DEPARTMENT OF STATE REVENUE

04-20160685.LOF

Letter of Findings Number: 04-20160685
Indiana Sales and Use Tax
For Tax Years 2011 - 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 Indiana Department of Revenue'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 This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.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 supplier was entitled to a reduction of additional tax assessments for certain fixed assets. Indiana supplier was also entitled to an adjustment of additional taxable amounts for nonreturnable packaging materials and a waiver of penalty. Indiana supplier was entitled to a partial adjustment of additional taxable amounts for service contract transactions, and interest on the remaining assessment cannot be waived.

ISSUES

I. Use Tax - Imposition - Fixed Assets.

Authority: IC § 6-2.5-3-2; IC § 6-8.1-5-1; IC § 6-8.1-5-4; Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463,466 (Ind. 2012); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014); 45 IAC 2.2-3-4.

Taxpayer requests abatement of use tax assessed on five assets.

II. Use Tax - Nonreturnable Packing Materials.

Authority: IC § 6-2.5-5-9; IC § 6-2.5-5-9 (effective July 1, 2012); 45 IAC 2.2-5-16.

Taxpayer argues that certain of its purchases of wrapping materials should be exempt from use tax.

III. Use Tax - Service Contract.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-1; Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002); 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); 45 IAC 2.2-4-27; 45 IAC 2.2-4-2; Sales Tax Information Bulletin 2 (March 2013); Sales Tax Information Bulletin 2 (December 2006).

Taxpayer argues that it is not liable for tax on charges it incurred under an optional maintenance agreement.

IV. Tax Administration - Negligence Penalty.

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

Taxpayer requests that the Department abate the negligence penalty.

V. Tax Administration–Interest.

Authority: IC § 6-8.1-10-1.

Taxpayer protests the imposition of interest on the portion of its tax liability at issue.

STATEMENT OF FACTS

Taxpayer is a "leading supplier of maintenance, repair, and operations products to the managers and owners of

multifamily, hospitality and commercial properties as well as healthcare, and government facilities." Taxpayer was subject to an Indiana sales and use tax audit for tax years 2011 through 2014. The audit determined that Taxpayer purchased and used certain tangible personal property but did not pay sales tax at the time of the purchase of the property. As a result, Taxpayer was assessed additional use tax and negligence penalty.

Taxpayer agreed to and paid a portion of the assessment. Taxpayer protested the remaining assessment as well as the negligence penalty and interest. An administrative hearing was held. This Letter of Findings results. Further facts will be supplied as required.

I. Use Tax - Imposition - Fixed Assets.

DISCUSSION

Pursuant to the audit, the Indiana Department of Revenue ("Department") assessed use tax on purchases of fixed assets, including the purchase of five vehicles. Taxpayer notes that, during the audit, documentation showing that tax was collected when the vehicles were purchased was not available. This documentation was made available as a part of Taxpayer's protest.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463,466 (Ind. 2012). The retail merchant "must keep books and records so that the department can determine the amount, if any, of the [retail merchant's] liability for that tax by reviewing those books and records." IC § 6-8.1-5-4(a). Thus, a taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment 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.'" 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.

"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." IC § 6-2.5-3-2. "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." 45 IAC 2.2-3-4.

The audit assessed use tax on purchases of trucks made during the audit period for which no sales tax was paid. Taxpayer provided copies of each truck's Indiana Application for Certificate of Title ("Title") in which the amount of sales tax charged by Indiana is listed. Taxpayer also provided copies of the invoices for the purchase of each truck. Indiana sales tax charged per the invoices matched the sales tax listed on the Title for each truck. This is sufficient to show that Indiana sales tax was charged at the time each truck was purchased. Transactions involving these vehicles should be removed from the audit assessment.

The Department's supplemental audit will remove these transactions from the assessment.

FINDING

Taxpayer's protest is sustained.

II. Use Tax - Nonreturnable Packing Materials.

DISCUSSION

In reviewing Taxpayer's expenses, the audit noted that Taxpayer "maintains that certain of its purchases of [c]orner boards[,] [t]ape[, and] [p]oly bags qualify for the 'nonreturnable packages exemption' found in IC § 6-2.5-5-9(d)." The audit determined that these items did not qualify for the exemption as they do not "act to enclose or contain a product." As such, use tax was assessed on these purchases.

