DEPARTMENT OF STATE REVENUE

04-20140451.LOF

Letter of Findings Number: 04-20140451
Sales and Use Tax
For Tax Years 2010-12

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Business was able to produce documentation and explanation showing that some sales under protest were not subject to sales tax. Therefore, those sales will be removed from the Department's calculations of sales tax due. Business was also able to produce documentation and explanation showing that some purchases under protest were not subject to use taxes. Therefore, those purchases will be removed from the Department's calculations of use tax due. Waiver of penalty was warranted.

ISSUES

I. Sales Tax–Collection as a Retail Merchant.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-2.5-3-7; IC § 6-2.5-8-8; IC § 6-8.1-5-1; Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 2.2-4-2; Sales Tax Information Bulletin 2 (May 2002); Sales Tax Information Bulletin 2 (December 2010); Sales Tax Information Bulletin 2 (November 2011); ; Sales Tax Information Bulletin 2 (March 2013).

Taxpayer protests the imposition of sales tax on certain transactions.

II. Use Tax–Imposition.

Authority: IC § 6-2.5-1-27; ; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-9; IC § 6-8.1-5-1; IC § 6-2.5-1-11.5; Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Lowe's Home Centers, LLC, v. Indiana Dept. of State Revenue, 23 N.E.3d 52 (Ind. Tax 2014); 45 IAC 2.2-3-4; 45 IAC 2.2-3-7; 45 IAC 2.2-4-22; Sales Tax Information Bulletin 60 (April 2011); 2016 Ind. Acts 1939, P.L. 181-2016, § 18 (codified at I.C. § 6 -2.5-3-2(c)).

Taxpayer protests the imposition of use tax on certain transactions.

III. Tax Administration–Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is a retail business with operations in Indiana and other states. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not collected and remitted sales tax on all transactions it had as a retail merchant and all purchases it made as a consumer during the tax years 2010, 2011, and 2012. The Department therefore issued proposed assessments for sales tax, use tax, penalty, and interest for those years. Due to the large number of transactions under review, the Department used a sample and projection method to determine Taxpayer's compliance rate regarding its retail merchant sales tax collection and remittance duties. That rate was applied to Taxpayer's sales and purchases respectively to determine sales tax that should have been remitted during the tax years. That amount was compared to the amount of sales tax and

use tax actually remitted during the tax years. Sales tax was imposed on the difference between the amount of sales tax actually remitted and what the Department determined should have been remitted based on the compliance rate. Similarly, due to the large number of Taxpayer's purchases as a consumer, the Department used a sample and projection method to determine Taxpayer's compliance rate regarding its use tax remittance duties. The Department applied the use tax compliance rate against the amount of use tax remitted and imposed use tax on the difference. Purchases of fixed assets which Taxpayer made were reviewed for use tax compliance on a transactional basis. Taxpayer protested the imposition of sales tax on some transactions and the imposition of use tax on some transactions. Taxpayer also protested the imposition of penalty. An administrative hearing was conducted and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax–Collection as a Retail Merchant.

DISCUSSION

Taxpayer protests the imposition of sales tax which the Department determined should have been collected and remitted on certain transactions during the tax years 2010, 2011, and 2012. The Department based its proposed assessments on the fact that Taxpayer did not collect and remit sales tax on some transactions which the Department determined were taxable sales. Taxpayer protests that several transactions which the Department believed were taxable sales were actually not subject to sales tax and that the compliance rate is understated resulting in the overstatement of the proposed assessments.

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 Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. 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, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Sales tax is imposed by IC § 6-2.5-2-1, which states:

> (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
> (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Therefore, when a retail merchant sells tangible personal property to its customer, the retail merchant is responsible for collecting and remitting the sales tax on that transaction.

Also of relevance is IC § 6-2.5-4-1, which states in relevant parts:

> (a) A person is a retail merchant making a retail transaction when the person engages in selling at retail.
> (b) A person is engaged in selling at retail when, in the ordinary course of the person's regularly conducted trade or business, the person:
> (1) acquires tangible personal property for the purpose of resale; and
> (2) transfers that property to another person for consideration.
> (c) For purposes of determining what constitutes selling at retail, it does not matter whether:
> (1) the property is transferred in the same form as when it was acquired;
> (2) the property is transferred alone or in conjunction with other property or services; or
> (3) the property is transferred conditionally or otherwise.
> (d) Notwithstanding subsection (b), a person is not selling at retail if the person is making a wholesale sale as described in section 2 of this chapter. However, in the case of sales of gasoline (as defined in IC 6-6-1.1-103), a person shall collect the gasoline use tax as provided in IC 6-2.5-3.5.
> (e) The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:
> (1) the price of the property transferred, without the rendition of any service; and
> (2) except as provided in subsection (g), 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.

