

**Letter of Findings: 04-20170176**  
**Gross Retail and Use Tax**  
**For the Years 2013, 2014, and 2015**

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Transportation Provider failed to meet its burden of demonstrating that it was a segregated, distinct, and independent legal entity from that of the company on whose behalf it delivered the company's products, that it transported the company's property pursuant to an arm's-length business agreement, that it was compensated for providing the company transportation services, and that it was entitled to claim the public transportation sales tax exemption.

### ISSUE

#### I. Gross Retail and Use Tax - Public Transportation Exemption.

**Authority:** IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-3-4; IC § 6-2.5-4-1(b), (c); IC §§ 6-2.5-5 et seq.; IC § 6-2.5-5-27; 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); Dep't of Treasury of Ind. v. Dietzen's Estate, 21 N.E.2d 137 (Ind. 1939); Conklin v. Town of Cambridge City, 58 Ind. 130 (1877); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Universal Group Limited v. Indiana Department of Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-5-61](#); [45 IAC 2.2-5-61\(j\)](#); Sales Tax Information Bulletin 12 (July 2015); Sales Tax Information Bulletin 12 (September 2014); Sales Tax Information Bulletin 12 (July 2010).

Taxpayer argues that it is entitled to claim the public transportation exemption and that the Department's audit decision to the contrary is erroneous.

### STATEMENT OF FACTS

Taxpayer is an Indiana company which provides transportation services. Taxpayer distributes Bottling Operation's products. Taxpayer delivers Bottling Operation's products to retailers, distribution centers, and warehouses. Taxpayer owns its own vehicles but has no employees. The employees - drivers and management personnel - work for Bottling Operation. Taxpayer "leases" the employees from Bottling Operation.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and tax returns. The audit resulted in an assessment of additional sales/use tax because the Department concluded that Taxpayer's property and vehicles were not "predominately . . . used in providing public transportation." Taxpayer disagreed with the audit results 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 Tax - Public Transportation Exemption.

### DISCUSSION

The issue is whether Taxpayer has provided sufficient information to establish that it was a separate legal entity distinct from that of Bottling Operation, that it was in the business of providing "public transportation," that it was engaged in transporting products it did not own, that it was compensated by Bottling Operation for providing those

services, and that the Department's assessment of additional sales/use tax was incorrect.

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 an 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, the interpretation and application of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

## A. Audit Results.

In determining whether Taxpayer was entitled to the public transportation exemption, the Department's audit cited to [45 IAC 2.2-5-61](#) and Sales Tax Information Bulletin 12 (July 2015), 20080528 Ind. Reg. 045080397NRA. See also Sales Tax Information Bulletin 12 (September 2014), 20150128 Ind. Reg. 045150028NRA; Sales Tax Information Bulletin 12 (July 2010), 20100623 Ind. Reg. 045100390NRA. Under those authorities, the audit noted that in order to qualify for the sought-after exemption, a taxpayer must meet certain criteria:

- Public transportation is defined as the movement of goods, persons, or property for consideration by a common or contract carrier;
- The carrier must operate under authority issued by a federal or state agency;
- The carrier must receive consideration (payment) for transporting people or property;
- The property being transported must be owned by someone other than the carrier;
- The equipment or property purchased by carrier must be predominately used in providing public transportation;
- "Predominately used" means that the equipment or property is used more than 50 percent in providing public transportation.

The Department's audit report cited to the "critical" and "non-critical" factors set out in Sales Tax Information Bulletin 12. This Bulletin "includes a listing of factors the Department weighs in determining whether a transportation company is engaged in public transportation." As explained in the audit report:

The department has broken down these requirements between critical factors and non-critical factors. A transportation company fails to qualify for the exemption if it does not, at a minimum, adhere to all the critical requirements. However, a failure to adhere to one or more of the "non-critical" requirements can also result in a transportation company's failure to qualify for the exemption.

