DEPARTMENT OF STATE REVENUE

04-20120312.LOF

Letter of Findings Number: 04-20120312
Sales and Use Tax
For Tax Years 2008, 2009, and 2010

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ISSUE

I. Sales and Use Tax – Public Transportation Exemption – Methodology.

Authority: IC § 6-2.5-1-1 et seq.; 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 § 6-2.5-5-27; IC § 6-8.1-3-12; IC § 6-8.1-5-1; 45 IAC 2.2-5-61; Indiana Dep't. of State Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App. 1979); Carnahan Grain, Inc. v. Indiana Dep't of State Revenue, 828 N.E.2d 465 (Ind. Tax Ct. 2005); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Panhandle Eastern Pipeline Co. v. Indiana Dep't. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoade 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); Wendt LLP v. Indiana Dep't of Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012).

Taxpayer protests the assessments of use tax on various purchases of tangible personal property, claiming that it was entitled to the public transportation exemption.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation, which operates various lines of business, including hauling, construction-related services, and landscaping operations. Taxpayer also sells tangible personal property, including construction materials and landscaping materials ("Materials"), to customers in Indiana and outside of Indiana.

To facilitate its business, Taxpayer purchases or leases various types of equipment, including semi-tractors and dump trucks ("Trucks"). Taxpayer uses the Trucks to haul Materials for itself and its affiliates. Taxpayer also offers Trucks to transport property of others, including contractors. Contractors often directly purchase tangible personal property from quarries or suppliers ("Suppliers"); thus, Taxpayer simply transports the contractors' purchases from the Supplier's locations to the job sites designated by the contractors. For customers who do not purchase directly from Suppliers, Taxpayer purchases the Materials from Suppliers, resells (with markups), and delivers the Materials to the customers. In those instances, Taxpayer charges the customers one price, which consists of costs of Materials, markups, and delivery. Periodically, based on its billing codes, Taxpayer bills its customers the total amount due, in aggregate.

The Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer's records for tax years 2008, 2009, and 2010. The audit determined that, in general, Taxpayer, as a retail merchant, properly collected and remitted sales tax on the tangible personal property it sold. However, the audit determined Taxpayer failed to pay sales/use tax on some of the tangible personal property it purchased and used in the course of its business.

Taxpayer protested only a portion of the assessments with respect to the Trucks, parts, and related supplies, including, but not limited to, on-road diesel, employee uniforms, and consumable supplies, which it claimed qualified for the public transportation exemption outlined in IC § 6-2.5-5-27. This portion of the assessments included capital items and expense items ("Items at Issue"). An administrative hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Public Transportation Exemption – Methodology.

DISCUSSION

During the audit, the Department found that Taxpayer purchased the Items at Issue without paying sales tax or self-assessing and remitting use tax on those purchases. The Department reviewed Taxpayer's use of Trucks based on mileage. The audit, with Taxpayer's apparent consent, selected and examined its business records of the second quarter, 2008; the third quarter, 2009; and the fourth quarter, 2010. Specifically, the audit reviewed the driver's daily trip sheets and the information within a file named the "Sales Tax Audit Analysis" ("Summary"), which contained lists of all 2008-2010 invoices in an Excel spreadsheet compiled by Taxpayer. The audit found that not every Truck was predominantly used in public transportation. Thus, the audit granted exemption to Trucks which were documented to be predominantly used in transporting property of others (namely, third parties) and assessed tax on the remaining Trucks. Additionally, the audit found that the Items at Issue contained expense items, the use of which Taxpayer did not identify nor relate to specific Trucks. The Department also could not verify the use of those unidentifiable expense items. After considering all the records, the Department concluded

that it was justified in granting a 38 percent exemption concerning those unidentifiable expense items and assessed use tax at 62 percent.

Taxpayer, to the contrary, claimed that it was entitled to a public transportation exemption on all purchases of the Items at Issue pursuant to IC § 6-2.5-5-27 and Indiana case law. Taxpayer asserted that it predominantly used the Items at Issue based on "income" from hauling property of others, in aggregate, as compared to the total income from hauling.

As a threshold issue, "if the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(b). 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 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. 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).

In general, all purchases of tangible personal property are taxable. 45 IAC 2.2-5-61(j). 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. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 101.

