

Letter of Findings: 04-20120733
Sales and Use Tax
For the Tax Years 2008-2011

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ISSUES

I. Sales and Use Tax—"Manufacturing Exemptions."

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-2.5-5-4; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992) ; Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Mumma Bros. Drilling Co. v. Department of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of use tax on its purchases of items used in manufacturing.

II. Sales and Use Tax—Software Licenses.

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 § 6-2.5-4-1.

Taxpayer argues that it is entitled to a refund of the sales tax paid on its purchase of software licenses.

III. Sales and Use Tax—"Maintenance Contracts."

Authority: IC § 6-2.5-2-1; IC § 6-2.5-4-17; IC § 6-8.1-3-3; IC § 6-8.1-5-1; [45 IAC 2.2-4-2](#); Carroll County Rural Elec. Membership Coop. v. Dep't of State Revenue, 733 N.E.2d 44 (Ind. Tax Ct. 2000); Sales Tax Information Bulletin 2 (May 2002); Sales Tax Information Bulletin 2 (December 2006); Letter of Findings 05-0438 (August 11, 2006).

Taxpayer argues that it is entitled to a refund of the sales tax paid and abatement of the use tax assessed on its purchase of "maintenance contracts."

IV. Sales and Use Tax—"Services."

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-2; IC § 6-2.5-2-1; 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 2.2-1-1](#); [45 IAC 2.2-4-1](#); [45 IAC 2.2-4-2](#); Frame Station, Inc. v. Indiana Dep't of Revenue, 771 N.E.2d 129 (Ind. Tax Ct. 2002); Sales Tax Information Bulletin 21 (May 2002).

Taxpayer protests the imposition of use tax on its purchase of certain "services."

V. Sales and Use Tax—Imposition.

Authority: IC § 6-8.1-5-1.

Taxpayer argues that the Department incorrectly assessed use tax on its purchases from three vendors: "Vendor I," "Vendor CM," and "Vendor FE."

STATEMENT OF FACTS

Taxpayer is a manufacturer with two plants in Indiana. Taxpayer submitted to the Department of Revenue ("Department") a request for refund for sales and use taxes it paid for the tax periods from March 31, 2008, through December 31, 2010. Taxpayer's refund claim was granted in part and denied in part. For the 2008 tax periods of the refund claim, the Department conducted an investigation and issued an investigation report granting a partial refund. For the 2009 and 2010 tax periods of Taxpayer's refund claim, the Department addressed the refund issues as part of an audit examination. The Department conducted an audit review of Taxpayer's business records employing a statistical sampling methodology covering the 2009, 2010, and 2011 tax years. As a result of the audit, the Department issued an audit report that determined that Taxpayer owed additional use tax for the 2009, 2010, and 2011 tax years. Taxpayer protested certain of the purchases for which the refunds were denied and certain of the purchases on which use tax was assessed. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as required.

I. Sales and Use Tax—"Manufacturing Exemptions."

DISCUSSION

All tax assessments are prima facie evidence that the Department's claim for the tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. 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 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). In general, all purchases of tangible personal property are subject to sales and/or use tax. An exemption from use tax is granted for transactions where sales tax was paid at the time of the purchase pursuant to IC § 6-2.5-3-4. In certain circumstances, additional enumerated exemptions from sales and/or use tax are available.

Taxpayer asserts that its purchases of "counting scales" and repair parts for a lathe are not subject to use tax because the purchases qualify for exemption under the "manufacturing exemptions."

A. "Counting Scales."

The Department determined that the "counting scales" did not qualify for the manufacturing exemption and assessed use tax on the purchase. The Department found, as follows:

The scales are used to verify quantities in the non-returnable containers and pallets. Inside the non-returnable containers are multiple packages of Taxpayer's finished goods . . . Packaging of product to facilitate shipment to the customer is a post production function subject [to] tax pursuant to [45 IAC 2.2-5-8\(d\)](#).

Taxpayer maintains that its "counting scales" qualify for exemption under the "manufacturing equipment exemption" as found in IC § 6-2.5-5-3. Taxpayer states that "the scale is used to 'count' pieces by weight prior to completion of the product, which includes packaging."