### 1. Critical Factor - Leased Driver and Mechanic Employees.

The audit determined that Taxpayer failed to meet two of the "critical" requirements. The audit found that Taxpayer failed to establish that all transactions between itself and Bottling Operation be "evidenced by actual invoicing and payments." As explained in the audit report:

[Taxpayer] is never invoiced for the lease of [Bottling Operation's] employees covered under the lease agreement, and never makes payment for any employee lease expenses to [Bottling Operation]. While the employee lease agreement does cover the drivers and mechanics, the two entities [Taxpayer and Bottling Operation] have failed to follow the terms of their own agreement. Under exhibit A "compensation schedule" of the employee lease agreement, it reads in part, "[Taxpayer] shall pay the compensation it is required to pay to the [Bottling Operation] under this agreement on the 31st day of the month of July 1998 and on the same day of the month every month thereafter until this agreement is terminated." "[Taxpayer] shall compensate [Bottling Operation] for the services provided by [Bottling Operation's] employees by any or all of the following methods, as set forth on Addendum A." Addendum A states the method of compensation shall

be "actual employee costs and benefits plus 10[percent]."

The audit report notes Taxpayer makes "journal entries" in its books to account for "labor expense and corresponding credits to [its] income . . . in an effort to show the full cost and income [for] providing transportation services to [Bottling Operation] . . ." However the audit report points out that "no money is being exchanged regarding [Taxpayer's] use of lease employees."

In the end, [Taxpayer] bills and receives payment only for the direct costs they incur for fuel, tires, repairs, licenses, insurance and depreciation along with the agreed upon 10[percent] markup. [Bottling Operation] receives nothing for the use of [Bottling Operation's] employees, pays only the direct costs bills . . . and expenses those reimbursed amounts as vehicle lease costs in [Bottling Operation's] books.

Because Taxpayer and Bottling Operation's relationship was not "evidenced by actual invoicing and payments," the audit found that Bottling Operation was "not entitled to any exemption regarding equipment used to deliver their products, as no bottling company would have any exemption available for equipment used to deliver their own product."

## **2. Critical Factor - Management and Administrative Costs.**

In addition, the audit found that Taxpayer's relationship with Bottling Operation lacked "detailed records regarding the [Bottling Operation's] administrative and management personnel that are performing duties for both entities."

There is no dispute that Taxpayer has no employees of its own. Instead, Taxpayer "leases" Bottling Operation's employees to operate Taxpayer vehicles. In addition, Bottling Operation employees perform Taxpayer's routine administrative and management duties.

The audit report noted that Taxpayer has "no personnel to handle business functions and has no independent management [personnel] . . ." The report states that "[j]ob functions that must be performed by this personnel would include funding the bank account, paying bills, decisions on equipment purchases, dispatching, handling customer complaints, collections, billing, filing required returns, and responsibility for the transportation operations meeting required federal and state regulations."

## **3. Audit Conclusion.**

Because Taxpayer failed to meet two of the Information Bulletin's "critical" requirements, the audit concluded that Taxpayer was not entitled to claim the public transportation sales tax exemption.

While the [T]axpayer has complied with several of the listed criteria in [Sales Tax Information Bulletin 12], the failure to have a meaningful, arms-length charge for the use of employees to operate the partnership is a major stumbling block in documenting that [Taxpayer] and [Bottling Operation] have an overall arm's length business relationship.

. . .

[T]here are no actual charges to [Taxpayer] for using any [Bottling Operation's] employees to operate the business. The [T]axpayer claims that journal entries made on the books of [Taxpayer] regarding the drivers and mechanics meet the requirement for "actual invoicing and payments for all transactions" between the two related entities. The partnership returns may show income and expense pertaining to the drivers as a result of these journal entries, but there is certainly no consideration being exchanged between the two entities for actual payroll cost of the drivers. There is no doubt that [Bottling Operation's] management and administrative personnel that operate [Taxpayer] are not accounted for in the transactions between the two entities.

