DEPARTMENT OF STATE REVENUE

04-20150410.LOF

Letter of Findings: 04-20150410
Gross Retail and Use Tax
For the Years 2005 through 2014

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Indiana Advertising Company's sale of advertising materials to Indiana customers was subject to sales tax; the Department did not agree that Advertising Company was a service provider with the distribution of the materials to Indiana recipients secondary to the provision of the services; the assessment of 2005 through 2014 tax was not barred by the three-year statute of limitations because Advertising Company never filed sales tax returns.

ISSUES

I. Gross Retail Tax - Advertising Materials.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-1(a); IC § 6-2.5-1-2; IC § 6-2.5-1-5; IC § 6-2.5-2-1(a); IC § 6-2.5-4-1(a); IC § 6-2.5-4-1(b); IC § 6-2.5-9-3; IC § 6-8.1-5-1(c); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 2.2-1-1(a); 45 IAC 2.2-4-1; Commissioner's Directive 21 (July 1, 2014).

Taxpayer argues that it was not required to collect sales tax from its Indiana customers when it arranged to provide advertising materials subsequently distributed to Indiana recipients.

II. Gross Retail Tax - Statute of Limitations.

Authority: IC § 1-1-4-1; IC § 6-8.1-5-2(a); IC § 6-8.1-5-2(f); Ind. Dep't of State Revenue, Ind. Revenue Bd., Ind. Gross Income Tax Division v. Colpaert Realty Corp., 109 N.E.2d 415 (Ind. 1952); Jefferson Smurfit Corp. v. Indiana Dep't of State Revenue, 681 N.E.2d 806 (Ind. Tax Ct. 1997); State Bd. of Accounts v. Ind. Univ. Found., 647 N.E.2d 342 (Ind. Ct. App. 1995); E.g., Leehaug v. State Bd. of Tax Comm'rs, 583 N.E.2d 211 (Ind. Tax Ct. 1991); Montgomery Ward & Co. v. Gregg, 554 N.E.2d 1145 (Ind. Ct. App. 1990).

Taxpayer maintains that the Department's assessment of sales tax was invalid on the ground that the 2005 through 2014 assessments violate the three-year statute of limitations.

III. Gross Retail Tax - Commission Income.

Authority: IC § 6-8.1-5-1(c).

Taxpayer claims that it should not be required to pay sales tax on commission income unrelated to the direct distribution of advertising materials.

IV. Administration - Negligence Penalty.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(2); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks the Department to abate the ten-percent penalty on the ground that Taxpayer's failure to collect and remit the tax was not due to its negligence.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of providing advertising services and distributing advertising materials on behalf of Indiana customers. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's business records.

The audit found that Taxpayer was selling "direct mailers to Indiana residents" but had failed to collect sales tax from its Indiana customers.

The Department issued an assessment of sales tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Gross Retail and Use Tax - Advertising Materials.

DISCUSSION

Taxpayer solicits business from Indiana companies. Some of these companies enter into agreements with Taxpayer to prepare and distribute "direct mailers." The mailers include discount coupons and other advertising materials. Taxpayer engages an out-of-state company to print the materials and coupons. Taxpayer then arranges for the materials to be sent to Indiana residents based upon criteria established by it and the Indiana customers. As Taxpayer explains in its protest letter, "The [advertising] program . . . involves the distribution of printed coupons and other advertising material from area retailers to a mailing list of prospective customers for a fee."

Taxpayer bills each of its Indiana customers one amount for services and the cost of the advertising materials. The Department found that Taxpayer did not collect sales tax from these customers and assessed Taxpayer for that uncollected tax.

Taxpayer disagrees stating that it does not owe the tax because the "true object" of the transaction is the provision of exempt advertising services.

A. Audit Results

The audit did not agree that Taxpayer was selling nontaxable services to its customers. The audit report indicates that Taxpayer's representative confirmed "that there is not any digital web-based advertising, it is all direct distribution." The audit reviewed the five invoices Taxpayer chose to provide and concluded that the "invoices did not indicate that there was any web-based advertising."

The audit concluded the transactions between Taxpayer and its customers were "unitary transactions" which included the price of the printed materials and "the necessary services to complete the sale." The audit report cited to IC § 6-2.5-1-5 as the basis for assessing the uncollected tax. IC § 6-2.5-1-1(a) provides that a "'unitary transaction' includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." The audit report explained that a "retail unitary transaction" occurs when a retail merchant purchases tangible personal property in the retail merchant's ordinary course of business and then sells that property along with services as a unitary transaction. IC § 6-2.5-1-2.

The audit report also cited to Commissioner's Directive 21 (July 1, 2014), 20140827 Ind. Reg. 045140317NRA, which provides in part:

> A purchaser of direct mail that is going to be delivered to recipients in several jurisdictions shall provide the delivery information to the seller, and the seller shall collect the tax for the appropriate jurisdictions.

