DEPARTMENT OF STATE REVENUE

04-20120426.SLOF

Supplemental Letter of Findings: 04-20120426
Gross Retail Tax
For the Years 2008, 2009, and 2010

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ISSUES

I. Out-of-State Delivery – Gross Retail Tax.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-2(e); IC § 6-2.5-13-1; IC § 6-8.1-5-1(c); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991).

Taxpayer argues that the Department of Revenue failed to provide Taxpayer a credit for sales tax paid on transactions for the purchase of office furniture when the furniture was delivered to out-of-state locations.

II. Purchase for Resale – Gross Retail Tax.

Authority: IC § 6-2.5-2-1; IC § 6-8.1-5-1(c); IC § 6-2.5-5-8(b); IC § 6-2.5-8-8(a); IC § 6-2.5-8-8(b); IC § 6-8.1-5-4; Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 101 (Ind. Ct. App. 1974); Fell v. West, 73 N.E. 719 (Ind. App. 1905).

Taxpayer maintains that its sale of software to Financial Institution was exempt because the software was eventually resold to a purportedly exempt third-party Leasing Company.

III. Computer Services – Gross Retail Tax.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-4-1(a); IC § 6-2.5-4-1(b).

Taxpayer claims that it was not required to pay sales tax on the price paid to a vendor for what it characterizes as a service contract.

IV. Computer Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-5-3(b); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer maintains that the tangible personal property it acquired to provide its clients'computer services is exempt because the equipment is purportedly used in the direct production of tangible personal property (computer software).

STATEMENT OF FACTS

Taxpayer is an Indiana business which conducts business in Indiana and outside Indiana. Taxpayer supplies its customers with telephone, computer software, and information services. Taxpayer is registered for sales and withholding tax.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records. The audit resulted in the assessment of additional sales/use tax. Taxpayer protested on the ground that portions of the assessment were not justified by either fact or law. A hearing was conducted during which Taxpayer's representatives explained the basis for the protest. Thereafter, a Letter of Findings was issued which denied Taxpayer's protest in part and sustained it in part.

Taxpayer disagreed with those portions of the Letter of Findings in which the protest was denied. Taxpayer requested and was granted a rehearing in order to allow Taxpayer the opportunity to provide additional information. A supplemental hearing was scheduled to be conducted by telephone but Taxpayer's representatives failed to take part. Taxpayer requested a second opportunity to resubmit its evidence; that request was granted and Taxpayer's representatives did take part in the second rehearing. This Supplemental Letter of Findings results.

I. Out-of-State Delivery – Gross Retail Tax.

DISCUSSION

Taxpayer purchased business furniture from an Indiana vendor. Taxpayer argues it should have been provided a "credit" for taxes paid on the purchase of the furniture because the property was destined to be shipped to and used at out-of-state locations.

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).

As a threshold issue, it is Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the

person against whom the proposed assessment is made."

Tax exemption provisions – such as that here sought by Taxpayer – are strictly construed against exemption from the tax. Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

Taxpayer argues that it should be given credit for the amount of tax paid on various invoices. The invoices were issued by "Business Furniture." Taxpayer explains that the "sole purpose of these purchases was to acquire tangible personal property that was to be solely used outside Indiana." In support of its contention that certain invoices were not subject to tax, Taxpayer cites to IC § 6-2.5-3-2(e) which states:

(e) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:

(1) the property is delivered into Indiana by or for the purchaser of the property;

(2) the property is delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and

(3) the property is subsequently transported out of state for use solely outside Indiana.

In addition, Taxpayer cites to IC § 6-2.5-13-1 which states in part:

(d) The retail sale, excluding lease or rental, of a product shall be sourced as follows:

(1) When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location.

(2) When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser (or the purchaser's donee, designated as such by the purchaser) occurs, including the location indicated by instructions for delivery to the purchaser (or donee), known to the seller.

(3) When subdivisions (1) and (2) do not apply, the sale is sourced to the location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith. IC § 6-2.5-13-1(d).

Taxpayer indicates the purchase of furniture from Business Furniture was not subject to sales tax because – although the furniture was purchased from an Indiana vendor – Taxpayer never took possession of the furniture in Indiana and that the documentation provided establishes that the furniture was delivered to Taxpayer's out-of-state locations.

Taxpayer is correct; the Business Furniture invoice does establish that some of the furniture was delivered to Missouri and some of the furniture was delivered to South Carolina. IC § 6-2.5-13-1 provides that the underlying retail sale should be "sourced" to those states.

FINDING

To the extent that Taxpayer purchased tangible personal property from Business Furniture and the documentation establishes the furniture was delivered directly to Missouri or South Carolina, Taxpayer's protest is sustained.

II. Purchase for Resale – Gross Retail Tax.

DISCUSSION

Taxpayer was assessed tax on the sale of software to a Financial Institution. Taxpayer maintains that the software was eventually resold to third-party Leasing Company which presented the Financial Institution an exemption certificate. The exemption certificate asserts that the transaction between the Financial Institution and the third-party is exempt because the third-party will subsequently resell the software back to the Financial Institution. Taxpayer believes that the initial transaction between itself and the Financial Institution should, therefore, be exempt.