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). 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). "Exemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of government." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) *aff'd* 599 N.E.2d 588 (Ind. 1992) (Internal citations omitted). Thus, "[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*, 310 N.E.2d at 101. Accordingly, the taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d at 404.

IC § 6-2.5-5-3(b) states:

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it **for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. (Emphasis added).**

Thus, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture . . . of other tangible personal property." In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. "[F]airly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Department of Revenue*, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, must (1) be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being 'produced.'" *Id.* Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. *General Motors*, 578 N.E.2d at 401. The application of Indiana's double-direct manufacturing exemptions often varies based on a determination of when a taxpayer's manufacturing process is considered to have begun and ended.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-8\(c\)](#). [45 IAC 2.2-5-8\(d\)](#) excludes pre-production and post production activities by providing that "'direct use in the production process' begins at the point of first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its complete form." Therefore, proper application of the exemption requires determining at what point "production" begins and at what point "production" ends.

Further, [45 IAC 2.2-5-8\(g\)](#) states:

Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article

being produced." Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

Additionally, [45 IAC 2.2-5-8\(j\)](#) provides:

Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading.

Accordingly, tangible personal property purchased for the use in the production of a manufactured good is subject to sales and use tax unless the property used has an immediate effect on and is essential to the production of the marketable good. Thus, it is only the property that has an immediate effect on and is essential to the direct production of a marketable good that is exempt.

During the hearing, Taxpayer presented a picture to demonstrate how the "counting scales" are used. In the picture, an open box sits on top of the scale. Inside the box are little sealed packages of the product identified with a "UPS code," product description, and product quantity number. Based on the documentation presented, this scale is used in Taxpayer's fulfillment/shipping area to fulfill specific customers' orders of Taxpayer's packaged product—i.e., the little sealed packages. Thus, the weighing of the items on the scale is a post production activity.

Therefore, Taxpayer's protest to the imposition of use tax on the "counting scales" is respectfully denied.

B. Repair Parts: Lathe.

Taxpayer maintains that the repair parts for the lathe qualify for exemption as repair parts purchased for equipment that is exempt under IC § 6-2.5-5-4. Taxpayer states that the lathe "can only be used to make equipment and parts by changing the shape of steel through turning and cutting to make parts for a machine or to grind and drill steel to make a mold used in manufacturing." In effect, Taxpayer protests that the parts in question were used on exempt equipment and therefore the replacement parts themselves are exempt from sales and use tax.

Under [45 IAC 2.2-5-8\(h\)\(2\)](#), replacement parts for production equipment qualify for sales and use tax exemption. Thus, an exemption applies to replacements parts purchased to the extent the machinery for which the replacements parts were purchased is used in production. The question then turns to the exemption of the equipment for which the replacement parts are purchased. Taxpayer maintains the lathe qualifies for exemption under IC § 6-2.5-5-4, which provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described in section 2 or 3 of this chapter.

Accordingly, purchases of tangible personal property are exempt if the property is used to manufacture or produce equipment that will qualify as exempt manufacturing equipment—i.e. equipment that is directly used to directly manufacture or produce tangible personal property.

As stated previously, the exemption to which Taxpayer aspires, IC § 6-2.5-5-4, like all tax exemption provisions, is 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).

Taxpayer has not provided any information/documentation beyond its general assertion that the "parts for the lathe" are used in the manufacturing process. Taxpayer has not provided any information about the specific items of equipment made by the lathe and how those specific items are used in its manufacturing process. Without specific information about the equipment being made and how that equipment is used during the production process, a determination about the exempt status of the lathe cannot be made. Therefore, it is not possible to conclude that the repair parts for the lathe are directly used in Taxpayer's production of its goods or that it has "an immediate effect on the article being produced."

Accordingly, Taxpayer's protest to the imposition of use tax on the repair parts for the lathe is respectfully denied.

FINDING

Taxpayer's protest to the imposition of use tax on the counting scale is respectfully denied, as discussed in subpart A. Taxpayer's protest is to the imposition of use tax on the repair parts for the lathe is respectfully denied, as discussed in subpart B.

II. Sales and Use Tax—Software Licenses.

DISCUSSION

Taxpayer purchased computer software license agreements. The Department's audit noted that the invoices for the transactions in question demonstrated that Taxpayer correctly paid sales tax to the vendor at the time of purchase.