The audit concluded that "since all recipients are believed to be in Indiana, sales tax should have been collected on the entire amount for all sales."

The audit considered Taxpayer's objection that the price by its customers included intangible sales but found the documents "provided during the audit did not prove this fact."

B. Taxpayer's Response

Taxpayer states that it is not in the business of selling coupons and other advertising materials but that "the

purpose of [its] business is to sell advertising services." As Taxpayer explains, the printed materials sold to its customers "merely conveys the message and is thus used incidental to providing a service." According to Taxpayer, it "was at all time relevant hereto a service provider."

In addition, Taxpayer states that the cost of the tangible personal property - paper, ink, envelopes, labels, and the like - is "inconsequential compared to the price charged for the services."

Moreover, Taxpayer states that it provides a supplemental digital service whereby the recipients of the advertising materials are directed to Taxpayer's website. Once at the website, the direct mail recipients are offered additional discount coupons.

Taxpayer summarizes:

> [Taxpayer] is not subject to sales tax because it is only a service provider and is not subject to the complimentary use tax because it did not exercise any right control and/or power "incident to the ownership of" any tangible personal property.

C. Hearing Analysis

The issue is whether Taxpayer was required to collect sales tax from its Indiana customers when it prepared and distributed advertising materials on behalf of those customers.

As a threshold issue, it is the 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." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, [W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

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." A retail merchant engaged in selling tangible personal property is required to "collect the tax as agent for the state." IC § 6-2.5-2-1(b). The retail merchant "holds those taxes in trust for the state and is personally liable for the payment of those taxes . . . ." IC § 6-2.5-9-3.

The Department's audit found that Taxpayer's sale of advertising materials constituted a "unitary transaction" under 45 IAC 2.2-1-1(a). This regulation states that:

> For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

The regulation derives from IC § 6-2.5-1-1, which states that a "'unitary transaction' includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." A "retail unitary transaction" occurs when a retail merchant purchases tangible personal property in the retail merchant's ordinary course of business and then sells that property along with services as a unitary transaction. Id.

As explained in 45 IAC 2.2-4-1, "gross retail income subject to tax" includes "all elements of consideration" including:

> Any additional bona fide charges added to or included in such price for preparation, fabrication, alternation,

> modification, finishing, completion, delivery or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.

(Emphasis added).

A review of sample invoices and customer agreements provided during and after the hearing indicates that Taxpayer's customers are being billed for "coupons" (e.g. "Coupon, Premium 4/4, Coated") and - in some cases - "digital distribution." For example, on a 2013 invoice, the Indiana customer was billed $7,600 for 40,000 "homes mailed," and $25 for "digital distribution." In an earlier 2011 invoice, the Indiana customer was billed $6,460 for "380,000 homes mailed" but there was no individual charge for separate services.

Of the approximately 35 sample invoices provided during the administrative hearing (for 2007, 2008, 2009, 2010, 2011, 2012, 2013, and 2014) a minority of the invoices indicated that the customer was paying for "digital distribution." Of those invoices indicating that the customer was being charged for this additional service, none were charged more that a nominal ($25) cost for "digital distribution."

The documentation on its face is straightforward as are the transactions between Taxpayer and its customers. Taxpayer sold advertising materials to its Indiana customers at a price based on the per-unit cost of that material, Taxpayer distributed those materials, and Taxpayer billed its Indiana customers one amount for the cost of the materials and any services incurred in preparing the materials. Taxpayer's customers negotiated for and bought the materials, and Taxpayer was required to collect sales tax. Taxpayer may indeed be in the business of providing "services" but the transactions between it and its customers are - on their face - charges for the sale of tangible personal property subject to tax.

Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c) of establishing that the assessment was wrong.

FINDING

Taxpayer's protest is respectfully denied.

II. Gross Retail Tax - Statute of Limitations.

DISCUSSION

The Department issued proposed assessments of sales tax for 2005 through 2014. Taxpayer argues that the assessments violate the three-year statute of limitations and points out that - although it did not file sales tax returns - it did file adjusted gross income tax returns from 2005 to 2014. In making that argument, Taxpayer relies on IC § 6-8.1-5-2(a). The statute provides:

> Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed, or either of the following:
>
> (1) The due date of the return.
>
> (2) In the case of a return filed for the state gross retail or use tax, the gasoline tax, the special fuel tax, the motor carrier fuel tax, the oil inspection fee, or the petroleum severance tax, the end of the calendar year which contains the taxable period for which the return is filed.

(Emphasis added).

Taxpayer states that the three-year statute of limitations began to run on the date it filed its adjusted gross income tax returns. In order to accept Taxpayer's argument, it is necessary to interpret the reference to "the return" as referencing any Indiana tax return.