. . . .

(Emphasis added).

Taxpayer protests that some of its customers were exempt from sales tax. Specifically, Taxpayer states that two of the transactions of tangible personal property ("TPP") considered to be taxable sales by Taxpayer were in fact drop shipments to exempt customers with third party delivery addresses. In support of this position, Taxpayer was able to provide exemption certificates for the two customers which it states were the actual purchasers of the TPP. Of relevance is IC § 6-2.5-3-7, which provides:

(a) A person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana, unless the person or the retail merchant can produce evidence to rebut that presumption.
(b) A retail merchant is not required to produce evidence of nontaxability under subsection (a) if the retail merchant receives from the person who acquired the property an exemption certificate which certifies, in the form prescribed by the department, that the acquisition is exempt from the use tax.

Also, IC § 6-2.5-8-8 states:

(a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. 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.
(b) The following are the only persons authorized to issue exemption certificates:
(1) retail merchants, wholesalers, and manufacturers, who are registered with the department under this chapter;
(2) organizations which are exempt from the state gross retail tax under IC 6-2.5-5-21, IC 6-2.5-5-25, or IC 6-2.5-5-26 and which are registered with the department under this chapter; and
(3) other persons who are exempt from the state gross retail tax with respect to any part of their purchases.
(c) The department may also allow a person to issue a blanket exemption certificate to cover exempt purchases over a stated period of time. The department may impose conditions on the use of the blanket exemption certificate and restrictions on the kind or category of purchases that are exempt.

Therefore, if a retail merchant receives a properly completed exemption certificate, it is not responsible for the collection and remittance of sales tax on transactions with that customer. Since Taxpayer has provided exemption certificates and invoices establishing that the transactions in question were with exempt customers, those transactions were not subject to sales tax. Taxpayer has met the burden of proving this portion of the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

The next area of protest concerns transactions for installation only. Taxpayer states that several transactions identified by the Department as taxable transactions of TPP were actually installation transactions with no TPP sold by Taxpayer. In the course of the protest process, Taxpayer was able to provide documentation which establishes that the transactions at issue were in fact charges for delivery and installation services only. As provided by IC § 6-2.5-4-1(e), services are only taxable if they are rendered as part of the same transaction and are performed prior to the transfer of the TPP. In this case, the entries listed as delivery and installation were separate transactions. No TPP was involved in these instances and so no sales tax was due on them. Taxpayer has met the burden of proving this portion of the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

The next area of protest concerns optional warranty sales. The Department determined that Taxpayer had not collected sales tax at the time it sold optional warranties to its customers. The Department based its determination on the grounds that Sales Tax Information Bulletin 2 20100804 Ind. Reg. 045100497NRA (December 2010) and Sales Tax Information Bulletin 2 20111228 Ind. Reg. 045110764NRA (November 2011), which were the versions of that information bulletin in effect during the tax years, required retail merchants to collect sales tax on the sale of optional warranties. In the earlier versions of Sales Tax Information Bulletin 2, the underlying regulation was 45 IAC 2.2-4-2.

Taxpayer protests that Sales Tax Information Bulletin 2 25 Ind. Reg. 3595 (May 2002) was the only version of the information bulletin to be published in the Indiana Register until August 4, 2010, and that version of the information bulletin instructed that optional warranties were not subject to sales tax. Taxpayer also protests that

the Department later changed its position in Sales Tax Information Bulletin 2 20130327 Ind. Reg. 045130126NRA (March 2013) back to the stance that it considered optional warranties to not be subject to sales tax imposed on the purchasers of the warranties. Taxpayer argues that it was always following the position the Department later agreed to, even if that agreement occurred after the tax years at issue. The Department does not agree with Taxpayer's position. Retail merchants are required to follow the Department's instructions, including instructions found in information bulletins, when performing their sales tax collection and remittance duties.