Taxpayer maintains that the software license agreements were partially utilized outside Indiana. Taxpayer

argues that since a portion of the software licenses were used on computers located outside Indiana, it would be more reasonable to allocate a portion of the purchase fees to locations outside Indiana based upon the ratio of Indiana users compared to users in all jurisdictions. Taxpayer states that if you compare the number of Indiana "SAP users" to "SAP users" outside of Indiana, then approximately 55 percent of the licenses were used outside Indiana. Taxpayer asserts that it should get a "refund" in the form of a "credit" in the audit for the portion of the sales tax it paid that relates to this "out-of-state usage." Taxpayer, therefore, maintains that it is entitled to a refund/credit of 55 percent of the sales tax that was paid to the vendors on these transactions.

Presumably, Taxpayer is referring to the "temporary storage" exception for use tax. Pursuant to IC § 6-2.5-3-2, "[A]n 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" (Emphasis added). Indiana law provides a "temporary storage" exception under IC § 6-2.5-3-1(b) which defines "[s]torage" [as] the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana." (Emphasis added).

However, the invoices provided by Taxpayer demonstrate that Taxpayer paid sales tax on the items in questions. There is not a temporary storage exception for sales tax. Sales tax is a transaction tax that is imposed on the occurrence of a retail sales transaction. IC § 6-2.5-2-1(a). The purchaser in the retail transaction is liable for the sales tax and must pay the sales tax to the retail merchant. IC § 6-2.5-2-1(b). A retail transaction is defined 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 § 6-2.5-1-2. "A person is a retail merchant making a retail transaction when he engages in selling at retail." IC § 6-2.5-4-1(a). Further, IC § 6-2.5-4-1(b) 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." On the other hand, the use tax is imposed on a person's use of property in Indiana by IC § 6-2.5-3-2(a). Thus, the sales tax is a tax imposed on the purchaser for the occurrence of a retail transaction, and the use tax is a tax imposed on a purchaser for the purchaser's use of the property in Indiana.

In conclusion, the use tax "temporary storage exception" does not apply to the transactions in question. The vendor properly collected sales tax from Taxpayer.

FINDING

Taxpayer's protest of the "credit" for sales tax paid on its software licenses purchases is denied.

III. Sales and Use Tax—"Maintenance Contracts."

DISCUSSION

Taxpayer purchased "hardware maintenance agreements" and paid tax on the transactions at the time of purchase. Taxpayer also purchased "software maintenance agreements" and paid tax on the transactions at the time of purchase. The Department also found that Taxpayer purchased "software maintenance agreements" without paying sales tax at the time of purchase, and assessed used tax on the purchases.

Taxpayer protests the denial of refund and imposition of sales and use tax on the "maintenance contracts." Taxpayer asserts that its purchases of "hardware maintenance agreements" and "software maintenance agreements" were neither purchases of tangible personal property nor "enumerated services," and therefore, are not subject to sales and use tax. Taxpayer maintains that it is entitled to a refund of the sales tax paid and that the use tax assessed by the Department should be abated. The issue is whether the various protested "maintenance contracts" were properly subject to Indiana sales and use tax.

A. Equipment Maintenance Contracts.

The first type of "maintenance contract" is for items other than computer software.

The Department's audit denied refund and/or imposed sales and use tax on Taxpayer's purchase of optional/extended warranty contracts. Taxpayer, to the contrary, asserted that it was not responsible for sales tax on its sales of the optional/extended warranties.

The prior version of Sales Tax Information Bulletin 2 stated as follows:

Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax. Any parts or tangible personal property supplied pursuant to this type of agreement are subject to use tax. Sales Tax Information Bulletin 2 (May 2002), 25 Ind. Reg. 3595.

However, a later version of Sales Tax Information Bulletin 2 upon which the Department's audit relied stated as follows:

Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are subject to sales tax if there is a reasonable expectation that tangible personal property will be provided. Any parts or tangible personal property supplied pursuant to this type of agreement are not subject to sales or use tax. Sales Tax Information Bulletin 2 (December 2006), 20100804 Ind. Reg. 045100497NRA (Effective August 4, 2010).