As Taxpayer explains:

Taxpayer would like to clarify this transaction. The software was sold to [third-party Leasing Company] for which an exemption certificate has been provided; however, the invoice incorrectly listed [Financial Institution]. [Financial Institution] did not purchase the software to lease to [third -party]. [Third-party] purchased the software to lease to [Financial Institution]. Payment of the software was made by [Financial Institution] which is the parent of [third-party]. Taxpayer can supply information related to the payment to support that the original transaction was to [third-party] who paid through its parent for the software.

Under IC § 6-2.5-8-8(a), "A person . . . who makes a purchase in a transaction which is exempt from the state gross retail tax and use taxes, may issue an exemption certificate to the seller instead of paying the tax." Once the purchaser provides the exemption certificate, the retail merchant is under no obligation to collect sales tax on the transaction. IC § 6-2.5-8-8(a) states that, "A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase."

Although the documentation does not specifically support Taxpayer's contention, Taxpayer states that – in

reality – it did not sell the software to Financial Institution even though Financial Institution paid for the software. Taxpayer states that Financial Institution paid for the software prematurely and that the actual transaction was between Taxpayer and third-party Leasing Company. Taxpayer explains that it sold the software to Leasing Company which then either sold or leased the software back to Financial Institution. Since Leasing Company subsequently provided Taxpayer an exemption certificate, Taxpayer believes it was not required to pay tax on the original transaction.

Under IC § 6-2.5-8-8(a), "A person . . . who makes a purchase in a transaction which is exempt from the state gross retail tax and use taxes, may issue an exemption certificate to the seller instead of paying the tax." Once the purchaser provides the exemption certificate, the retail merchant is under no obligation to collect sales tax on the transaction. IC § 6-2.5-8-8(a) states that, "A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase."

Taxpayer relies on the exemption set out in IC § 6-2.5-5-8(b) which states:

> 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.

In applying any tax exemption, such as IC § 6-2.5-5-8(b), the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

Taxpayer argues that the Leasing Company's exemption certificate, should be applied to what is – on its face – a transaction between itself and Financial Institution. As explained in the original Letter of Findings and is restated here:

> Specifically, Taxpayer explains that its "sale was to [third-party Leasing Company] and not [Financial Institution] and [third-party] resold or leases the software to [Financial Institution].

The Department is unable to agree that Taxpayer has met its burden under IC § 6-2.5-5-8(b) of establishing that the original assessment was "wrong." Taxpayer is reminded of the requirement under IC § 6-8.1-5-4 which states, "Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for tax by reviewing those books and records." "[W]here [] 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." Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 101 (Ind. Ct. App. 1974). In this case, although the transaction is well documented, the documents do not reflect what is purportedly the parties' actual business intentions.

Taxpayer states that it has established an essentially combined, integrated relationship between the different parties who claim either a primary or secondary interest in the software transaction and that Taxpayer is entitled to claim the exemption permitted under IC § 6-2.5-5-8(b) because the software was eventually the object of a leasing transaction entered into between third-party Leasing Company and Financial Institution.

Again, the Department must disagree. As noted above in Part I, IC § 6-2.5-2-1, imposes the tax on retail transactions made in Indiana unless an exemption is applicable. In other words, the tax is imposed on the retail transaction and not on the tangible personal property – in this case software – which is the subject of the transactions. In this case, the transaction consists of an agreement or exchange between Taxpayer and the Financial Institution and not between and any of the interested parties.

Taxpayer seeks an interpretation of both the statute imposing the tax and on the exemption statue which allows for an exception from imposition of the tax by means of an exemption certificate issued by third-party Leasing Company. Taxpayer asks too much. Indiana law has long held that, "The 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)" and that – as noted above – "tax exemptions are strictly construed in favor of taxation and against the exemption." Kimball Int'l Inc., 520 N.E.2d at 456. Taxpayer's argument meets neither test and Taxpayer has not met the statutory burden of establishing that the assessment is "wrong." IC § 6-8.1-5-1(c).

FINDING

Taxpayer protest is respectfully denied.

III. Computer Services – Gross Retail Tax.

DISCUSSION

The audit assessed sales tax on the price Taxpayer paid to a company here referred to as "Vendor I."

Taxpayer disagreed with the assessment on various grounds. Taxpayer argued a different entity would ultimately pay use tax on these same transactions. Taxpayer explained that it has "provided unequivocal proof" that any Indiana sales tax due on invoices issued by "Vendor I" from 2008 through 2010 will be paid to the Department through an audit of "Vendor I".

Taxpayer made a third argument related to the nature of the transaction between itself and "Vendor I" by which Taxpayer acquired pre-written software. Taxpayer argued that the price it paid allows it to access the pre-written software by means of "cloud computing" and that the pre-written software is therefore not subject to tax.