The Department's instructions after August 4, 2010 were to collect sales tax on the sales of optional warranties. Taxpayer did not do so. Therefore, while Taxpayer was applying the instructions of the version of the information bulletin as it was published until August 4, 2010, Taxpayer did not follow the instructions of the information bulletin from August 4, 2010 through the end of 2012. Therefore, while those sales of optional warranties which occurred from January 1, 2010 through August 3, 2010 did not need to have sales tax collected, those sales which occurred on August 4, 2010 through December 31, 2012 did need to have sales tax collected at the time of the transaction. Taxpayer has partially met the burden of proving this portion of the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

In conclusion, Taxpayer has met the burden of proving the proposed sales tax assessments wrong with regard to some of the items under protest. Specifically, the transactions which were drop shipments to exempt customers, the separate transactions which were delivery and installation only, and the sales of optional warranties from January 1, 2010 through August 3, 2010 are not subject to sales tax and therefore those transactions will be reclassified as non-taxable. The non-protested transactions and sales of optional warranties sold from August 4, 2010 through December 31, 2012, will remain subject to sales tax. Using these revised classifications, the Department will recalculate Taxpayer's sales tax compliance rate. The new compliance rate will be applied to Taxpayer's overall sales and credit will be allowed for sales tax collected and remitted during the tax years. The reduced difference between sales tax actually remitted and that which should have been remitted using the revised compliance rate will be subject to sales tax.

FINDING

Taxpayer's protest is sustained in part and denied in part, as explained above.

II. Use Tax–Imposition.

DISCUSSION

Taxpayer protests the imposition of use tax on certain purchases it made during the tax years. The Department reviewed capital purchases for sales and use tax compliance and imposed use tax on those transactions upon which it believed tax was due but had not been paid. The Department also reviewed Taxpayer's expense purchases and classified those upon which no sales tax or use tax was remitted during the tax years as subject to use tax. The Department then compared Taxpayer's overall sales/use tax payment rate on consumer expenses against the amount of use tax remitted. Proposed use tax assessments were issued on the difference.

As provided in Issue I above, 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 Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. 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, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Sales tax is imposed by IC § 6-2.5-2-1, which states:

> (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
> (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Use tax is imposed by IC § 6-2.5-3-2(a), which states:

> An 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, regardless of the location of that transaction or of the retail merchant making that transaction.

45 IAC 2.2-3-4 further explains:

> Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction.

Taxpayer's first point of protest concerns transactions which Taxpayer state were services only, with no transfer of TPP. In support of its position, Taxpayer provided invoices and other documentation showing that these transactions were in fact for services only, without the transfer of TPP. Taxpayer has met the burden of proving this portion of the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

The next point of protest concerns those sales where Taxpayer states that sales tax was in fact collected and no imposition of sales tax is needed. In support of its protest, Taxpayer provided invoices showing sales tax charged to Taxpayer by the vendors. Therefore, these three transactions for which Taxpayer has supplied invoices showing that it paid sales tax at the time of the transactions will be removed from the Department's calculations of sales tax due. Taxpayer has met the burden of proving this portion of the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

The next point of protest concerns instances in which Taxpayer paid sales tax or had use tax imposed upon TPP which was used to make improvements to real property with a roofing contractor via maintenance contracts with two separate HVAC service providers. Taxpayer states that the Indiana Tax Court's decision in Lowe's Home Centers, LLC, v. Indiana Dept. of State Revenue, 23 N.E.3d 52 (Ind. Tax 2014) results in overpayment of sales tax and therefore it is due a refund on those amounts and also does not owe use tax on the amount assessed. Specifically, the court in Lowe's stated:

> Because Indiana Code § 6-2.5-3-2(c) does not impose use tax liability contingent upon the type of contract a contractor uses, that distinction as contained in 45 I.A.C. 2.2-3-9 and 45 I.A.C. 2.2-4-22 is invalid.

Id. at 59.

