DEPARTMENT OF STATE REVENUE

04-20170994.LOF

Letter of Findings Number: 04-20170994
Sales and Use Tax
For Tax Years 2014-16

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 was able to provide documentation in support of its protest that it did not owe all of the sales and use taxes assessed. This documentation was sufficient to establish that some of the proposed assessments were incorrect. However, the documentation was not sufficient to establish that all of the proposed assessments were incorrect. Therefore, the proposed assessments were reduced but not eliminated.

ISSUES

I. Sales Tax–Assessment.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-11.5; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-7; IC § 6-2.5-4-1; IC § 6-2.5-5-8; IC § 6-2.5-8-8; IC § 6-8.1-5-1; IC § 9-32-13-7; *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 3.1-1-1; *Frame Station, Inc. v. Ind. Dept. of State Revenue*, 771 N.E.2d 129 (Ind. Tax 2002); *Howland v. Ind. Dept. of State Revenue*, 790 N.E.2d 627 (Ind. Tax 2003); Sales Tax Information Bulletin 2 (March 2013) *20130327 Ind. Reg. 045130126NRA*; Sales Tax Information Bulletin 28S (March 2017) *20170426 Ind. Reg. 045170210NRA*.

Taxpayer protests the assessment of sales taxes.

II. Use Tax–Demonstrator Vehicles and Capital Assets.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-3-5; 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 2.2-3-8; 45 IAC 3.1-1-1; Sales Tax Information Bulletin 2 (March 2013) *20130327 Ind. Reg. 045130126NRA*; Sales Tax Information Bulletin 28S (March 2017) *20170426 Ind. Reg. 045170210NRA*; Treas. Reg. § 1.132-5.

Taxpayer protests the imposition of use tax on demonstrator vehicles and capital assets.

III. Tax Administration–Negligence Penalties and Interest.

Authority: IC § 6-8.1-10-1; IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of penalties and interest.

STATEMENT OF FACTS

Taxpayer is an Indiana automobile retailer. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not collected and remitted sales tax on all taxable transactions it conducted as a retail merchant and that Taxpayer had not paid sales or use taxes on all taxable purchases it made as a consumer during the tax years 2014, 2015, and 2016. The Department therefore issued proposed assessments for sales tax, use tax, penalties, and interest for those years. Taxpayer protested a portion of the proposed assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax–Assessment.

DISCUSSION

Taxpayer protests the imposition of a portion of the proposed assessments which resulted from an audit of sales tax for the tax years 2014-16. The Department reviewed Taxpayer's records and determined that Taxpayer had not collected and remitted sales tax on all taxable transactions it conducted in its role as a retail merchant. Due to the number of transactions involved, the Department used a block sample and projection method to determine Taxpayer's compliance rate for collection of sales tax on vehicle deals. The Department conducted a separate block sample and projection method to determine Taxpayer's compliance rate for collection of sales tax on transactions dealing with parts, service, and the body shop. Taxpayer protests that the Department included non-taxable transactions in both of these compliance rate calculations. Taxpayer states that these transactions should not be subject to sales tax.

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.* (*Emphasis added*).

Therefore, retail merchants are required to collect sales tax on retail transactions, unless the transaction is exempt from sales tax.

Next, IC § 6-2.5-5-8 provides in relevant part:

> (a) As used in this section, "new motor vehicle" has the meaning set forth in IC 9-13-2-111.
> (b) *Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property*.
> (c) *The following transactions involving a new motor vehicle are exempt from the state gross retail tax:*
> *(1) A transaction in which a person that has a franchise in effect at the time of the transaction for the vehicle trade name, trade or service mark, or related characteristics acquires a new motor vehicle for resale, rental, or leasing in the ordinary course of the person's business.*
> *(2) A transaction in which a person that is a franchisee appointed by a manufacturer or converter manufacturer licensed under IC 9-23 acquires a new motor vehicle that has at least one (1) trade name, service mark, or related characteristic as a result of modification or further manufacture by the manufacturer or converter manufacturer for resale, rental, or leasing in the ordinary course of the person's business*.
> (3) A transaction in which a person acquires a new motor vehicle for rental or leasing in the ordinary course of the person's business.
> . . . .
> (*Emphasis added*).

Also, IC § 6-2.5-8-8(a) states:

> A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax.

> The person shall issue the certificate on forms and in the manner prescribed by the department. *A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase*.
> (*Emphasis added*).

The first four points of protest deal with the vehicle sales compliance calculations.
Taxpayer's first point of protest is in regard to sales it made to exempt customers. In support of its position, Taxpayer provided several properly executed exemption certificates. The relevant statute is IC § 6-2.5-3-7, which states:

> (a) A person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana, unless the person or the retail merchant can produce evidence to rebut that presumption.
> (b) *A retail merchant is not required to produce evidence of nontaxability under subsection (a) if the retail merchant receives from the person who acquired the property an exemption certificate which certifies, in the form prescribed by the department, that the acquisition is exempt from the use tax*.
> (*Emphasis added*).