Because of the delayed publication of Sales Tax Information Bulletin 2 (December 2006), the Department's guidance and interpretation on this issue relevant to the years for which Taxpayer was audited is found in Sales Tax Information Bulletin 2 (May 2002) which states that "Optional warranties and maintenance agreements that

contain the right to have property supplied in the event it is needed are not subject to sales tax." Id. Therefore, Taxpayer was not required to remit sales or use tax on the warranties/maintenance agreements it purchased until August 4, 2010. After August 4, 2010, Taxpayer was required to remit sales or use tax on the warranties/maintenance agreements. Therefore, Taxpayer's protest is denied to the extent the transactions took place after August 4, 2010.

However, Taxpayer's protest is sustained to the extent that a supplemental audit determines that the transactions took place before August 4, 2010, and that Sales Tax Information Bulletin 2 (May 2002) applies to the situation. The audit division is requested to review the original assessment of tax on the sale of warranties/maintenance agreements to its customers based on Sales Tax Information Bulletin 2 (May 2002) in effect during the first part of the audited years and to make whatever adjustment is appropriate.

B. Software Maintenance Contracts.

The second type of "maintenance contract" is for items of computer software. Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

Taxpayer purchased various "software maintenance agreements." During the audit, the Department found instances where Taxpayer had purchased software "maintenance agreements" without paying sales tax at the time of purchase, and assessed use tax on the purchases.

Taxpayer maintains that since the "software maintenance agreements" do not contain a provision which guaranteed that Taxpayer would automatically receive software updates and upgrades, the "software maintenance agreements" are not subject to Indiana sales/use tax.

Again, 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).

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).

The 2002 version of Sales Tax Information Bulletin 2 did not require the vendor to collect sales tax on the sale of the extended warranties and maintenance agreements; however the vendor was required to self-assess use tax on any parts supplied pursuant to the terms of the warranty or agreement. The 2006 version of Sales Tax Information Bulletin 2, effective in August 2010, essentially reversed that requirement. The vendor was required to collect sales tax on the sale of the warranty but was not required to self-assess use tax on any parts supplied pursuant to the terms of the warranty.

However, the Department must point out that prior to the issuance of the Sales Tax Information Bulletin 2 (December 2006) in August 2010, the Department issued Letter of Findings 05-0438 (August 11, 2006), 20061101 Ind. Reg. 045060474NRA, in which the Department addressed the question of whether "Software Maintenance Agreements" were subject to sales tax. The Department found that these agreements were subject to sales tax on a "prospective basis" as follows:

There is no regulation that sets out the department's position regarding the application of sales and use tax to optional warranties. The department first issued Sales Tax Information Bulletin [] 2 concerning Optional Warranties . . . on May 2, 1983. In that Information Bulletin, the department explained that if there was a possibility that no tangible personal property would be transferred with the warranty, then there was no certainty that there would be a retail sale and the sales and related use tax did not apply. This position was restated in the revised Sales Tax Division Information Bulletins issued in August 1991, November 2000, and May 2002. Each of the revisions restated the general rule. In the May 2002 revision, it was stated "[o]ptional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax." Each of the revisions also gave a specific example concerning computer software situations. The examples stated that sales and use tax would apply to the sale of an optional warranty or maintenance agreement in the software situation only if there was a guarantee of the transfer of tangible personal property (updates) pursuant to the agreement.

Computer technology and use has evolved since the issuance of the first Sales Tax Information Bulletin [] 2 on May 2, 1983. Almost all software optional warranties and software maintenance agreements sold today include the automatic provision of updates-sometimes on a day-by-day or week-by-week basis. Purchasers of these agreements have a reasonable expectation that they will receive the updates whether or not the actual contract couches the provision of updates as "optional." The substance of the agreements is that tangible personal property in the form of software updates will be provided no matter what the language of the contract says. The department determines tax consequences by construing the substance of the agreement over the form. *Wholesalers, Inc. v. Indiana Department of State Revenue*, 597 N.E.2d 1339 (Ind. Tax 1992). In the case of software maintenance agreements or optional warranties, it is clear that the parties presume that tangible personal property in the form of updates will be transferred. Therefore, **the department will construe software maintenance agreements and optional agreements as presumed to be subject to the sales and use tax.** A taxpayer could rebut this presumption by demonstrating that no updates were actually received pursuant to a particular maintenance agreement or optional warranty.