The Department notes that IC § 6-2.5-3-2 as amended by the Indiana General Assembly in 2016, applies here because subsection (c) was made retroactive to January 1, 2010. P.L. 181-2016, § 18. As amended in 2016, IC § 6-2.5-3-2(c) states in relevant part:

> The use tax is imposed on a contractor's conversion of construction material into real property if that construction material was purchased by the contractor. However, the use tax does not apply to conversions of construction material described in this subsection, if:
> (1) the state gross retail or use tax has been previously imposed on the contractor's acquisition or use of that construction material;
> (2) the person for whom the construction material is being converted could have purchased the material exempt from the state gross retail and use taxes, as evidenced by a properly issued exemption certificate, if that person had directly purchased the construction material from a retail merchant in a retail transaction; or
> (3) the conversion of the construction material into real property is governed by a time and material contract as described in IC 6-2.5-4-9(b).

(Emphasis added).

Further, IC § 6-2.5-4-9 provides:

> (a) A person is a retail merchant making a retail transaction when the person sells tangible personal property which:
> (1) is to be added to a structure or facility by the purchaser; and
> (2) after its addition to the structure or facility, would become a part of the real estate on which the structure

or facility is located.

(b) A contractor is a retail merchant making a retail transaction when the contractor:

(1) disposes of tangible personal property; or

(2) converts tangible personal property into real property; under a time and material contract. As such a retail merchant, a contractor described in this subsection shall collect, as an agent of the state, the state gross retail tax on the resale of the construction material and remit the state gross retail tax as provided in this article.

(c) Notwithstanding subsections (a) and (b), a transaction described in subsection (a) or (b) is not a retail transaction, if the ultimate purchaser or recipient of the property to be added to a structure or facility would be exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

(Emphasis added).

Also, 45 IAC 2.2-4-22 provides:

(a) A contractor may purchase construction material exempt from the state gross retail tax only if he issues either an exemption certificate or a direct pay certificate to the seller at the time of purchase.

(b) A contractor, who purchases construction material exempt from the state gross retail tax or otherwise acquires construction material "tax-free", is accountable to the Department of Revenue for the state gross retail tax when he disposes of such property unless the ultimate recipient could have purchased it exempt (see 6-2.5-5[45 IAC 2.2-5]).

(c) A contractor has the burden of proof to establish exempt sale or use when construction material, which was acquired "taxfree", is not subject to either the state gross retail tax or use tax upon disposition.

(d) Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

(1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax); or

(2) Construction material sold over-the-counter. Over the counter sales of construction materials will be treated as exempt from the state gross retail tax only if the contractor receives a valid exemption certificate issued by the person for whom the construction is being performed or by the customer who purchases over-the-counter, or a direct pay permit issued by the customer who purchases over-the-counter.

(e) Disposition subject to the use tax. With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:

(1) He converts the construction material into realty on land he owns and then sells the improved real estate;

(2) He utilizes the construction material for his own benefit; or

(3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

A disposition under C. [subsection (e)(3) of this section] will be exempt from the use tax if the contractor received a valid exemption certificate from the ultimate purchases (purchaser) or recipient of the construction material (as converted), provided such person could have initially purchased such property exempt from the state gross retail tax.

(Emphasis added).

As highlighted above, IC § 2.5-3-2(c) now does specifically and retroactively impose use tax liability contingent upon the type of contract used between a contractor and its customer. Therefore, the legislative amendment to IC § 6-2.5-3-2(c) nullifies the court's decision in Lowe's. Since Lowe's has been legislatively nullified, Taxpayer's position is not convincing. Taxpayer has not met the burden imposed under IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong regarding the roofing contractor. Neither is there an overpayment of sales/use tax to refund under the Lowe's decision.

However, regarding the two HVAC maintenance contracts with two separate vendors, Taxpayer offers an alternate position that use tax should not have been imposed on those amounts. Taxpayer bases its position on the basis that the maintenance contracts were lump sum contracts for maintenance on HVAC equipment and that the HVAC maintenance is actually considered an improvement to realty and is therefore not taxable to it as a consumer.

