DEPARTMENT OF STATE REVENUE

04-20170604.LOF

Letter of Findings: 04-20170604
Gross Retail Tax
For the Years 2006 through 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Promotion Company failed to establish that it was not required to collect sales tax from its Indiana customers when it provided those customers promotional materials and imprinted t-shirts; the "true object" of the customer transactions was for the delivery of custom designed shirts; Promotion Company failed to provide or maintain the records documenting the nature of the customer transactions, and did not meet the ten-percent "de minimis" service provider exemption.

ISSUE

I. Gross Retail Tax - Promotional Items.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-4-1(b); IC § 6-8.1-5-1(b); IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); IC § 6-8.1-5-4(c); IC § 6-2.5-9-3; *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); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.,* 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 2.2-4-1; 45 IAC 2.2-4-2; 45 IAC 2.2-4-2(a)(4); 45 IAC 2.2-4-2(b).

Taxpayer argues that it was not required to collect sales tax from its customers because it provided those customers exempt services and did not sell them tangible personal property.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of providing various promotional materials such as t-shirts, pencils, pens, hats, and key tags. Taxpayer's customers acquire the promotional items from Taxpayer, arrange with Taxpayer to have the customer's logo imprinted on the items, after which the items are distributed to the final recipients such as members of community groups, schools, and members of other local organizations.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's books and records. The audit concluded that Taxpayer was in the business of selling its customers "tangible personal property" and should have collected Indiana sales tax from its customers. The audit resulted in an assessment of sales tax for the years 2006 through 2015.

Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Gross Retail Tax - Promotional Items.

DISCUSSION

The issue is whether Taxpayer was selling its customers "tangible personal property" such as hats and t-shirts or whether it was providing those customers exempt services.

Taxpayer solicits business from local organizations to purchase items which will have imprinted the organization's name, advertisement, or logo. The items are then distributed without cost to members of local schools, civic organizations, charitable entities, and the like.

The audit report describes business practice as follows:

> The [T]axpayer sells promotional items. They specialize in the sale of a t-shirt called [brand name]. The [T]axpayer creates an artistic illustration for the front of the shirt which includes important landmarks in the community. The [T]axpayer's sales representatives go into a community and solicit businesses to purchase a package which will include an ad spot for their business on the back of the [shirt]. There are various packages that the customer may select. The package the customer selects determines if they will have one ad spot on the back of the [shirt] or more than one ad spot. The ad package they purchase also determines how many [shirts] they will receive and the color and style. The more expensive packages include more shirts, colors, and fabrics. The most expensive package provides wicking shirts. The customer also has the option of purchasing additional shirts at the cost of seven dollars and fifty cents or nine dollars and fifty cents per shirt. For [Taxpayer's] customers that desire to advertise on the [shirt], the t-shirts are absolutely critical to the transaction. There would be no transaction but for the customer's desire to advertise on the t-shirt. Therefore, any services provided by [Taxpayer] are incidental to the purpose of the transaction - the sale of the [shirts]. The final selling price of the items sold reflect all costs associated with the production of that item which include design service charges. *The [T]axpayer is selling tangible personal property*. (*Emphasis added*).

The Department's audit concluded that Taxpayer was in the business of selling tangible personal property to its customers and should have collected sales tax when it sold the items to its Indiana customers.

As authority for its decision, the audit cited to 45 IAC 2.2-4-1 which provides as follows:

> (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.
> (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.

In its protest letter, Taxpayer explains that it is not in the business of selling promotional materials such as t-shirts. According to Taxpayer:

> [Taxpayer] is a marketing and advertising company which sells advertising [and] community promotion services in Indiana. These services are why customers hire us (as opposed to, say, a print-screening shirt company). We do not sell T-shirts or any other tangible personal property, and any T-shirts (or any other goods) that are used by us are used solely as an incident to the performance of our services to customers, and their price is inconsequential when compared to the value of our services.

Taxpayer states that the value of the shirts and promotional items is less than two percent of the price it charges its customers. In addition, Taxpayer states that it pays out-of-state sales tax when it purchases the original, unprinted shirts.

