DEPARTMENT OF STATE REVENUE

04-20170129.LOF

Letter of Findings Number: 04-20170129
Sales and Use Tax
For Tax Years 2013-15

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 did not produce sufficient documentation showing that its graphic design service was separate from other taxable services it listed on one invoice. Therefore, the entire transaction on the invoice became subject to sales tax. Additionally, Business did not prove that its equipment lease transaction was tax exempt. Therefore, the equipment is subject to use tax.

ISSUES

I. Sales Tax–Graphic Design Service.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-1-27; IC § 6-2.5-1-1; 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); Galligan v. Indiana Dept. of State Revenue, 825 N.E.2d 467 (Ind. Tax 2005); 45 IAC 2.2-4-1.

Taxpayer protests the imposition of sales tax.

II. Use Tax–Equipment Lease.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-10; IC § 6-2.5-5-3; 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 2.2-3-4.

Taxpayer protests the imposition of use tax.

STATEMENT OF FACTS

Taxpayer is a printing, graphics, and design shop located in Indiana. As a result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer provided graphic design services to its customers in 2013, 2014, and 2015 without collecting or remitting sales tax to the Department. The Department further found that Taxpayer's equipment lease was subject to use tax. The Department, therefore, issued proposed assessments for sales and use tax, penalty, and interest for those years specific to those items. Taxpayer timely protested the assessment of sales tax on its graphic design service and use tax on its equipment lease. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax–Graphic Design Service.

DISCUSSION

Taxpayer protests the assessment of sales tax on transactions in which it provided graphic design service to its customer which it states was not connected to producing tangible personal property ("TPP"). Taxpayer produces and sells signage, wraps, and other TPP. In addition, Taxpayer provides graphic design service connected to its printing service. With regard to some transactions which Taxpayer had with its customers, the Department considered charges for graphic design to be part of a single transaction which included both TPP and services,

when Taxpayer listed both items on its customer's invoice. Taxpayer disagrees with the Department's characterization and argues that the separate graphic design service is not subject to taxation.

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.

Next, IC § 6-2.5-4-1 provides the following:

> (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. For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.
> (f) Notwithstanding subsection (e):
> (1) in the case of retail sales of special fuel (as defined in IC 6-6-2.5-22), the gross retail income received from selling at retail is the total sales price of the special fuel minus the part of that price attributable to tax imposed under IC 6-6-2.5 or Section 4041(a) or Section 4081 of the Internal Revenue Code; and
> (2) in the case of retail sales of cigarettes (as defined in IC 6-7-1-2), the gross retail income received from selling at retail is the total sales price of the cigarettes including the tax imposed under IC 6-7-1.
> (g) Gross retail income does not include income that represents charges for serving or delivering food and food ingredients furnished, prepared, or served for consumption at a location, or on equipment, provided by the retail merchant. However, the exclusion under this subsection only applies if the charges for the serving or delivery are stated separately from the price of the food and food ingredients when the purchaser pays the charges. (Emphasis added).

In addition, IC § 6-2.5-1-27 provides 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."

Thus, in the audit report, the Department referred to 45 IAC 2.2-4-1, which provides:

> (a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant".
> (b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:
> (1) The price arrived at between purchaser and seller.
> (2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer. (Emphasis added).
> (3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to transfer of such property at retail. (Emphasis added).

The court in Galligan v. Indiana Dept. of State Revenue, 825 N.E.2d 467, 481 (Ind. Tax 2005), reiterated the provision of services as not taxable. However, that court also emphasized, in relevant part that:

> **Services, generally outside the scope of taxation, are subject to tax to the extent the income represents "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." Id. at 481(Emphasis in original)(**Emphasis added**).

That case also provided that invoices reflecting the combined costs of the material, the sales tax on the materials, and the cost of services indicate a unitary transaction. Id. at 481.

IC § 6-2.5-1-1 defines a unitary transaction, in relevant part, as follows:

> (a) Except as provided in subsection (b), "unitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.
> (Emphasis added).

Here, Taxpayer contends that some of its invoices list graphic design and printing, but that the graphic design services on that invoice are prepared for their customer's next print job rather than the printing services listed on the invoice. Upon delivery, this constitutes "services performed in respect to or labor charges for work done with respect to such property prior to transfer," as defined by 45 IAC 2.2-4-1(b)(2).

Next, Taxpayer argues that the graphic design service listed on its invoice may not be connected with other taxable products listed on the same invoice. Relevant to this case is Taxpayer's bookkeeping methodology. Given that Taxpayer mixes both transactions, distinguishing the taxable sale of property from the non-taxable sale of services is often difficult, as explained by the court in Galligan. Since Taxpayer listed several charges on its invoices, the Department was unable to discern separate transactions. Therefore, Taxpayer has not met the burden of proving the proposed assessment wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

II. Use Tax–Equipment Lease.

DISCUSSION

Taxpayer protests the imposition of use tax on its equipment lease from an Indiana-based lessor. Specifically, Taxpayer states that it purchased an envelope-stuffing machine which it used to fulfill its customers' mailing orders. The Department determined that the equipment leased did not produce tangible personal property ("TPP"), was subject to use tax, and therefore issued proposed assessments for years 2013, 2014, and 2015. Taxpayer disagrees with the Department's determination.

As provided above in Issue I and 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.

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.

In the audit report, the Department referred to 45 IAC 2.2-3-4, which provides:

> 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. (Emphasis added).

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.

Next, IC § 6-2.5-5-3(b) states:

> Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

Also, IC § 6-2.5-4-10 provides:

> (a) A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person other than for subrent or sublease.
> (b) A person is a retail merchant making a retail transaction when the person sells any tangible personal property which has been rented or leased in the regular course of the person's rental or leasing business.
> (c) Notwithstanding subsection (a), a person is not a retail merchant making a retail transaction when the person rents or leases motion picture film, audio tape, or video tape to another person. However, this exclusion only applies if:
> (1) the person who pays to rent or lease the film charges admission to those who view the film; or
> (2) the person who pays to rent or lease the film or tape broadcasts the film or tape for home viewing or listening.
> (Emphasis added).

Therefore, renting or leasing TPP is subject to sales tax and use tax in the same manner as the sale of TPP. It is therefore incumbent on a person claiming an exemption to establish that the rental is indeed eligible for the exemption.

Here, Taxpayer used the equipment to provide a service to its customers. The equipment counts Taxpayer's customers' correspondence in envelopes, seals the envelopes, and affixes postage to the envelopes. No new TPP is created. Since the equipment was used in conjunction with service and not the actual production process, the lease transaction did not qualify for an exemption, pursuant to IC § 6-2.5-5-3(b). Therefore, Taxpayer's equipment lease is subject to use tax, pursuant to 45 IAC 2.2-3-4. Taxpayer has not met the burden of proving the

proposed assessment wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

SUMMARY

Taxpayer is denied in Issue I regarding the imposition of sales tax on its graphics charges which were part of unitary transactions. Taxpayer is denied in Issue II regarding the imposition of use tax on its equipment lease for non-exempt equipment.

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