Taxpayer disagrees with this assessment noting that the items it fabricates and resells such as "aluminum window screen frames, doors, [and] cabinets, have "irregular and custom sizing." In order to properly package these

items, "corner board, stretch film, tape, and strapping are used to enclose the product." Taxpayer further explains that it "also encloses smaller items, such as springs and anchors, in poly bags based on a customer's specified order quantity. These poly bags are then placed in larger enclosures (boxes or envelopes) for shipment . . . ." As such, Taxpayer believes the "corner board, strapping, stretch film, tape, and poly bags are used in a nontaxable manner in accordance with Ind. Admin. Code 2.2-5-16(a)."

IC § 6-2.5-5-9, effective July 1, 2012, states:

> (a) As used in this section, "returnable containers" means containers customarily returned by the buyer of the contents for refuse as containers.
> (b) Sales of returnable containers are exempt from the state gross retail tax if the transaction constitutes selling at retail as defined in IC 6-2.5-4-1 and if the returnable containers contain contents.
> (c) Sales of returnable containers are exempt from the state gross retail tax if the containers are transferred empty for the purpose of refilling.
> (d) Sales of wrapping materials and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for:
> (1) selling the contents that the person adds; or
> (2) shipping or delivering tangible personal property that:
> (A) is owned by another person;
> (B) is processed or serviced for the owner; and
> (C) will be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in the owner's business of manufacturing, assembling, constructing, refining, or processing.

Prior to July 1, 2012, IC § 6-2.5-5-9 similarly read:

> (a) As used in this section, "returnable containers" means containers customarily returned by the buyer of the contents for reuse as containers.
> (b) Sales of returnable containers are exempt from the state gross retail tax if the transaction constitutes selling at retail as defined in IC 6-2.5-4-1 and if the returnable containers contain contents.
> (c) Sales of returnable containers are exempt from the state gross retail tax if the containers are transferred empty for the purpose of refilling.
> (d) Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds.

Under 45 IAC 2.2-5-16(a), "[t]he state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added . . . ." Further, "[t]o qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way: (A) [t]he purchaser must add contents to the containers purchased; and (B) [t]he purchaser must sell the contents added." 45 IAC 2.2-5-16(d)(1). "Returnable containers" are those which are "customarily returned by the buyer of the contents for reuse as containers; "nonreturnable containers" are "all containers which are not returnable containers." 45 IAC 2.2-5-16(e).

Thus, sales of nonreturnable containers or wrapping materials and empty containers are exempt if the purchaser uses the items as nonreturnable packages to which it adds contents which the purchaser sells. The audit makes the distinction that wrapping materials or containers qualify for the exemption only if they "act to enclose or contain a product." The audit explained its determination stating that:

> While corner boards protect the corners of the boxes, they are not enclosures. Tape used to seal boxes is not an enclosure. Straps used to reinforce the box are not enclosures for the items being shipped. While the items used in shipping may help to preserve the product during shipping, these items used in shipping are not the packaging that acts to enclose or contain the product.

In support of its protest, Taxpayer provided several pictures to demonstrate the use of the corner board, strapping, stretch film, tape, and poly bags. The pictures clearly show that the corner board, strapping, stretch film and tape are used to contain and package the items Taxpayer sells to its customers. These materials form a container that is customized to contain the product Taxpayer adds and cannot be reused. Taxpayer also uses small plastic "poly bags" to contain the springs and anchors that are a part of its products. The poly bags are placed in larger boxes or envelopes along with instructions and presumably other items packaged for shipping. The poly bags themselves contain the product and are not returned to the Taxpayer.

Taxpayer has established that the corner board, strapping, stretch film, tape, and poly bags in question were used as nonreturnable enclosures for selling tangible personal property. Taxpayer's use of these materials qualifies for the exemption under IC § 6-2.5-5-9.

The file will be sent back to audit so that these purchases will be removed from the assessment.

FINDING

Taxpayer's protest is sustained.

III. Use Tax - Service Contract.

DISCUSSION

As a part of its review of expenses, the audit noted that Taxpayer rents trucks from a third-party vendor ("Vendor"). The audit determined that the rental agreements were subject to Indiana sales tax. Taxpayer disagrees with this assessment and argues instead that the agreement is not a lease agreement, rather, it is "an optional service and maintenance agreement."

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). The person who sells the property in a retail transaction (a "retail merchant") "collect[s] the tax as agent for the state." 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).

