DEPARTMENT OF STATE REVENUE

04-20160237.LOF

Letter of Findings Number: 04-20160237
Sales/Use Tax
For Tax Years 2012-2014

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

HOLDING

The LLC provided documentation to affirmatively establish that some of the protested purchases were not subject to use tax. The remaining amounts of use tax were properly assessed.

ISSUE

I. Sales/Use Tax-Imposition.

Authority: IC § 6-2.5-3-2; IC § 6-8.1-5-1; IC § 6-2.5-5-1; IC § 6-2.5-1-1; IC § 6-2.5-5-8; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-1-24; IC § 6-2.5-3-4; IC § 6-2.5-4-1; 45 IAC 2.2-4-1; 45 IAC 2.2-3-4; 45 IAC 2.2-4-2; Dep't 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); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Sales Tax Information Bulletin 8; Sales Tax Information Bulletin 2.

Taxpayer protests the assessment of sales and use tax.

STATEMENT OF FACTS

Taxpayer is an Indiana Limited Liability Company ("LLC"). The Indiana Department of Revenue ("Department") conducted a sales and use tax audit for the years 2012, 2013, and 2014. The Department determined that Taxpayer had not paid sales or use tax on some transactions during the audit period. The Department therefore issued proposed assessments of sales and use tax. Taxpayer protested the imposition of use tax on certain transactions. An administrative hearing was conducted and this Letter of Findings results. Further facts will be presented as required.

I. Sales/Use Tax-Imposition.

DISCUSSION

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.'" Dep't 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.

The Department assessed tax on an elevator maintenance contract, software purchases, and tangible personal property provided through construction contracts but not used in construction. Taxpayer protests that some of the items listed as taxable in the Department's calculations were actually exempt from tax because they related to service contracts. Taxpayer argues that the Department erred in assessing tax on transactions it entered into with certain vendors on the grounds that the transactions involved supplies and building services. Taxpayer provided

invoices and some contracts in support of its protest.

Use tax is imposed under 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 ("TPP") is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction, or if there is another applicable exemption to sales and use taxes. A transaction subject to the state's sales tax necessarily involves the transfer of TPP.

A. Elevator Maintenance Contract

The Department assessed use tax on Taxpayer's elevator maintenance contract because the Department determined that the contract was a "bundled transaction" containing the possible transfer of tangible personal property. Taxpayer protests the assessment of use tax on invoices for elevator services. 45 IAC 2.2-4-2(a) states that:

> 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:
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> (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.

However, the Department assessed tax because the transaction was considered a "bundled transaction." IC § 6-2.5-1-11.5 states in relevant part:

> (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%) of the total purchase price or the total sales price of the bundled products[.]

The Department has provided guidance on this issue through Information Bulletin 2. There are three different

information bulletins that apply to the tax years at issue: Information Bulletin 2 (November 2011); Information Bulletin 2 (January 2013); and Information Bulletin 2 (March 2013). Each information bulletin has remained consistent with its interpretation of maintenance contracts, only the interpretation of warranty contracts has differed. Information Bulletin 2 (March 2013), 20130327 Ind. Reg. 045130126NRA provides in relevant part.

> Maintenance contracts generally meet the definition of bundled transactions under IC 6-2.5-1-11.5 and are subject to sales tax on that basis. The determination as to whether a contract is a maintenance contract is not based on the particular title of or language used in the contract. Instead, the determination is based on the substantive provisions contained in the contract. Whether there is an explicit guarantee that tangible personal property will be provided under the contract is irrelevant. What is important is that both the customer and the service provider are aware at the time of the contract is executed that consumable items will be provided under the contract.

Taxpayer provided invoices and a letter from the vendor explaining that the transactions listed in the audit report are for services rendered. Taxpayer also provided the agreement between Taxpayer and vendor. The agreement is for a preventative maintenance program, which includes, "cleaning, lubricating, packing, adjusting, calibrating, repairing, and replacing parts and equipment for maintenance purposes, and furnishing of all cleaning material, and testing equipment necessary for the performance." Thus, Taxpayer's agreement meets the "bundled transaction" as described in IC § 6-2.5-1-11.5 and Information Bulletin 2, thus Taxpayer owes tax on the amount of the contract. However, Taxpayer did not provide sufficient documentation to show that the tangible personal property transferred fell under the de minimums standard. IC § 6-2.5-1-11.5(d)(2)(B). Therefore, the Department was correct in assessing sales tax on the elevator maintenance contract.

B. Software

The Department assessed tax on software purchased by Taxpayer. 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). The use tax is functionally equivalent to the sales tax. See Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002) (Emphasis added).

IC § 6-2.5-1-27 specifies that:

> "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. (Emphasis added).

"Prewritten computer software" is defined in IC § 6-2.5-1-24 which provides in part as follows:

> 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.

The Department has explained that computer software - acquired and stored on servers located outside Indiana but accessed by persons within the state - is subject to Indiana's sales and use tax.

