

Letter of Findings: 04-20130229 & 04-20130230
Use Tax
For the Tax Years 2008, 2009, and 2010

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is suspended by the publication of another document in the Indiana Register.

ISSUE

I. Use Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-1-24; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-3; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5 et seq.; IC § 6-2.5-5-40; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoades v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); [45 IAC 2.2-4-2](#).

STATEMENT OF FACTS

Taxpayers, Corp A and Corp B, are affiliates that do business in Indiana. Corp A sells medical testing and diagnostic products and services to researchers, physicians, hospitals, laboratories, and wholesalers inside and outside Indiana. Corp B manufactures various products that include medical testing and diagnostic tools, along with the associated research and development and distribution of those items.

The Indiana Department of Revenue (the "Department") audited Taxpayers' business and tax records for sales and use tax compliance for the tax years 2008, 2009, and 2010. As a result of the audits, the Department assessed Taxpayers additional use tax and interest for those periods. Taxpayers jointly protested a portion of their assessments on the same issues. A hearing was held on Taxpayers' protest, and this Letter of Findings ensues. Additional facts will be presented as needed.

I. Use Tax – Imposition.

DISCUSSION

Due to the large volume of Taxpayers' invoices, the Department assessed Taxpayers additional use tax based on a statistical sampling of their invoices. The sample was for both expenses and assets. Taxpayers provided SAP ("System Applications Products") data files for the years at issue. The accounts that were used in the sample were agreed to by the Department's auditor and Taxpayers. It was agreed also to combine the records into a single file resulting in one sample. The sample invoices were categorized into seven different strata based on dollar amounts. Each purchase was reviewed and a determination was made whether to make an adjustment or not. The taxable purchases in each stratum were applied to the total of the sample purchases for that stratum in order to arrive at an error percentage for each stratum. Each stratum's error rate was applied to the stratum base amounts to arrive at additional taxable purchases for each stratum. The results were allocated based on Corp A's and Corp B's purchasing activity for each stratum. The total of additional taxable purchases for all strata was used as the numerator and the total for all the strata base amounts was used as the denominator. The resulting percentage was used as the error percentage to be applied to the totals for each year. Stratum 7 purchases were reviewed in detail. Since a detailed review was performed, the taxable purchases in that stratum for each company were assigned on an actual basis. It should be noted that credit card transactions were not included in this statistical review. A separate sample was used to review the credit card transactions.

The review of the statistical sample invoices for expenses and assets for stratum 1 through 7, revealed fourteen areas of noncompliance. Taxpayers raised issues relating to a few of these areas. Each of these contested areas will be addressed below.

As a threshold issue, 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. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of 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). In effect and practice, the use tax is generally functionally equivalent to the sales tax. See Rhoades v. Ind. Dep't of State

Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

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. IC § 6-2.5-5 et seq.

A. Taxpayers' request for tax credit for property used outside Indiana.

Taxpayers protest that they did not receive an "out of state use" tax credit in the Department's audit for certain Indiana purchases of software licenses, promotional materials, and computers where Taxpayers had paid sales tax on the purchases. Taxpayers protest that the Department's audit accepted their breakdown of Indiana use and storage relating to these contested purchases for assessment of use tax, but the Department's audit did not proportionately credit Taxpayers where they had already paid sales tax on similar items.

Taxpayers mistakenly conflate the function of the sales and use taxes regarding the taxability of certain items. This contested area highlights a difference between the Indiana sales and use taxes which generally otherwise function as complementary taxes.

Pursuant to IC § 6-2.5-3-2, the Department's audit assessed use tax on certain items Taxpayers had acquired in retail transactions without paying sales tax and which Taxpayers had used, stored, or consumed in Indiana. IC § 6-2.5-3-3 requires the use tax to be measured on the purchase price of those items and to be imposed at the same rate as the sales tax. Some of these items included software licenses, promotional materials and computers some of which were used outside Indiana.

In assessing the additional use tax, the Department's audit agreed with Taxpayers that the taxability of the software licenses be allocated based on the number of users of the software licenses in Indiana. For example, if Taxpayers purchased a software license for \$1,000,000 to cover all of its employees but only 60 percent of its employees were in Indiana, then only 60 percent of the software licenses would be used in Indiana. Given that the use tax, per IC § 6-2.5-3-2(a), is imposed on the use, storage or consumption of tangible personal property in Indiana, the Department agreed to allocate the taxability of the software licenses as Taxpayers requested, the Taxpayers would pay Indiana use tax on \$600,000, which is the portion of the purchase price that related to the licenses used in Indiana and not the entire purchase price.

Also, in assessing the additional use tax, the Department's audit agreed with Taxpayers that some of the promotional materials and computers Taxpayers had purchased without paying sales tax were shipped out of Indiana for use outside Indiana. Pursuant to IC § 6-2.5-3-2, 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. IC § 6-2.5-3-1(b) 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). Furthermore, IC § 6-2.5-3-2(e)(3) states that the Indiana use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property if the property is subsequently transported out of state for use solely outside Indiana. This is generally referred to as the use tax "temporary storage" exception. Based on this "temporary storage" exception, the Department's audit agreed that a percentage of the purchase price relating to the promotional materials and computers temporarily stored in Indiana, then shipped and used out of state, would not be subject to use tax. Taxpayers now protest that the Department's audit accepted their breakdown of Indiana use and storage for assessment of use tax, but the Department's audit did not proportionately credit Taxpayers where they had already paid sales tax on similar items. Taxpayers assert that they should get a "refund" in the form of a "credit" in the audit for the portion of the sales tax they paid that relates to this "out-of-state usage"/"temporary storage."