In this particular taxpayer's situation, the department will apply this interpretation prospectively. (Published in the Indiana Register and available at <http://www.in.gov/legislative/iac/20061101-IR045060474NRA.xml.html>. **(Emphasis added)**).

As of the publication of Letter of Findings 05-0438 the Department fulfilled its obligation to give notice of its "change of interpretation" concerning the taxability of software maintenance agreements. As summarized in the Letter of Findings, "The taxpayer's protest is sustained as to the maintenance agreements and optional warranties in this assessment. The taxpayer is advised that in the future, there will be a rebuttable presumption that all software maintenance agreements and optional warranties will be subject to the sales and use taxes."

In the case of the software maintenance agreements, the interpretations set out in the Sales Tax Information Bulletins are irrelevant. Instead, the interpretation set out in the August 2006 Letter of Findings governs the issue. Notwithstanding that a "new" interpretation of law based upon a change in facts—like the one in the August 2006 Letter of Findings which discusses the effects of the "new facts" reflecting the change in the industry—would not require publication to be implemented. If publication was needed to implement a new interpretation, the publication of that Letter of Findings met the publication requirements set out in IC § 6-8.1-3-3. See Carroll County Rural Elec. Membership Coop. v. Dep't of State Revenue, 733 N.E.2d 44, 49 n.5 (Ind. Tax Ct. 2000) ("The publication of the Letter of Findings is a prerequisite for the Department before it can change its position as to the interpretation of a tax, where the change would increase the taxpayer's liability.").

Accordingly, the Department has consistently found that "software maintenance agreements" were subject to sales and use tax with a rebuttable presumption since August 2006. However, as of July 1, 2010, the legislature effectively removed the rebuttable presumption with the enactment of IC § 6-2.5-4-17 (effective July 1, 2010) which provides that "software maintenance agreements" are always subject to tax. Therefore, Taxpayer was required to remit sales or use tax on the "software maintenance agreements" since August 2006, which is a date prior to the transactions in question.

Alternatively, Taxpayer asserts that if its "software maintenance agreements" were subject to sales and use tax, sales and use tax should not be due on the entire amount of the transactions. Taxpayer maintains that it did not receive updates and/or received limited updates on multi-year agreements. Taxpayer, therefore, argues that the "value of any tangible personal property" received should not be based on the full amount of the purchase and requires a pro-rating of the amount subject to tax.

During the course of the protest, Taxpayer submitted a list of "maintenance agreement" purchases, numerous invoices, numerous agreements, and a Taxpayer prepared spreadsheet. However, other than its bare assertions in the form of notations of "update/no update/update in 1 yr" on this spreadsheet, Taxpayer did not provide documentation that demonstrated whether or not the updates were actually received pursuant to the software maintenance agreement. Absent a written statement from the vendor or other documentation from the vendor, the Department lacks sufficient legal and factual grounds to conclude that the full amount of the transactions should not have been subject to Indiana sales or use tax. Thus, Taxpayer has failed to meet its burden of proof under IC § 6-8.1-5-1(c).

Accordingly, Taxpayer's protest relating to "software maintenance agreements" is denied.

FINDING

Taxpayer's protest related to "hardware maintenance contracts" is denied in part, but is sustained in part to the extent that a supplemental audit determines that the transactions took place before August 4, 2010, and that Sales Tax Information Bulletin 2 (May 2002) applies to the transaction, as discussed in subpart A. However, Taxpayer's protest with regard to "software maintenance agreements" is denied in full, as discussed in subpart B.

IV. Sales and Use Tax—"Services."

DISCUSSION

The Department found that Taxpayer purchased tangible personal property without paying sales tax at the time of purchase, and assessed use tax on the purchases. Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

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). In general, all purchases of tangible personal property are subject to sales and/or use tax. An exemption from use tax is granted for transactions where sales tax was paid at the time of the purchase pursuant to IC § 6-2.5-3-4. In certain circumstances, additional enumerated exemptions from sales and/or use tax are available.

Taxpayer maintains that the Department incorrectly assessed use tax on its purchases of services from two vendors: "Vendor G" and "Vendor L."