The first relevant statute is IC § 6-2.5-1-11.5, which states:

(a) This section applies to retail transactions occurring after December 31, 2007.
(b) "Bundled transaction" means a retail sale of two (2) or more products, except real property and services to real property, that are:
(1) distinct;
(2) identifiable; and
(3) sold for one (1) nonitemized price.
(c) The term does not include a retail sale in which the sales price of a product varies, or is negotiable, based on other products that the purchaser selects for inclusion in the transaction.
(d) The term does not include a retail sale that:
(1) is comprised of:
(A) a service that is the true object of the transaction; and
(B) tangible personal property that:
(i) is essential to the use of the service; and
(ii) is provided exclusively in connection with the service;
(2) includes both taxable and nontaxable products in which:
(A) the seller's purchase price; or
(B) the sales price; of the taxable products does not exceed ten percent (10[percent]) of the total purchase price or the total sales price of the bundled products; or
(3) includes both exempt tangible personal property and taxable tangible personal property:
(A) any of which is classified as:
(i) food and food ingredients;
(ii) drugs;
(iii) durable medical equipment;
(iv) mobility enhancing equipment;
(v) over-the-counter drugs;
(vi) prosthetic devices; or
(vii) medical supplies; and
(B) for which:
(i) the seller's purchase price; or
(ii) the sales price; of the taxable tangible personal property is fifty percent (50[percent]) or less of the total purchase price or the total sales price of the bundled tangible personal property. The determination under clause (B) must be made on the basis of either individual item purchase prices or individual item sale prices.
(Emphasis added).

Also of relevance is 45 IAC 2.2-3-7(b), which provides:

For purposes of this regulation [45 IAC 2.2], "construction material" means any tangible personal property to be used for incorporation in or improvement of a facility or structure constituting or becoming part of the land on which such facility or structure is situated.

Taxpayer believes that IC § 6-2.5-1-11.5(b) exempted the maintenance contracts at issue from sales and use taxes because the HVAC equipment which was being serviced was incorporated into the realty of the buildings. Also, Taxpayer refers to Sales Tax Information Bulletin 60 20110427 Ind. Reg. 045110247NRA (April 2011)(Suspended October 2016), which provided that construction materials included central air conditioning units, and also stated that "Improvements" to real property included repairs to existing improvements to real property.

After review of the maintenance agreement for one vendor and of the invoices for both vendors, the Department agrees with Taxpayer's position. Since the HVAC systems were construction materials to be incorporated into a facility as defined by 45 IAC 2.2-3-7(b) and since IC § 6-2.5-1-11.5(b) excludes real property and services to real property from the definition of bundled transactions, the maintenance of those systems was not taxable to Taxpayer. Rather, the sales/use tax burden regarding TPP in these cases is the responsibility of the vendors, as provided by 45 IAC 2.2-4-22(b). Taxpayer has met the burden of proving this portion of the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

The next point of protest concerns purchases which Taxpayer states are from outside the tax years at issue. In support of its position, Taxpayer provided invoices showing that the purchases in question occurred prior to the tax years. Since the tax years at issue are 2010-12, any purchases which occurred before January 1, 2010 and after December 31, 2012 will not be included in the Department's calculations of use tax due for this audit period.

The next point of protest concerns postage charged by an Indiana printer hired by Taxpayer to print and directly mail insurance forms to Taxpayer's employees. Taxpayer believes that, since only twelve percent of its employees are located in Indiana, only twelve percent of the postage charges should be subject to use tax. The relevant statute is IC § 6-2.5-1-5(a), which during the years at issue provided:

> Except as provided in subsection (b), "gross retail income" means the total amount of consideration, including cash, credit, property, and services, for which tangible personal property is sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for:
> (1) the seller's cost of the property sold;
> (2) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
> (3) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
> (4) delivery charges; or
> (5) consideration received by the seller from a third party if:
> (A) the seller actually receives consideration from a party other than the purchaser and the consideration is directly related to a price reduction or discount on the sale;
> (B) the seller has an obligation to pass the price reduction or discount through to the purchaser;
> (C) the amount of the consideration attributable to the sale is fixed and determinable by the seller at the time of the sale of the item to the purchaser; and
> (D) the price reduction or discount is identified as a third party price reduction or discount on the invoice received by the purchaser or on a coupon, certificate, or other documentation presented by the purchaser.
> For purposes of subdivision (4), delivery charges are charges by the seller for preparation and delivery of the property to a location designated by the purchaser of property, including but not limited to transportation, shipping, postage, handling, crating, and packing.

(Emphasis added).