IC § 6-2.5-5-27 states:

> Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

45 IAC 2.2-5-61, in relevant part, provides:

> (a) The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property.
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> (b) Definition: Public Transportation. Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation unless it is in fact engaged in the transportation of persons or property for consideration as defined above.
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> (c) In order to qualify for exemption, the tangible personal property must be **reasonably necessary** to the rendering of public transportation. The tangible personal property must be **indispensable and essential in directly transporting persons or property**. (**Emphasis added**).

In Indiana Dep't. of State Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App. 1979), the taxpayer, Calcar Quarries, Inc. (Calcar), had multiple lines of business, including a stone quarry, a hot mix asphalt plant, and a ready mix concrete facility in Indiana. Id. at 940. After an audit, the Department determined that Calcar engaged primarily in the service of hauling its own product, and, thus, was not entitled to public transportation exemption on trucks and equipment it purchased or rented because it was not engaged in public

transportation. Id. The Indiana Court of Appeals found that Calcar's trucks had been used for hauling property owned by others. Id. at 941. Additionally, the Court of Appeals also found that Calcar charged separately for the stone and maintained separate accounting records for its trucking operation from those of the quarry, asphalt, and ready mix operations. Id. The Court of Appeals further noted,

> [W]hen an item has been used for several purposes and only some of the purposes qualify the item for exemption, the taxpayer can gain exemption for the total amount of the purchase price of the item by showing that the item was used predominantly in an exempt manner.
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> Id. at 941 n.1.

Ruling in Calcar's favor, the Court of Appeals concluded that Calcar demonstrated that it predominantly used the trucks and equipment in transporting property of others.

In Panhandle Eastern Pipeline Co. v. Indiana Dep't. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001), Panhandle Eastern Pipeline Co., and its subsidiaries (Panhandle) claimed that, based on the amount of tangible personal property publicly transported, they were entitled to a 100 percent exemption of sales/use tax for equipment purchased and used in the distribution of natural gas, but the Department only granted a prorated exemption based on the actual amount of gas Panhandle publicly transported. Id. at 817. Ruling in favor of Panhandle, the Tax Court stated:

> [T]he public transportation exemption provided by section 6-2.5-5-27 is an all-or-nothing exemption. If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption.
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> Id. at 819.

In Carnahan Grain, Inc. v. Indiana Dep't of State Revenue, 828 N.E.2d 465 (Ind. Tax Ct. 2005), the Department determined that, based upon total miles traveled for each of the audited years, the taxpayer, Carnahan Grain, Inc. (Carnahan), predominantly used the tractor-trailers and related equipment to haul property owned by third parties, but it received only approximately 22 percent of its total income from hauling property of others. Thus, the Department assessed Carnahan additional sales/use tax on the tractor-trailers and related equipment on the ground that, although Carnahan predominantly used the tractor-trailers for third-party hauling, it was not predominantly engaged as a business in hauling for third parties, pursuant to the two-prong test outlined in the Panhandle Eastern Pipeline Co. decision. Id. at 467. Rejecting the Department's "income" approach, the Tax Court explained the proper application, as follows:

> If [] the property is used predominantly for third-party public transportation, then the taxpayer is entitled to the exemption. Conversely, if the property is not predominantly used for third-party public transportation (i.e., it is predominantly used to transport the taxpayer's own property), then the taxpayer is not entitled to the exemption.
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> Id. at 468.

Specifically, following the Calcar decision, the court in Carnahan Grain reasoned that "when **an item** has been used for several purposes and only some of the purposes qualify **the item** for exemption, the taxpayer can gain exemption for the total amount of the purchase price of the item by **showing that the item was used predominantly in an exempt manner**." Id. at 469 (emphasis added) (quoting Calcar, 394 N.E.2d at 941 n.1). The Tax Court ruled in Carnahan's favor based upon miles the trucks traveled to conclude that Carnahan predominantly used the trucks to transport property of others and thus public transportation exemption applied to the trucks and related equipment. Id.