> Prewritten computer software maintained on computer servers outside of Indiana also is subject to tax when accessed electronically via the Internet (i.e., "cloud computing"). The accessing of prewritten computer software by Indiana residents constitutes a transfer of the software because the customers gain constructive possession and the right to use, control, or direct the use of the software.
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> [Example] An Indiana resident purchases a new computer that enables the purchaser to access prewritten

> computer programs maintained on a third party's computer servers located outside of Indiana. The purchaser never receives the software in a tangible medium. Instead, the purchaser's software, including any documents created with the software, is housed on the third party's server. The sales of these programs are subject to tax. Sales Tax Information Bulletin 8 (November 2011), (20111228 Ind. Reg. 045110765NRA).

Taxpayer protests sales tax assessed on four software transactions. Taxpayer argues that each software had servers out of state and each main office was located out of state as well. Software 1 was used as an accounting system. Software 2 was used as a Point of Sale system. Software 3 was a corporate POS type system. Software 4 was used by a reputation company that provides reports of reviews of Taxpayer. Taxpayer provided invoices to support its argument that the payments are for services and that each software company is located outside Indiana. Taxpayer could not show that Software 1, 2, and 3 were actual services provided by the software company. Taxpayer could however show that Software 4 was a third party service provider and provides a service of tracking Taxpayer's reputation on social media. Indiana has determined that prewritten software is subject to Indiana sales tax. Id. Thus, Taxpayer is responsible for the sales tax on the software programs with the exception of Software 4.

C. Tangible Personal Property Transferred under Capital Improvement Contracts

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. IC § 6-2.5-5-1 et seq.

The Department reviewed Taxpayer's depreciation schedule and made adjustments to tangible personal property purchased by Taxpayer. The Department determined that:

> The taxpayer entered into an agreement with a contractor where a single stated price was paid for addition of tangible personal property (construction materials) to a structure or facility, which after its addition, the property became part of the real estate on which the structure or facility is located. The contractor is responsible for accruing and paying use tax on construction materials. However, the contract included tangible personal property (no construction materials) that was transferred to the taxpayer. A few examples of the types of property that were purchased included interior signage, window treatments, artwork, lighting, seating, and micro ridges.

The Department requested the invoices for the non-construction tangible personal property to determine whether sales tax was paid on those transactions. When the invoices did not show sales tax paid, the Department assessed use tax on the non-construction tangible personal property and also included the related delivery and installation fees.

Taxpayer protested this assessment stating that the transactions were part of a "lump sum contractor contract for realty," and therefore the contractor was responsible for sales tax. Taxpayer in the alternative argued that the tangible personal property was an "improvement to realty" and therefore exempt from sales tax.

The Department points out that Taxpayer is assuming that all the tangible personal property transferred under the construction contract is taxed or not taxed the same. In this instance, there are two categories of tangible personal property transferred under the contract: the construction materials and non-construction tangible personal property. Unitary transactions, transactions that include tangible personal property and services "which are furnished under a single order or agreement and for which a total combined charge or price is calculated" are "retail unitary transactions." IC § 6-2.5-1-1(a). 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) states 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." Therefore, the sales tax due on a retail unitary transaction is based on the total price of the transaction, including delivery and installation fees.

Regarding improvement to realty, IC § 6-2.5-3-2, states in relevant part:

> (c) 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).

Thus, a contractor is liable for sales or use tax due on construction materials under a lump sum contract, but a consumer is liable for sales or use tax of non-construction tangible personal property.

Taxpayer argues that use tax assessed was on tangible personal property which was included in a lump sum contractor contract, and that the tax assessed already included delivery and installation cost. In the alternative Taxpayer argues that the tangible personal property was incorporated into real property and therefore exempt from use tax. During the hearing Taxpayer provided an explanation of Contractor's billing, invoices, estimate quotes, cost summaries, breakdown of deposit billing, changes in the orders, and cost coverages and changes. The contract included both improvements to real property and non-construction tangible personal property. The audit only assessed tax on the non-construction tangible personal property, not the tangible personal property used as construction material, and included the "delivery and installation fees" based on IC § 6-2.5-1-1 and IC § 6-2.5-4-1. IC § 6-2.5-3-2 does not apply in this instance, since the items on which tax was assessed were not construction material but rather tangible personal property such as, furniture, hair dryers, beds, etc. The delivery fees are included in the price of the retail transaction and are always taxable in a non-exempt transaction. The installation fees were also taxable in this instance because they were transferred under a "unitary transaction." Taxpayer's documentation did not separately state installation charges and therefore, pursuant to IC § 6-2.5-1-1 and IC § 6-2.5-4-1, use tax was properly assessed the "delivery and installation" fees, as well.

D. Sales Tax Invoice

Taxpayer also protested the sales tax assessed on an invoice. Taxpayer argued in its protest letter that sales tax was paid at the time of purchase. Taxpayer provide the disputed invoice, number 3304156. The invoice does not show sales tax was paid. At the hearing, Taxpayer reviewed the invoice again and withdrew its protest on tax assessed on this invoice.

In conclusion, Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) for the elevator maintenance protest. Taxpayer, however, has not met its burden under IC § 6-8.1-5-1(c) for the software and construction protests. Taxpayer conceded the final issue.

FINDING

Taxpayer's protest is sustained for use tax assessed on Software 4. Taxpayer's protest is denied for the elevator maintenance contract, for the capital improvement contracts, and use tax assessed on Software 1, 2, and 3.

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