The audit noted that Taxpayer pays a monthly fee to Vendor based on mileage driven. Vendor also charges Taxpayer for repairs to the trucks. The audit found these transactions to be subject to tax under 45 IAC 2.2-4-27, which states:

> (a) In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation [45 IAC 2.2] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction.
> (b) Every person engaged in the business of the rental or leasing of tangible personal property, other than a public utility, shall be deemed to be a retail merchant in respect thereto and such rental or leasing transaction shall constitute a retail transaction subject to the state gross retail tax on the amount of the actual receipts from such rental or leasing.
> **(c) In general, the gross receipts from renting or leasing tangible personal property are subject to tax. The rental or leasing of tangible personal property constitutes a retail transaction, and every lessor is a retail merchant with respect to such transactions. The lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts as agent for the state of Indiana. The tax is borne by the lessee, except when the lessee is otherwise exempt from taxation.**
> (d) The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe the transaction, is taxable.
> . . .
> (4) Supplies furnished with leased property. A person engaged in the business of renting or leasing tangible personal property is considered the consumer of supplies, fuels, and other consumables which are furnished with the property which is rented or leased.
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> (**Emphasis added**).

The audit's determination relies on the assumption that the arrangement between Taxpayer and Vendor is that of a lease or rental. At the hearing, Taxpayer provided a copy of the Vehicle Maintenance Agreement ("Agreement") at issue, noting that "this agreement **does not** include the rental/lease of vehicles. All of the vehicles under the . . . optional service and maintenance agreement are owned and operated by [Taxpayer]." This statement is verified

by the first line in the Agreement which reads, "[i]t is expressly understood and agreed that this is a contract of maintenance ONLY, and that [Vendor] has not and does not by these presents acquire any title to vehicles described in Schedule 'A' to this Agreement." Thus, it is apparent that the trucks in question are owned by Taxpayer and are not rented or leased from Vendor. As such, 45 IAC 2.2-4-27 does not apply to the Agreement.

Upon review of the Agreement, it is apparent that this is an arrangement for certain services, maintenance, and upkeep of vehicles which Taxpayer owns and Vendor maintains. At times, these services include the furnishing or use of tangible personal property. Taxpayer explains and a review of the Agreement confirms, that Vendor charges Taxpayer three different charges under the Agreement. Fixed charges "represent a fixed amount billed for each vehicle included in the [Agreement] and relate to general administration services provided by Vendor." Mileage charges "account for estimated preventive maintenance under the [Agreement]." "[Vendor] agrees to perform periodic maintenance, as well as, furnish operating parts and supplies necessary for the proper and efficient operation of the vehicle." Finally, Maintenance charges cover "unscheduled maintenance or repairs that do not fall under the [Agreement] (i.e. car accident repairs, flat tires, broken windows)."

The audit suggests, that "even if the charges are for maintenance, in accordance with the contract, since materials are guaranteed to be supplied, the entire charge would also be subject to sales tax." This statement is supported by Sales Tax Information Bulletin 2, which states:

> 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 necessarily 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. An explicit guarantee that tangible personal property will be provided under the contract is not required. What is important is that both the customer and the service provider are aware at the time the contract is executed that consumable items will be provided under the contract. However, the amount of tangible personal property supplied under the contract must be more than a de minimis amount. As a rule, the seller's purchase price or the sales price of the taxable items provided under the contracts must exceed 10[percent] of the total purchase price or the total sales price of the bundled products.
>
> For purposes of this bulletin, these contracts include the retail sales of two or more distinct and identifiable products for one non-itemized price and include repair labor as well as replacement parts, consumable items, and general services such as cleaning and inspecting that are provided on a periodic basis. These contracts include scenarios in which the specific repair and replacement parts and consumable items needed to maintain the equipment are provided at no additional cost or with a small deductible. Sales Tax Information Bulletin 2 (March 2013), 20130327 Ind. Reg. 045130126NRA; See also Sales Tax Information Bulletin 2 (December 2006) 20100804 Ind. Reg. 045100497NRA.