In Wendt LLP v. Indiana Dep't of Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012), the taxpayer, Wendt LLP, was in the business of relocating oversized factory machinery, claiming that it was entitled to the public transportation exemption on its tangible personal property used in the course of its business. Following the rulings of Panhandle Eastern Pipeline Co. and Carnahan Grain, the Tax Court reiterated that "[t]he public transportation exemption is all-or-nothing exemption" and this exemption requires "**an item** to be predominantly used, not exclusively used, in public transportation to be exempt." Id. at 484-85 (emphasis added). The Tax Court opined that a taxpayer, who claims the public transportation exemption, must demonstrate that the item is directly and predominantly used in providing public transportation. Id. The Tax Court stated that to satisfy the "direct use" requirement, the taxpayer must demonstrate (1) that the item is "necessary and integral" to its public transportation services; and (2) that the item is predominantly used in providing public transportation. Id. at 488. The Tax Court further illustrated that "predominate use may be shown by providing credible testimony, providing the ratio of income derived from the property's exempt use to the income derived from its non-exempt use, providing the ratio of the time spent using the property in an exempt manner to the time it is used in a non-exempt manner, or providing a similar ratio calculation based on volume." Id.

The Tax Court found that Wendt's services include four operational phases: (1) project planning (2) pre-transport preparations (3) transportation, and (4) reassembly. Id. at 481-82. The Tax Court concluded that the items used to plan the routes and obtain the travel permits; the items used to disassemble, load, and secure customer's machinery for subsequent movement over the highway; as well as the items used to transport, escort, and secure customer's machinery met the requirement of "direct use" for public transportation. Id. at 486-87. The

Tax Court, however, concluded that the items used to perform reassembly services post-delivery were "a convenience for its customers" and "fall outside the ambit of public transportation." Id. at 487-88. As to the requirement of "predominant use," the Tax Court stated that the evidence at trial established that Wendt predominantly used the items in providing public transportation. The evidence referenced includes Mr. Wendt's testimony, which was considered credible and was corroborated by the Department's audit findings. Id. at 488.

Accordingly, pursuant to the above mentioned statutes, regulations, and case law, a taxpayer is not required to be in the business of transporting property of others to claim the public transportation exemption. The taxpayer is entitled to the public transportation exemption on its purchase of an item only when the taxpayer demonstrates that the item is directly and predominantly used to transport property of others for consideration. When in doubt, the courts examine the actual use of the item in question. There are various ways to show the item qualifies for "predominant use," including miles traveled, the ratio of time spent, volume, or income derived from the use of the item in question.

In this instance, to determine whether the Items at Issue were exempt, the Department's audit examined Taxpayer's records of "semi-tractors and dump trucks [related to] the actual usage of the equipment (mileage)" and granted the public transportation exemption to some Trucks where the records supported that those Trucks were predominantly used to haul property of others. Also, the Department determined that "[t]he expense items under this adjustment could not be specifically identified to a specific truck therefore an exempt percentage was applied."

Taxpayer disagreed, claiming that the Department is prohibited from using an item-by-item basis to calculate the exempt/taxable mileages traveled, as compared to the total mileages traveled, in determining whether Trucks were exempt and the unidentifiable expense items were 38 percent exempt. Asserting that it was entitled to the exemption on all purchases related to the Items at Issue, Taxpayer argued that, as a matter of law, "the Tax Court has always made such determination based on the aggregate use of the taxpayer's property at issue, not on the item by item basis used in the preliminary audit report." Taxpayer stated that it predominantly used the Trucks based on the total income generated by providing public transportation and thus all items directly related to public transportation were exempt, which included fuel, uniforms, supplies, and unidentifiable expense items. Thus, Taxpayer believed that the audit erroneously assessed sales/use tax on some Trucks and the unidentifiable expense items. Taxpayer also claimed that, as a matter of fact, the audit cannot solely rely on the information contained in the driver's daily trip sheets because the information was insufficient to determine whether the Trucks were used to transport property of others based on the mileages.

To support its protest, Taxpayer provided its Summary, an analysis based on its gross income, which also included a description of its billings codes, and an Excel spreadsheet, which contained a list of information of its 2008, 2009, and 2010 invoices. Taxpayer also submitted samples invoices, load tickets, bills of lading, and driver's daily trip sheets, to demonstrate that the information from the driver's daily trip sheets alone was insufficient to determine the use of Trucks.