A. "Vendor G."

The Department found that use tax was due on Taxpayer's purchases from "Vendor G" on its "office supplies purchase card" where the auditor described the purchase as "[Vendor G] for IT Leaders Advisor/Reference." At

the time of the audit, the Department was unable to verify the nature of the transaction. Therefore, as Taxpayer had not paid sales tax at the time of the transaction, the Department assessed use tax on the purchase. As stated previously, Indiana imposes "an excise tax, known as the use tax," on tangible personal property that is acquired in retail transactions and is stored, used, or consumed in Indiana. IC § 6-2.5-3-2(a).

Taxpayer asserts that the Department's assessment of use tax on the "Vendor G" purchases is incorrect because these are service transactions that are exempt from use tax. Taxpayer maintains that the invoiced amount represents a charge "for telephone support, certain research done by [Vendor G] for [Taxpayer], and also enable [Taxpayer] to attend an annual seminar at a reduced price. Taxpayer presented invoices for the transactions with "Vendor G." However, the invoices contained one unitary price with the description on the invoice using the words "Advisor" and "Reference," which could reasonably be descriptions for items of tangible personal property.

Nonetheless, even taking Taxpayer's assertions at face value, the mere fact that a transaction might have a service component is not determinative. Pursuant to IC § 6-2.5-4-1(e), the amount of the retail transaction that is subject to sales tax includes "the price of the property transferred" and "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." Further, [45 IAC 2.2-4-1\(b\)\(3\)](#) provides that the amount of the retail transaction that is subject to tax includes the amounts collected for "services performed or work done on behalf of the seller prior to transfer of such property at retail." Thus, when services are performed or work is done to tangible personal property before the tangible personal property is transferred to the purchaser, the amount of the charges for the services or work done is also subject to sales tax.

Moreover, services that are performed as part of a retail "unitary transaction" are subject to sales and use tax. IC § 6-2.5-1-2(b). A retail "unitary transaction" is one in which items of personal property and services are furnished under a single order or agreement and for which a total combined charge or price is calculated. IC § 6-2.5-1-1(a). A unitary transaction includes all items of property and services for which a total combined selling price is computed irrespective of the fact that the cost of services, which would not otherwise be taxable, is included in the selling price. [45 IAC 2.2-1-1\(a\)](#). Therefore, Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c).

Accordingly, Taxpayer's protest to the imposition of use tax on its purchases from "Vendor G" is respectfully denied.

B. "Vendor L."

Taxpayer asserts that the Department's assessment of use tax on its "lawn care application" purchases from "Vendor L" is incorrect because these are service transactions that are exempt from use tax.

The Department's audit determined that Taxpayer did not pay sales/use tax on its "lawn care applications" transactions, which included the application of lawn fertilizer and pesticides to the lawn. When Taxpayer was billed for this transaction for the "lawn care applications," Taxpayer was charged one unitary price that included both the materials and service components of the transaction.

Pursuant to IC § 6-2.5-4-1(c)(2), in determining a retail transaction, it "does not matter whether the property is transferred . . . alone or in conjunction with other property or services." Additionally, pursuant to IC § 6-2.5-4-1(e), the amount of the retail transaction that is subject to sales/use tax includes "the price of the property transferred" and "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." Further, [45 IAC 2.2-4-1\(b\)\(3\)](#) provides that the amount of the retail transaction that is subject to tax includes the amounts collected for "services performed or work done on behalf of the seller prior to transfer of such property at retail."

In *Frame Station, Inc. v. Indiana Dep't of Revenue*, 771 N.E.2d 129 (Ind. Tax Ct. 2002), the court held that when customers were charged separate amounts for labor and materials for custom framing services the labor charges were subject to sales tax. *Id.* at 131. In arriving at that decision, the court reasoned that the focus of analysis should be "whether [Taxpayers'] services were performed before or after it transferred property to its customers." *Id.* The court found that services that are performed prior to the transfer of the property are taxable, and services that are performed after the transfer of the property are taxable to the extent that the services represent a "unitary transaction" and are "inextricable and indivisible" from the property being transferred. *Id.*

Accordingly, the determinative fact is when the services were performed by "Vendor L." Since the services occur prior (or concurrently) to the transfer of the fertilizer/pesticide, the services are subject to sales and use tax. In fact, Sales Tax Information Bulletin 21 (May 2002), 25 Ind. Reg. 3939, in relevant part, further explains:

Sales by a Lawn Care Company

The relationship between a lawn care company and its customer is contractual. The customer agrees to pay a set price and the company agrees to apply the necessary chemicals to a lawn for its proper care and maintenance. The chemical cannot be purchased separately from the company and applied by the customer. A unitary transaction is the purchase of tangible personal property and services under a single agreement for which a total combined charge is calculated. A retail unitary transaction is a unitary transaction that is also a

retail transaction. A retail transaction means a transaction that constitutes selling at retail. A lawn care application is a retail transaction because the lawn care company acquires tangible personal property (chemicals) and transfers them to its customers for consideration in the ordinary course of its regularly conducted business.

When "Vendor L" sold the "lawn care applications" to Taxpayer, it applied tangible personal property, such as fertilizer or pesticides, to Taxpayer's lawn/trees to complete the transactions. The fertilizer and pesticide were transferred for consideration and, therefore, were subject to sales tax.

Taxpayer maintains that these "lawn care applications" would fall under the service provider exception found at [45 IAC 2.2-4-2](#).

As explained in [45 IAC 2.2-4-2](#), "service providers" are granted a narrow exception from collecting sales tax on the entire retail transaction—i.e., contract price if certain conditions are met. [45 IAC 2.2-4-2\(a\)](#) illustrates the exception, as follows:

(a) 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 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.

Accordingly, a person who obtains and sells tangible personal property that has been combined or altered with services is a "retail merchant" that must collect sales tax on its transactions unless the person meets all four of the requirements of a "service provider" as found in [45 IAC 2.2-4-2\(a\)\(1\)-\(4\)](#). A "service provider" meeting all of these four requirements, does not have to collect sales tax on its sales transactions, and instead is allowed to pay use tax on the "materials consumed [by the service provider] as a necessary incident to the service" provided to the customer.

Taxpayer presented two signed statements from the "Vendor L." The first statement, dated May 24, 2012, asserted that "[o]ur [agreement] with [Taxpayer] is for a contracted flat monthly fee. This fee includes all labor and materials for activities listed in the contract[, and] ["Vendor L"] is responsible for and pays all sales tax for any materials" The second statement, dated April 4, 2013, asserted that "[t]he materials cost for any Spray applications for trees is less than 10[percent] of the total cost." While statements from a vendor can be a helpful tool to explain other documentation, the statement alone is self-serving and is insufficient to rebut the presumption of the Department's assessment. Without other documentation from "Vendor L" establishing the amount of materials and labor in question and the payment of the use tax, the Department cannot apply the service provider exception to the "Vendor L" transactions. Therefore, Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c).

Accordingly, Taxpayer's protest to the imposition of use tax on its "lawn care application" purchases from "Vendor L" is respectfully denied.

FINDING

Taxpayer's protest to the imposition of use tax on its purchases from "Vendor G" is respectfully denied, as discussed in subpart A. Taxpayer's protest to the imposition of use tax on its purchases from "Vendor L" is respectfully denied, as discussed in subpart B.

V. Sales and Use Tax—Imposition.

DISCUSSION

Taxpayer maintains that the Department incorrectly assessed use tax on its purchases from three vendors: "Vendor I," "Vendor CM," and "Vendor FE."

Again, 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).

Taxpayer asserts that the Department's assessment of use tax on its purchase of \$2,500 from "Vendor I" is incorrect because these are service transactions that are exempt from use tax. Taxpayer also asserts that the Department's assessment of use tax on its two purchases from "Vendor CM" in the amounts of \$597.80 and \$47.04 is incorrect because these purchases qualify for exemption. Taxpayer further asserts that the Department's assessment of use on its purchase of \$1,142 from "Vendor FE" is incorrect because these purchases qualify for exemption.

However, after a thorough review of the audit report, these four purchases could not be located in the audit report. Therefore, Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest to the imposition of use tax on these four transactions which were not listed in the audit report is respectfully denied.

SUMMARY

Taxpayer's protest related to "hardware maintenance contracts" is denied in part, but is sustained in part to the extent that a supplemental audit determines that the transactions took place before August 4, 2010, and that Sales Tax Information Bulletin 2 (May 2002) applies to the transaction, as discussed in Issue III(A). However, the remaining issues of Taxpayer's protest are respectfully denied.

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