The Department's audit concluded that "[t]he [T]axpayer is not engaged in business as an independent entity providing public transportation services when providing the vehicles to haul goods that are owed by [Bottling Operation]." As a result of that conclusion, the Department assessed sales tax on "all untaxed purchases for the audit years 2013, 2014, and 2015 . . ." including the purchases of "semi-trailers, semi-trucks, and a pickup truck . . ."

## **B. Taxpayer's Response.**

Taxpayer states that the Department's audit "erred in disallowing the sales tax exemption . . ." Taxpayer argues

that it "met all the requirements, including those considered to be 'critical requirements', listed in [Sales Tax Information Bulletin 12] for purposes of determining whether a transportation company qualifies for the public transportation exemption."

Taxpayer addressed the audit's contention that "there is certainly no consideration being exchanged between the two entities for [the] actual payroll cost for the drivers."

While Taxpayer acknowledges that there is no a separate payment from [Taxpayer] to [Bottling Operation] for the leased employees (i.e., drivers and mechanics), the Taxpayer contends that the cost of these leased employees is absolutely factored into the amount [Taxpayer] invoices [Bottling Operation] for the transportation services it provides. Furthermore, Taxpayer notes that there is no requirement in the statutes or regulations, or [Sales Tax Information Bulletin 12] for that matter, that requires a separate payment be made from [Taxpayer] to [Bottling Operation] for the leased employees as opposed to having the expense incorporated as an offset to the amount otherwise calculated to be due from [Bottling Operation] for the services [Taxpayer] provides.

Taxpayer explains that its invoices to Bottling Operation includes the routine expenses Taxpayer incurred such as fuel and repair costs along with the contractual 10 percent markup. Taxpayer provided a sample calculation of charges made to Bottling Operation. The calculation purportedly includes "wages (including fringe benefits), repairs, diesel, tires, depreciation, licenses, insurance . . . [and] the cost of diesel [fuel] . . ." In addition, the calculation accounts for "revenue for backhauling services that was initially received by [Bottling Operation] but are truly earnings of [Taxpayer] which performed the public transportation services."

Taxpayer also addressed the audit's contention that the transactions between itself and Bottling Operation failed to account for the management and administrative functions performed by Bottling Operation's personnel on behalf of Taxpayer. Taxpayer contends that Bottling Operation is not providing management or administrative services on behalf of Taxpayer. To that end, Taxpayer points to its "Operating Agreement" which provides:

The ordinary and day-to-day decisions concerning business affairs of [Taxpayer] shall be made by the Managing Member of the [Taxpayer].

In addition, Taxpayer explains that any "benefit it receives for any administrative support services provided by [Bottling Operation] is accounted for in the [ten-percent] markup percentage applied when computing the charge due to [Bottling Operation] for the public transportation services [Taxpayer] provides."

Taxpayer concludes as follows:

[Taxpayer] is an Indiana LLC authorized under federal and state authorities to provide public transportation services. [Taxpayer] transports goods primarily for [Bottling Operation], however on occasion [Taxpayer] will perform some back-haul activities for unrelated third-parties. [Taxpayer] is compensated by [Bottling Operation] for the services it provides. Additionally, [Taxpayer] does incorporate into the amount billed to [Bottling Operation] as an offset the cost of drivers and mechanics that it leases from [Bottling Operation]. [Bottling Operation] does not provide an[y] management services for Taxpayer as such function is performed by its Managing Member as required by the Taxpayer's Operating Agreement. Furthermore, although not required pursuant to any statute or regulation regarding the sales tax exemption for public transportation companies, Taxpayer accounts for any benefits received related to administrative activities provided by [Bottling Operation] personnel via the markup percentage that it charges [Bottling Operation] for providing such public transportation services. Therefore, based on the reasons stated above, Taxpayer respectfully contends that the Department erred in denying [Taxpayer] the sales and use tax exemption provided for under IC § 6-2.5-5-27(a), and thus requests the Proposed Assessments be canceled.