However, there is no "out of state usage" or "temporary storage" exception for sales tax. Indiana sales tax is a transaction tax that is imposed on the occurrence of a retail sales transaction in Indiana. 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.

The purchases by Corp A and Corp B for which Taxpayers wish to accrue partial credit were Indiana retail transactions. The invoices for the transactions in question demonstrate that Taxpayers correctly paid sales tax to the respective vendors at the time of purchase because these were Indiana retail transactions.

In conclusion, the use tax "out of state use"/"temporary storage" exception does not apply to the transactions in question. The vendors properly collected sales tax from Taxpayers on the retail transactions that occurred in Indiana. The Department correctly did not provide any sales or use tax credit to Taxpayers for a portion of the sales tax paid on these items that were purchased in Indiana retail transactions just because some of these items happened to be eventually used out of state.

Taxpayers' protest of these items is therefore respectfully denied.

B. Exemption for capitalized equipment used in Research & Development.

Taxpayers protest that the Department's audit did not give them credit for sales tax Corp A paid on the purchase of an item used in research and development and which is therefore subject to exemption under IC § 6-2.5-5-40(b)(3). The invoice is from Millipore Corporation (invoice number 4568625, stratum 5, sort 3). The version of IC § 6-2.5-5-40 in effect for the years at issue states:

- (a) As used in this chapter, "research and development activities" does not include any of the following:
 - (1) Efficiency surveys.
 - (2) Management studies.
 - (3) Consumer surveys.
 - (4) Economic surveys.
 - (5) Advertising or promotions.
 - (6) Research in connection with literary, historical, or similar projects.
 - (7) Testing for purposes of quality control.
- (b) As used in this section, "research and development equipment" means tangible personal property that:
 - (1) consists of or is a combination of:
 - (A) laboratory equipment;
 - (B) computers;
 - (C) computer software;
 - (D) telecommunications equipment; or
 - (E) testing equipment;
 - (2) has not previously been used in Indiana for any purpose; and
 - (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:
 - (A) new products;
 - (B) new uses of existing products; or
 - (C) improving or testing existing products.
- (c) A retail transaction:
 - (1) involving research and development equipment; and
 - (2) occurring after June 30, 2007;
 is exempt from the state gross retail tax.

The invoice at issue, presented by Taxpayers again at the protest (invoice number 4568625), is for a Luminex 200 xPONENT System from EMD Millipore Corp. Taxpayers did not further describe this item or how it is used by Corp A, therefore this Letter of Findings cannot determine whether or not this item qualifies for the research and development exemption.

Taxpayers' protest of this item is denied for lack of sufficient information.

C. Non-taxable services.

Taxpayers protest the inclusion of part of two Corp B invoices in the audit sample. These invoices contain charges for what Taxpayers argue are non-taxable services pursuant to [45 IAC 2.2-4-2](#).

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and
- (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

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

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

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

(1) Software support services – Kronos invoice.

The Department included in the audit's statistical sample amounts from an invoice for Corp B from Kronos

(invoice number 10557641, stratum 5, sort 101). According to Taxpayers, this invoice lists several line items which Taxpayers state are strictly software support services and do not include any tangible personal property and therefore should not be subject to sales or use tax.

Taxpayers explained that Kronos provided various levels of support for its software, and that the "Gold" level services were strictly support services that did not include the exchange of any tangible personal property. As evidence, at the hearing Taxpayers provided the invoice that designates those protested listings as pertaining to the "Gold" service level. Subsequent to the hearing, in an attachment to an email, Taxpayers also provided documentation from Kronos describing the "Gold" level service to demonstrate that that level of support was for services only.

According to the documentation provided by Kronos, the "Gold" level of services includes software patches. IC § 6-2.5-1-24 defines fixes of pre-written software as pre-written software too (Taxpayers have not argued that the software being maintained is not pre-written). Furthermore, the invoice that Taxpayers provided itself specifically designates four of the five protested listed items as taxable (the invoice has a column headed "Taxable," then below for each of the items there is a designation of "YES" or "NO"). IC § 6-2.5-1-24 states:

Subject to the following provisions, "prewritten computer software" means computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser:

- (1) The combining of two (2) or more prewritten computer software programs or prewritten parts of the programs does not cause the combination to be other than prewritten computer software.
- (2) Prewritten computer software includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the purchaser.
- (3) If a person modifies or enhances computer software of which the person is not the author or creator, the person is considered to be the author or creator only of the person's modifications or enhancements.
- (4) Prewritten computer software or a prewritten part of the software that is modified or enhanced to any degree, where the modification or enhancement is designed and developed to the specifications of a specific purchaser, remains prewritten computer software. However, where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such a modification or enhancement, the modification or enhancement is not prewritten computer software.

Therefore, without further information, Taxpayers' protest of the taxability of these items is denied.

(2) Document scanning – Document Management Solutions invoice.

The Department included in the audit's statistical sample amounts from an invoice for Corp B from Document Management Solutions (invoice number 24025, stratum 3, sort 79). According to Taxpayers, this invoice contains a line item for "document scanning" which Taxpayers state is strictly a service with no exchange of tangible personal property and therefore should not be subject to sales or use tax.

Without further documentation and explanation of the nature of the services provided under this invoice, it is not clear to what "document scanning" refers. For example, this charge could include the documents scanned. Taxpayers have not further explained how the elements of [45 IAC 2.2-4-2](#), upon which they rely in their protest, support their contention.

Therefore, without further information, Taxpayers' protest of the taxability of this item is denied.

FINDING

For the reasons stated above, Taxpayers' protest is respectfully denied.

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