After review of IC § 6-2.5-1-5(a), the Department does not agree with Taxpayer's position. First, the statute does not say anything about the destination of items dropped in the mail as being determinative on the taxable status of the postage charged. Second, Taxpayer took delivery of the mailings when the vendor mailed them on Taxpayer's behalf. Since the vendor is located in Indiana, it stands to reason that the items were mailed from an Indiana location and so the delivery charges including postage were incurred in Indiana. Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

The next point of protest concerns purchases from a specific vendor. Taxpayer states that it should not be required to pay use tax on purchases it made from that vendor but upon which the vendor did not collect sales tax. Taxpayer states that it knows that the vendor, as a retail merchant, paid the uncollected sales tax to the Department in an unrelated interaction with the Department. Taxpayer did not provide documentation supporting this position. Without documentation verifying that the uncollected sales tax on the transactions at issue in the instant protest, the Department is unable to agree with Taxpayer's position. Therefore, Taxpayer has not met the burden imposed under IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

The next point of protest concerns shipments of TPP to out-of-state locations. Taxpayer states that some of the transactions identified by the Department as subject to Indiana use tax were actually shipped from out-of-state vendors to Taxpayer's out-of-state locations and that the TPP never entered Indiana. As provided by IC § 6-2.5-3-2(a), TPP must be used, stored, or consumed in Indiana in order to be subject to Indiana use tax. Taxpayer provided invoices in support of its position. After review, Taxpayer has established that the transactions in question took place wholly outside Indiana and that the TPP was not used, stored, or consumed in Indiana. Therefore, Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) of proving the proposed assessments wrong with regard to these transactions.

The next point of protest concerns one instance where Taxpayer states that the Department made a calculation error. Specifically, Taxpayer states that the Department assessed use tax on the TPP sold in the transaction, but removed only $497.15 in labor charges when the labor charges actually were $595. Taxpayer has provided sufficient documentation to establish that the amount of labor charges which should have been removed from the Department's use tax calculations was $595.

The last point of protest is in regards to a computer software program. Taxpayer states that the program was custom-made and not a prewritten or "canned" software program. IC § 6-2.5-1-27 incorporates "prewritten

computer software" such as that purchased by Taxpayer in the definition of tangible personal property as follows:

> "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.

In the course of the protest process, Taxpayer was able to provide sufficient documentation including invoices and product descriptions from the programming company and analysis to establish that the program in question was a custom-made product and was not a prewritten program. Therefore, the program is not TPP as defined by IC § 6-2.5-1-27 and is not subject to sales tax or use tax. Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

In conclusion, Taxpayer has met the burden of proving the proposed assessments wrong regarding those transactions which were: for services only, had sales tax paid at the time of the transaction, were wholly conducted out-of-state, were conducted outside the audit period, were for custom computer software, should have had $595 in labor charges removed from taxable calculations, or were for HVAC maintenance contracts. Taxpayer has not met the burden of proving the proposed assessments wrong regarding charges for postage and regarding charges which Taxpayer alleged were paid by the vendor. The capital transactions upon which Taxpayer has been sustained will be removed from the Department's calculations of use tax due. The expense transactions upon which Taxpayer has been sustained will be reclassified as non-taxable and the Department will recalculate Taxpayer's use tax compliance rate. That rate will then be compared to Taxpayer's use tax remitted during the tax years and use tax will be due on the newly recalculated difference.

FINDING

Taxpayer's protest is sustained in part and denied in part as explained above.

III. Tax Administration–Penalty.

DISCUSSION

Taxpayer protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1 Penalty waiver is permitted if the taxpayers show that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> "Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at 45 IAC 15-11-2(c) as follows:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. 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 this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
>
> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
>
> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and

circumstances of each case.

Taxpayer protests the Department's assessment of penalty. After review of the documentation and analysis provided in the protest process, the Department may waive penalty as provided by IC § 6-8.1-10-2.1(e). Taxpayer has affirmatively established that it exercised ordinary business care in this case. Therefore, waiver of penalties is warranted under 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest to the imposition of penalties is sustained.

SUMMARY

Taxpayer's Issue I protest regarding the imposition of sales tax is sustained in part and denied in part as provided above. Taxpayer's Issue II protest regarding the imposition of use tax is sustained in part and denied in part as provided above. Taxpayer's Issue III protest regarding the imposition of penalty is sustained.

Posted: 02/22/2017 by Legislative Services Agency
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