### **C. Hearing Analysis.**

As noted above, the assessment constitutes evidence that the Department's claim for the unpaid sales/use tax is valid, and that Taxpayer here bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c)

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). 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 *Rhoads v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Id.*; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468-69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. *Id.* A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

In general, all purchases of tangible personal property are taxable unless specifically exempt by statute. [45 IAC 2.2-5-61\(j\)](#). 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 under IC §§ 6-2.5-5 et seq. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101 (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

IC § 6-2.5-5-27 (in effect for tax years 2013) states:

Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property. See also 2013 Ind. Acts 4141, P.L. 277-2013, § 27 (codified at IC § 6-2.5-5-27(a)).

[45 IAC 2.2-5-61](#), in relevant part, provides:

- (a) The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property.
- (b) Definition: Public Transportation. Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation **unless it is in fact engaged in the transportation of persons or property for consideration** as defined above.
- (c) In order to qualify for exemption, the tangible personal property must be reasonably necessary to the rendering of public transportation. The tangible personal property must be indispensable and essential in directly transporting persons or property. **(Emphasis added)**.

In weighing Taxpayer's argument and the information provided along with Taxpayer's protest, the Department bears in mind that the public transportation exemption under IC § 6-2.5-5-27 - like all other exemption statutes - is "strictly construed" while assessment and collection statutes are liberally construed in favor of state's taxing authority. "In construing tax statutes a liberal rule of interpretation must be indulged in order to aid the taxing power of the state." *Dep't of Treasury of Ind. v. Dietzen's Estate*, 532, 21 N.E.2d 137, 139 (1939). The Department acknowledges - as does the audit - that Taxpayer made "an effort to show the full cost and income [for] providing transportation services to [Bottling Operation] . . . ." In effect, the Taxpayer and Bottling Operation resolved driver and mechanic costs by "truing up" their accounts and - if necessary - by Bottling Operation writing a check to Taxpayer. However, that amount simply covers the direct costs incurred by Taxpayer. As pointed out in the audit report, "[Taxpayer] bills and receives payment only for the direct costs they incur for fuel, tires, repairs, licenses, insurance, and depreciation . . . ." Taxpayer has failed to refute the audit's conclusion that "there is . . . no consideration being exchanged between the two entities for actual payroll cost of the drivers."

The relationship between Bottling Operation and Taxpayer becomes even more ambiguous when accounting for the administrative and management functions performed by Bottling Operation on behalf of Taxpayer. In this respect, Taxpayer has no management or administrative personnel of its own but relies entirely on Bottling Operation's employees to perform those functions. Taxpayer addresses this in two ways; Taxpayer states its own operating agreement calls for "day-to-day decisions concerning [its] business" affair to be performed by its "managing member." In this case, the managing member is Taxpayer's president. (Publicly available information indicates that Taxpayer's president is also Bottling Operation's president.) Taxpayer also states any remaining administrative functions performed by Bottling Operation personnel are accounted for in the 10 percent markup of the amount Taxpayer assesses each month for its driver and mechanic costs. In other words, Taxpayer assumes that day-to-day administrative costs go hand-in-glove with those purported labor costs. However, as noted in the audit report, Taxpayer admits that it has no "detailed records" accounting for the specific costs or labor expenses related to the administrative and supervisory functions performed on behalf of Taxpayer. In other words, all of Taxpayer's supervisory, management, personnel, billing, purchasing, dispatching, and compliance functions are subsumed into Bottling Operation's operation and are accounted for by means of a ten-percent markup not tied directly - or even indirectly - to those administrative and management costs.

#### **D. Conclusion.**

The arrangement between Bottling Operation and Taxpayer is not indicative of an arms-length business relationship between a public transportation company and a bottling company. The Department concludes that Taxpayer has failed to meet the criteria necessary to establish that it is a fully independent company providing public transportation services when it transports and delivers Bottling Operation's products. In short, Taxpayer has failed to demonstrate that it transports property belonging to others; Taxpayer does not qualify for the public transportation exemption pursuant to IC § 6-2.5-5-27.

#### **FINDING**

Taxpayer's protest is respectfully denied.

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