As authority for its position that it is not required to collect Indiana sales tax from its customers, Taxpayer cites to 45 IAC 2.2-4-2 which provides in part:

> (a) 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:
> (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.

As a threshold issue, it is the Taxpayer's responsibility to establish that the sales 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). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are 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).

Consequently, a taxpayer submitting a protest 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, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

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). IC § 6-2.5-4-1(b) further explains that a person sells at retail when he "(1) acquires *tangible personal property* for the purpose of resale; and (2) transfers that property to another person for consideration." (*emphasis added*). A retail merchant - such as Taxpayer - is required to "collect the tax as agent for the state." IC § 6-2.5-2-1(b). The retail merchant "holds those taxes in trust for the state and is personally liable for the payment of those taxes . . . ." IC § 6-2.5-9-3.

During the course of the Department's audit, Taxpayer was asked to provide documentation which established and defined the financial relationship between Taxpayer and its customers. According to the audit report, "[T]axpayer was given numerous opportunities to provide sales records for the audit years." Taxpayer provided the audit fifteen invoices for the year 2015 which the audit found insufficient to document approximately two million dollars in sales. Taxpayer explained that the fifteen invoices were entirely sufficient but that "no additional sales records [would be] provided by the [T]axpayer." In the absence of more detailed records, the audit cited to IC § 6-8.1-5-1(b) as authority for issuing an assessment based on the "best information available." The provision reads as follows:

> If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. *Id.*

At the outset, it should be noted that Indiana law requires Taxpayer to maintain records of its sales. It should be pointed out that "[e]very person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." IC § 6-8.1-5-4(a). In addition, IC § 6-8.1-5-4(c) provides that, "A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times." Contrary to Taxpayer's assumption, it is not entitled to "pick-and-choose" what records it will or will not provide the Department during the course of an audit investigation.

During the course of the audit, Taxpayer was asked to provide the contracts it enters into with its customers. Taxpayer stated it was unable to do so because it did not have agreements with those customers but that all customer agreements were executed on a "handshake" basis. Taxpayer was also asked to provide copies of its promotional materials, brochures, advertisements and the like. Taxpayer stated that it had none of these documents. In addition, Taxpayer was asked to provide samples of invoices issued its customers during the course of 2006 through 2015. Taxpayer stated it was unable to provide the requested invoices.

The Department is unable to agree that Taxpayer has met its burden of establishing that the assessment is wrong. As noted at the outset, IC § 6-8.1-5-1(c) provides, "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Instead, the only reasonable interpretation - based on the information available - is that the object of the transactions between itself and its customers is preparation and delivery of the promotional t-shirts. Taxpayer cannot reasonably argue that its

customers would be satisfied if Taxpayer utilized its expertise to design logos and designs but failed to provide the promised t-shirts.

In addition, Taxpayer argues that the cash value of the promotional t-shirts is less than two percent of the price charged its customers. Perhaps so, but Taxpayer has provided nothing which would verify its assertion. In making this argument, Taxpayer relies on and cites to 45 IAC 2.2-4-2. However, Taxpayer overlooks 45 IAC 2.2-4-2(b) which provides:

> Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

In Taxpayer's case, the design work is performed prior to delivering the t-shirts and promotional materials and - as required in the regulation - the cost of those design services must "be included in taxable gross receipts of the retail merchant." *Id.*

Taxpayer recognizes one of the other regulatory requirements. 45 IAC 2.2-4-2(a)(4) provides that a service provider must pay "gross retail tax or use tax upon the tangible personal property at the time of acquisition." Taxpayer states that it paid local sales tax when it acquired the unprinted shirts from its own vendors but has provided nothing which would back up that assertion.

Taxpayer is in the business of providing its customers t-shirts and other promotional materials, has not maintained the records and documents required under Indiana law, has not provided sufficient documentation to verify its factual assertions, is not entitled to rely on the ten-percent "de minimis" exception, and has failed to meet the statutory requirement of establishing that the proposed assessment was "wrong." IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

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