Statutory construction of IC § 6-8.1-5-2(a) starts with the "plain and ordinary meaning of the language used." E.g., Leehaug v. State Bd. of Tax Comm'rs, 583 N.E.2d 211, 212 (Ind. Tax Ct. 1991). IC § 1-1-4-1 explains in part:

> The construction of all statutes of this state shall be by the following rules, unless the construction is plainly repugnant to the intent of the legislature or of the context of the statute:
>
> (1) Words and phrases shall be taken in their plain, or ordinary and usual, sense. Technical words and phrases having a peculiar and appropriate meaning in law shall be understood according to their technical import.

A technical word has a "peculiar and appropriate meaning in law" if, for example, it is defined elsewhere in a related code provision. State Bd. of Accounts v. Ind. Univ. Found., 647 N.E.2d 342, 347 (Ind. Ct. App. 1995). Otherwise, "when a particular construction has not been expressly provided, the legislature intends that words and phrases be given their plain and ordinary meaning." Montgomery Ward & Co. v. Gregg, 554 N.E.2d 1145, 1155 (Ind. Ct. App. 1990). This is particularly true if a word is well understood by the lay public and has been brought into the law from ordinary life experiences, not from legal treatises. Ind. Dep't of State Revenue, Ind. Revenue Bd., Ind. Gross Income Tax Division v. Colpaert Realty Corp., 109 N.E.2d 415, 419 (Ind. 1952).

It is well-established that a statute is not ambiguous merely because of "[s]imple disagreement between the parties." Leehaug, 583 N.E.2d at 212. (Internal citations omitted). An unambiguous statute must be read to "mean what it plainly expresses, and its plain and obvious meaning may not be enlarged or restricted." Jefferson Smurfit Corp. v. Indiana Dep't of State Revenue, 681 N.E.2d 806, 811 (Ind. Tax Ct. 1997).

The Department does not agree that the IC § 6-8.1-5-2(a) reference to "the return" means "any return." IC § 6-8.1-5-2(a) is plain on its face, there are no "technical words," and there are no ambiguities. In Taxpayer's case, it failed to register as a retail merchant, failed to collect Indiana sales tax from its Indiana customers, and failed to file sales tax returns when it was conducting retail sales of tangible personal property to Indiana customers. Accepting Taxpayer's interpretation would lead to consequences plainly not intended by the legislature. A taxpayer could start the running of the three-year limitation for any and all unreported taxes merely by filing any Indiana tax return such as - theoretically - a CIG-PT ("Cigarette Paper and Tube Tax Return") or a URT-1 ("Indiana Utility Receipts Tax Return").

IC § 6-8.1-5-2(f) provides, "If a person files a fraudulent, unsigned, or substantially blank return, or if a person does not file a return, there is no time limit within which the department must issue its proposed assessment." (Emphasis added). Taxpayer failed to file sales tax returns during the years here at issue; therefore, the statute of limitations did not begin to run and the pending assessments are otherwise valid.

FINDING

Taxpayer's protest is respectfully denied.

III. Gross Retail Tax - Commission Income.

DISCUSSION

Taxpayer is one company in a related group of companies. Taxpayer states that it receives commission income from the affiliates. As Taxpayer explains, this commission income is attributable to the distribution of advertising materials to Indiana recipients but that the distribution contract was between one of its related companies and one of that company's customers. Taxpayer apparently receives a pro-rata share of that income which it here describes as "commission" income not directly related to its own sale of advertising materials. Taxpayer claims that the Department's audit assessed tax on the commission income and that this particular income was not subject to sales tax.

As noted in Part I above, IC § 6-8.1-5-1(c) provides that "[t]he 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."

There is no mention in the audit report that this issue was addressed during the audit. Taxpayer did not develop or substantiate the issue in its written protest. Taxpayer has not provided documentation establishing that a portion of the money it received constituted commission income, establishing that the audit included "commission" income as a basis for making the pending assessment, nor establishing that the "commission" income should not be subject to the tax.

FINDING

Taxpayer's protest is respectfully denied.

IV. Administration - Negligence Penalty.

DISCUSSION

Taxpayer argues that the Department should exercise its discretion to abate the ten-percent "negligence" penalty on the ground that it "did not exercise willful neglect in failing to pay the sales tax assessed."

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case by case basis according to the facts and circumstances of each taxpayer." Id.

Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment - including the negligence penalty - is presumptively valid.

Taxpayer is a substantial, sophisticated entity in the business of selling large amounts of tangible personal property to Indiana customers by means of transactions for which it did not collect tax. The Department does not agree that the failure to collect the tax was a simple oversight. However, the Department agrees that the failure to collect the tax "was due to reasonable cause . . . ." Taxpayer has met its burden of establishing that the penalty should be abated.

FINDING

Taxpayer's protest is sustained.

SUMMARY

The Department will abate the ten-percent penalty. In all other respects, Taxpayer's protests are denied.

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