some of the transactions which the Department determined were subject to use tax were not subject to sales or use tax. Taxpayer states that some transactions had sales tax collected at the time of purchase and that some transactions were not subject to sales and use tax to begin with. Taxpayer provided a list of items which it believes were not subject to sales or use taxes on the basis that Taxpayer believes that some of the transactions were for services and not for the transfer of tangible personal property. Also, Taxpayer asserts that other transactions were for both services and tangible personal property and Taxpayer believes that use tax should only be charged for the portion of the transaction related to tangible personal property.

The Department refers to 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.

(Emphasis added).

Also, IC § 6-2.5-2-2(a) states:

The state gross retail tax is measured by the gross retail income received by a retail merchant in a retail unitary transaction and is imposed at seven percent (7[percent]) of that gross retail income.

(Emphasis added).

Also, 45 IAC 2.2-4-2, which 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.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

(Emphasis added).

Therefore, the value of tangible personal property transferred in the provision of a service must not exceed ten percent of the service charge in order for the exemption provided by 45 IAC 2.2-4-2 to apply.

Taxpayer did not provide documentation in support of its position that the transactions in question were not unitary transactions as defined by IC § 6-2.5-1-1. Neither did Taxpayer provide documentation which establishes that any of the transactions in question meet the four (4) requirements of the serviceman exemption found at 45 IAC 2.2-4-2.

Taxpayer did provide some documentation in support of its position that either sales or use tax had already been paid on some items. Taxpayer provided several Kentucky certificates of title which list that Kentucky "usage tax" had been paid. Taxpayer believes that this shows that sales or use tax was already paid to another state and that Indiana use tax should not be applied.

The Kentucky sales tax is imposed under Kentucky Rev. Stat. § 139.200 (West 2012), which states in relevant part:

A tax is hereby imposed upon all retailers at the rate of six percent (6[percent]) of the gross receipts derived from:

(1) Retail sales of:

(a) Tangible personal property, regardless of the method of delivery, made within this Commonwealth; and

(b) Digital property regardless of whether:

1. The purchaser has the right to permanently use the property;
2. The purchaser's right to access or retain the property is not permanent; or
3. The purchaser's right of use is conditioned upon continued payment; and

(2) The furnishing of the following:

(a) The rental of any room or rooms, lodgings, or accommodations furnished by any hotel, motel, inn, tourist camp, tourist cabin, or any other place in which rooms, lodgings, or accommodations are regularly furnished to transients for a consideration. The tax shall not apply to rooms, lodgings, or accommodations supplied for a continuous period of thirty (30) days or more to a person;

(b) Sewer services;
(c) The sale of admissions except those taxed under KRS 138.480;
(d) Prepaid calling service and prepaid wireless calling service;
(e) Intrastate, interstate, and international communications services as defined in KRS 139.195, except the furnishing of pay telephone service as defined in KRS 139.195; and
(f) Distribution, transmission, or transportation services for natural gas that is for storage, use, or other consumption in this state, excluding those services furnished:
1. For natural gas that is classified as residential use as provided in KRS 139.470(8); or
2. To a seller or reseller of natural gas.

The Kentucky use tax is imposed under Kentucky Rev. Stat. § 139.310 (West 2012), which states in relevant part:

(1) An excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property and digital property purchased for storage, use, or other consumption in this state at the rate of six percent (6[percent]) of the sales price of the property.

Kentucky Rev. Stat. § 138.460 (West 2012) states in relevant part:

(1) A tax levied upon its retail price at the rate of six percent (6[percent]) shall be paid on the use in this state of every motor vehicle, except those exempted by KRS 138.470, at the time and in the manner provided in this section.
(2) The tax shall be collected by the county clerk or other officer with whom the vehicle is required to be titled or registered:
(a) When the fee for titling or registering a motor vehicle the first time it is offered for titling or registration in this state is collected; or
(b) Upon the transfer of title or registration of any motor vehicle previously titled or registered in this state.
(3) The tax imposed by subsection (1) of this section and collected under subsection (2) of this section shall not be collected if the owner provides to the county clerk a signed affidavit of nonhighway use, on a form provided by the department, attesting that the vehicle will not be used on the highways of the Commonwealth. If this type of affidavit is provided, the clerk shall, in accordance with the provisions of KRS Chapter 139, immediately collect the applicable sales and use tax due on the vehicle.
(4) (a) The tax collected by the county clerk under this section shall be reported and remitted to the department on forms prescribed and provided by the department. The department shall provide each county clerk affidavit forms which the clerk shall provide to the public free of charge to carry out the provisions of KRS 138.450 and subsection (3) of this section. The county clerk shall for his services in collecting the tax be entitled to retain an amount equal to three percent (3[percent]) of the tax collected and accounted for.
(b) The sales and use tax collected by the county clerk under subsection (3) of this section shall be reported and remitted to the department on forms which the department shall prescribe and provide at no cost. The county clerk shall, for his or her services in collecting the tax, be entitled to retain an amount equal to three percent (3[percent]) of the tax collected and accounted for.
(c) Motor vehicle dealers licensed pursuant to KRS Chapter 190 shall not owe or be responsible for the collection of sales and use tax due under subsection (3) of this section.
(5) A county clerk or other officer shall not title, register or issue any license tags to the owner of any motor vehicle subject to the tax imposed by subsection (1) of this section or the tax imposed by KRS Chapter 139, when the vehicle is being offered for titling or registration for the first time, or transfer the title of any motor vehicle previously registered in this state, unless the owner or his agent pays the tax levied under subsection (1) of this section or the tax imposed by KRS Chapter 139, if applicable, in addition to any title, registration, or license fees.
(6) (a) When a person offers a motor vehicle:
1. For titling on or after July 1, 2005; or
2. For registration;
for the first time in this state which was registered in another state that levied a tax substantially identical to the tax levied under this section, the person shall be entitled to receive a credit against the tax imposed by this section equal to the amount of tax paid to the other state. A credit shall not be given under this subsection for taxes paid in another state if that state does not grant similar credit for substantially identical taxes paid in this state.
(b) When a resident of this state offers a motor vehicle for registration for the first time in this state:
1. Upon which the Kentucky sales and use tax was paid by the resident offering the motor vehicle for registration at the time of titling under subsection (3) of this section; and
2. For which the resident provides proof that the tax was paid;
a nonrefundable credit shall be given against the tax imposed by subsection (1) of this section for the sales and use tax paid.
(Emphasis added).

Therefore, Kentucky's "usage tax" is not the same thing as a sales or use tax. Kentucky has both a "usage

tax" and a "use tax." The "usage tax" is a separate motor vehicle tax. Since it is not the equivalent of a sales or use tax and since there is no evidence that any sales or use tax was paid in Kentucky or Indiana, Indiana use tax was properly imposed on these transactions.

Similarly, Taxpayer provided one Ohio certificate of title along with a Kentucky registration renewal notice. The notice states that a Kentucky motor vehicle tax rate of.45 percent was due on the vehicle in question. Since Kentucky's sales and use tax rates were six percent, it is clear that the motor vehicle tax listed on this document is not the Kentucky sales or use tax. Since there is no evidence that sales or use tax was paid anywhere, Indiana use tax was properly imposed on this transaction.

Next, Taxpayer provided a copy of an invoice from Schiferl System Resources. The invoice does not list sales tax on this transaction and so the Department determined that use tax was due. Taxpayer provided documentation establishing that no tangible personal property was transferred in this transaction and that services only were provided. Since services are not subject to sales or use tax, Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) regarding this transaction.

Next, Taxpayer provided documentation from Applestore, an online retailer. Taxpayer states that sales tax was collected at the time of sale and that use tax is not due on purchases from Applestore. After review, the Department agrees with Taxpayer. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) regarding transactions with Applestore.

In conclusion, Taxpayer has met the burden of proving that Indiana use tax is not due on the transactions listed in the Department's use tax calculations for Schifrel System Resources and Applestore. Taxpayer has not met the burden of proving that any other transactions were not properly included as taxable in the Department's use tax calculations. The Shifrel System Resources and Applestore transactions will be removed and the use tax error rate will be recalculated and applied to all years at issue in a supplemental audit.

FINDING

Taxpayer's protest is sustained in part and denied in part, as described above.

II. Tax Administration–Penalty and Interest.

DISCUSSION

The Department issued a proposed assessment and the ten percent negligence penalty and interest for the tax years in question. Taxpayer protests the imposition of penalty and interest. The Department notes that it is not allowed to waive interest, as provided by IC § 6-8.1-10-1(e). The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

. . .

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

. . .

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which 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.

(Emphasis added.)

45 IAC 15-11-2(c) provides in pertinent part:

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.

In this case, Taxpayer incurred an assessment which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer did not have a use tax accrual and remittance system in place at the time of the audit. Therefore, the negligence penalty was properly imposed. Again, the Department may not waive interest. However, since Taxpayer was partially sustained in Issue I above, penalty and interest will be recalculated after the Department's recalculation of base tax.

FINDING

Taxpayer's protest is denied.

SUMMARY

Taxpayer is partially sustained and partially denied on Issue I regarding the imposition of use tax. The use tax error rate will be recalculated after the removal of the transactions with Shifrel System Resources and Applestore

and the new rate will be applied to the tax years at issue. Taxpayer is denied on Issue II regarding the imposition of penalty and interest, however both will be recalculated after the recalculation of base tax.

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