Taxpayer is mistaken in its analysis and application of the law as well as facts. First, as a matter of law, the court in Wendt stated clearly and specifically, under the "Law-Predominant Use" section, that "the exemption statute has been construed to require **an item** to be predominantly used, not exclusively used, in public transportation to be exempt." Wendt, 977 N.E.2d at 484-85 (emphasis added); Carnahan Grain, 828 N.E.2d at 468-69; Panhandle Eastern Pipeline, 741 N.E.2d at 818-19; Calcar, 394 N.E.2d at 941. Thus, a taxpayer who claims the public transportation exemption on its purchase/lease of an item must demonstrate that a particular item is predominantly used in transporting others' property to qualify this exemption. In this instance, Taxpayer, during the audit and the protest process, referred to its Summary, asserting that all its purchases of Items at Issue were exempt because its "annual income from hauling for third parties" was 60.2 percent, 58.9 percent and 68.3 percent of its total gross income for the years at issue.

Taxpayer arrived at the percentages mentioned above based on the following steps: (1) classifying its income into three categories: "Excluded Sales," "Trucking for Others," and "Trucking for Taxpayer"; (2) subtracting its costs of Materials and markup (Taxpayer stated that it charged 10 percent markups on each Material resold) from the category of "Trucking for Taxpayer"; (3) totaling income from the "Trucking for Others" and income from "Trucking for Taxpayer" (minus costs of Materials and 10 percent markups); and then (4) comparing the income from "Trucking for Others" and total income from step (3). However, after review, the Department is not able to agree with Taxpayer's method – comparing "annual income from hauling for third parties vs. its total hauling income for each Taxable Year" – because Taxpayer's Summary made no reference to its use of any equipment or Trucks and it also failed to substantiate its claimed cost of Materials and markups.

Unlike the taxpayer in Calcar which maintained separate records for the hauling operation from its other operations, Taxpayer's records showed that it did not separate the accounting records, but charged its customers one price when it sold and delivered the Materials. Taxpayer presented a complex "billing code" system, which showed that it charged its customers based on various circumstances including different services it rendered, different materials it sold, and different methods (by hour or weight) in calculating delivery charges. Assuming that its billing practice is the industry's common practice, Taxpayer offered no documentation to substantiate the costs of Materials and markups, which it excluded, to arrive at its calculation of predominant use. Taxpayer's proposed

method based on total income fails because its calculation was not substantiated and its proposed method based on income is similar to the method used by the Department in Carnahan Grain, which was rejected by the Tax Court. In short, Taxpayer's reliance on its "annual income from hauling for third parties vs. its total hauling income for each Taxable Year" method is misplaced.

Taxpayer also mistakenly claimed that the auditor solely reviewed and relied on the driver's daily trip sheets to determine the taxable/exempt mileages when the trip sheets alone did not indicate the ownership of the property being hauled and the miles traveled on each trip. The Department's audit report stated that "[w]hen an item was in question as to whether it was [third] party or hauling of the taxpayer's own product, the ticket numbers on the driver's trip ticket were referenced to the [Summary] provided by the taxpayer." Thus, the audit did not solely rely on the information of the daily trip sheets to arrive at the taxable/exempt mileages of each Truck. The auditor actually referred to Taxpayer's records, including the trip sheets, load tickets, and the information in the Summary compiled by Taxpayer.

Upon review, the drivers' daily trip sheets contained the (1) date, (2) driver's name, (3) truck/trailer number (4) job (starting time and ending time), (5) miles (start and finish), (6) total mileage for different states, (7) location of fuel loaded, (8) ticket number (for each load), (9) weight of material hauled (for each load), (10) Places (to and from), and (11) time (load and unload), which each driver was required to fill out when he or she delivered on a specific day using a specific Truck. Notably, under the "to" columns, the drivers recorded each customer's name and the locations where the drivers were expected to deliver the property. Referencing Taxpayer's Summary and information available to the Department, the Department is required to use a reasonable method, which includes statistical sampling methods and/or based on the best information available at the time of the audit. IC § 6-8.1-3-12(b); IC § 6-8.1-5-1(b). To meet its burden of proof, Taxpayer must demonstrate that the audit's method was unreasonable. Given the totality of the circumstances and in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden.

In conclusion, Taxpayer bears the burden of proving the Department's assessments were incorrect. Taxpayer's documentation was insufficient to establish that the audit methodology was unreasonable and that it directly and predominantly used the Items at Issue to transport property owned by third parties other than Taxpayer itself for consideration.

FINDING

Taxpayer's protest is respectfully denied.

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