The original Letter of Findings rejected both of the arguments. The argument open for consideration is

whether or not Taxpayer was purchasing an exempt service or was it purchasing software and hardware.

As noted previously, IC § 6-2.5-2-1(a) imposes sales tax on retail transactions made in Indiana. IC § 6-2.5-1-2 defines a retail transaction as "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4-1 . . . or that is described in any other section of IC § 6-2.5-4." IC § 6-2.5-4-1(a) provides that "[a] person is a retail merchant making a retail transaction when he engages in selling at retail." IC § 6-2.5-4-1(b) further explains that a person sells at retail when he "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration." As Taxpayer correctly concludes, if the subject transaction does not involve the acquisition of tangible personal property, the transaction is not subject to sales tax because there is no "retail transaction."

As before, Taxpayer asks for a review of its "Master Service Agreement" with "Vendor I" and the invoices it received from "Vendor I." Taxpayer is correct in that its business relationship with "Vendor I" does require "Vendor I" to provide services to Taxpayer. The "Master Service Agreement" states that, "[Vendor I] agrees to provide the services provided for in and subject of the Agreement . . . ." However, the invoices establish that "Vendor I" is also selling Taxpayer tangible personal property such as cabinets, computer servers, and computer software.

In the original Letter of Findings, The Department agreed with Taxpayer to the extent that "Vendor I" was selling Taxpayer exempt services. However, the Department was unable to agree with Taxpayer's assertion that "We do not receive any tangible personal property from [Vendor I]." A cursory review of the documents provided indicates that Taxpayer bought and paid for such items as a "processing node," "Microsoft server," "cabinet," "MS Basic DR," "External WAN switch port," "2x4 Core Processor," Colocation Cabinet," and "Microsoft Virtual Machine." These items represent taxable tangible personal property subject to the sales tax. As provided in IC § 6-2.5-1-27:

> "Tangible personal property" means personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses. The term includes electricity, water, gas, steam, and prewritten computer software.

The "Vendor I" invoices contain separately stated specific costs for items which are clearly "services" such as "storage," "24x7 support," and "Managed Services." The audit division was asked to review the "Vendor I" invoices and remove from the assessment those amounts clearly attributable to Taxpayer's acquisition of exempt services. That review has been accomplished and the service charges removed.

The Department is unable to agree that Taxpayer should not be required to pay sales tax or self-assess use tax on the purchase of the various items of tangible personal property acquired from Vendor I and reiterates the decision set out in the original Letter of Findings.

FINDING

Taxpayer's protest is respectfully denied.

IV. Computer Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer provides software and/or services to a call center. The software is purportedly available to Taxpayer's call center customers. The software is located on computer servers. The computer servers are not sold but remain in Taxpayer's possession.

Taxpayer argues that the software and servers are not subject to sales tax because the software and servers are directly used in the production of the "tangible personal property." As explained by Taxpayer:

> Taxpayer would contend servers and company purchased software such as firewall software are used directly in the production of cloud access software. Without the servers and underlying software, the service could not be provided. It is the interaction of source code and other software products that are managed through the servers which produce a viable cloud product. If [T]axpayer used the servers to burn code on a disc there would be no question that the machine would qualify as production equipment. The servers in the case of hosted software do not act any differently.

Elsewhere, Taxpayer further explains that:

> [Taxpayer] believes that any tangible personal property (i.e. computer hardware, computer software, software maintenance agreements, etc.) which is necessary to proving prewritten computer software via "cloud computing" should be excluded from Indiana sales tax . . . .

The original Letter of Findings rejected the argument. While agreeing that computer software constitutes "tangible personal property" under IC § 6-2.5-1-27, the Letter of Findings explained as follows:

> [T]he Department is unable to agree that either Taxpayer's software or servers have an active and direct effect on the software Taxpayer presumably provides its customers. (A "server" is simply a device "that manages centralized data storage or net communications resources." The American Heritage Science Dictionary, http://dictionary.reference.com/browse/server (last visited December 09, 2012)). Taxpayer provides its customers various services, and the exemption to which Taxpayer resorts requires the production of tangible personal property.

Taxpayer suggests that its computer equipment and ancillary supplies would be exempt if the computers were "burning" computer code unto disk, after, disk, after disk; perhaps so, but Taxpayer here is acting as a service provider whereby it manages, integrates, and "hosts" customer information.

Taxpayer asks that the Department extend the "manufacturing exemption" found at IC § 6-2.5-5-3(b). Indiana law provides the standard by which the exemption is provided. "[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." RCA Corp., 310 N.E.2d at 101. The Department is unable to agree that Taxpayer's interpretation and application of IC § 6-2.5-5-3(b) clearly falls "within the exact letter of the law."

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

To the extent that Taxpayer purchased tangible personal property from Business Furniture and the documentation establishes the furniture was delivered directly to Missouri or South Carolina, Taxpayer's protest is sustained; in all other respects, Taxpayer's protest is denied.

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