The Agreement involves a third-party (Vendor) who provides services to Taxpayer's vehicles. At times, the services include the furnishing of certain tangible personal property. There are only seven transactions at issue here; three Fixed charges, three Mileage charges and one Maintenance charge. Taxpayer provided copies of Vendor statements which show these charges. Fixed and Mileage charges are listed by Vendor location and truck. A total charge is shown, but there is no breakdown between services performed and tangible personal property used in the total. The Maintenance charge in question is simply listed as "Miscellaneous Maintenance Activity." There is a reference to an invoice and a tire, but no breakdown between the cost of the tire and the cost of labor. Taxpayer was able to provide a copy of the purchase order detail which showed the breakdown between the cost of the tire and labor. Of the total $384.70 charge, $219.05 or 57 percent was for the tire. Thus, according to the guidance provided in Sales Tax Information Bulletin 2, the amount subject to tax in the audit should be $219.05, not $384.70. The audit assessment will be adjusted to reflect just the cost of the tire.

As Fixed charges only represent charges for services, Taxpayer argues that these should not be taxable. This argument comports with the guidance provided in 45 IAC 2.2-4-2 which provides that "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."

Regarding Mileage charges, Taxpayer argues that Vendor was already audited by the Department for these charges and Vendor "affirmed that they in fact pay sales or use tax on the parts or property" included in these charges. The same is true for the single Maintenance charge. Taxpayer argues that because these transactions were included in Vendor's audit, they should be excluded from Taxpayer's audit as to avoid double taxation.

The Department cannot agree. Taxpayer has not provided proof to support its claim. Taxpayers are required to

provide documentation in support of their challenge that the Department's assessment is wrong. Without supporting documentation, Taxpayer's argument is poorly developed and non-cogent and is therefore subject to waiver. Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Further, the State is not barred from auditing the same transaction in separate taxpayer audits and the Department does not have a mechanism to determine if a given transaction has already been reviewed in another audit.

In summary, Taxpayer is not liable for tax on those charges which are Fixed charges as described above. Taxpayer is liable for tax assessed on the Mileage charges and the Maintenance charge, as adjusted to reflect only the purchase of the tire. If tax has already been collected and remitted to the Department by Vendor, it is up to the two parties to reconcile this between themselves.

FINDING

Taxpayer is sustained in part and denied in part.

IV. Tax Administration - Negligence Penalty.

DISCUSSION

Pursuant to the audit and the Department's policy, the Department imposed a ten percent negligence penalty for the tax years at issue. Taxpayer argues that it should not be subject to the penalty and requests an abatement.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

> (1) fails to file a return for any of the listed taxes;
> (2) 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;
> (3) incurs, upon examination by the department, a deficiency that is due to negligence;
> (4) fails to timely remit any tax held in trust for the state; or
> (5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department[.]

45 IAC 15-11-2(b) further states:

> "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 Department may waive a negligence penalty as provided in 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.

As the result of the audit, the Department assessed a ten percent negligence penalty in addition to the tax assessment. Taxpayer requested that the penalty be abated because "[d]uring the audit period, [Taxpayer] underwent many restructuring changes. Due to the changes, employee turnover was extensive. Despite the turnover and many changes beyond our control, [Taxpayer] remitted all taxes collected and filed the returns in a timely manner."

The audit noted that penalty was assessed due to the large percentage of under-reported use tax found in the audit. However, Taxpayer has been sustained on many of these issues. Specifically, Taxpayer's liability as it relates to fixed assets and nonreturnable containers has been abated as a whole while the assessments relating to the service contract has been abated in part. Thus, the majority of the penalty will be eliminated with these adjustments.

The remaining penalty relates to service contracts, specifically mileage charges. Because Taxpayer cannot show which portion of these charges relate to services and which part relates to tangible personal property, the penalty will not be waived. This should serve as incentive for Taxpayer to work with Vendor to obtain invoices that detail these charges.

FINDING

Taxpayer's protest is denied.

V. Tax Administration–Interest.

DISCUSSION

Taxpayer requests a reduction in interest corresponding to the assessments at issue. Indiana imposes interest on overdue tax pursuant to IC § 6-8.1-10-1(a), which states:

> If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on the person's return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

In the case of the interest assessed, the Department has no discretion to abate or adjust the amount of interested owed. IC § 6-8.1-10-1(e). Where Taxpayer has been sustained, a reduction in the assessment will result in a reduction of interest, otherwise, Taxpayer's request is denied.

FINDING

Taxpayer's protest of interest is denied.

SUMMARY

Taxpayer is sustained in relation to its fixed asset, nonreturnable containers and penalty protests. Taxpayer is also sustained in part as it relates to its service contract protest. Taxpayer's interest protest is denied.

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