Since Taxpayer was able to provide exemption certificates for several of its customers, under the provisions of IC § 6-2.5-3-7(b) Taxpayer is not required to produce evidence of nontaxability. Therefore, Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong. Transactions with the customers who provided exemption certificates will be removed from the Parts, Service, and Body Shop compliance calculations of sales tax due to the extent there are transactions with those customers in the sample population.

Taxpayer's second point of protest is in regard to the Department's imposition of sales tax on documentation fees charged by Taxpayer to its customers. Specifically, Taxpayer states that the fees were for services performed after the customers had taken possession and control of the vehicle. Taxpayer refers to IC § 9-32-13-7, which states:

> It is an unfair practice for a dealer to require a purchaser of a motor vehicle as a condition of the sale and delivery of the motor vehicle to pay a document preparation fee, unless the fee:
> (1) reflects expenses actually incurred for the preparation of documents;
> (2) was affirmatively disclosed by the dealer;
> (3) was negotiated by the dealer and the purchaser;
> (4) is not for the preparation, handling, or service of documents that are incidental to the extension of credit; and
> (5) is set forth on a buyer's order or similar agreement by a means other than preprinting.

Taxpayer states that IC § 9-32-12-7 clearly means that documentary fees cover both the sale and delivery of a vehicle. Particularly, Taxpayer argues that this statutory definition of coverage by a documentary fee of both sale and delivery of a vehicle fee means that the imposition of the documentary fee occurs post-transfer of the vehicle, which in turn means that the fee is not part of the taxable transaction. Also, Taxpayer refers to a November 9, 2015 statement issued by the Automobile Dealers Association of Indiana in which that association notified its members that the Indiana Attorney General's office had agreed not to investigate documentation fee complaints on fees of less than $200. Taxpayer believes that this also supports its position that documentation fees are not subject to sales tax.

The Department refers to IC § 6-2.5-4-1(e), which states:

> *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.

The Department has also published specific guidance on this matter. Sales Tax Information Bulletin 28S (March 2017) *20170426 Ind. Reg. 045170210NRA* provides on Page 4:

> **C. Documentation Fees**
> Documentation fees for services performed **after the transfer** of a vehicle or trailer are not considered part of the sales price and, therefore, are not subject to sales tax. Transfer of a vehicle or trailer takes place when the purchaser takes possession and control of the property and assumes the risk of loss, even though the title has not yet been transferred. *The dealer must maintain adequate records to show which services pertain to the fees charged and that the services were performed after the transfer of the vehicle or trailer to be exempted from sales tax*. Documentation fees charged for services performed **prior to the customer taking physical possession** of the vehicle or trailer are subject to sales tax.
> (**Emphasis in original**)(*Emphasis added*)(*See also* Sales Tax Information Bulletin 28S (April 2012) *20120530 Ind. Reg. 045120259NRA*).

Therefore, as explained by Sales Tax Information Bulletin 28S, whether or not documentation fees are subject to sales tax depends on verification by dealer records establishing when those fees were imposed on the customer.

The Indiana Tax Court has provided explanation regarding the timing of transfer of possession and the imposition of sales tax. In *Frame Station, Inc. v. Ind. Dept. of State Revenue*, 771 N.E.2d 129 (Ind. Tax 2002), the court stated:

> The transfer of property occurs when the buyer (1) agrees to buy property from a seller, (2) pays the purchase price, and (3) takes ownership and possession of the property. *See Webb v. Clark County*, 87 Ind.App. 103, 159 N.E. 19, 20-21 (1927). In this case, the evidence shows that customers pay the total price for their framed art when they pick it up, after all framing services have been performed. (Pet'r Exs. 1-3, 10, 13; Trial Tr. at 25, 37.) Therefore, Framemakers' services are performed prior to the transfer of property and constitute taxable retail unitary transactions under Indiana Code Section 6-2.5-4-1(e).
> *Id*. at 131.

Taxpayer refers to the Indiana Tax Court's decision in *Howland v. Ind. Dept. of State Revenue*, 790 N.E.2d 627 (Ind. Tax 2003), in which the court explained:

> As this Court has previously explained, services rendered in retail unitary transactions are taxable only if the transfer of property and the rendition of services are inextricable and indivisible. *Cowden & Sons Trucking, Inc. v. Indiana Dep't of State Revenue*, 575 N.E.2d 718, 722 (Ind. Tax Ct.1991) (citing *Indiana Dep't of State Revenue v. Martin Marietta Corp.*, 398 N.E.2d 1309, 1312 (Ind.App.Ct.1979)). In turn, the transfer of property and the rendition of services are inextricable and indivisible when the services are performed before the property was transferred to the transferee. See IND.CODE § 6-2.5-4-1(e) (providing that a retail unitary transaction is taxable to the extent that income from the transaction represents (1) the price of the property transferred and (2) 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*) (emphasis added); *Frame Station, Inc. v. Indiana Dep't of State Revenue*, 771 N.E.2d 129, 131 (Ind. Tax Ct.2002). Services provided after a transfer of property, however, indicate a divisible transaction in which the sale is taxed but the services are not. Accordingly, the issue in this case turns on whether Howland's installation services were performed before or after he transferred title to the satellite dish equipment to his customers.

Also, IC § 6-2.5-1-1 states:

> (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.
> (b) "Unitary transaction" as it applies to the furnishing of public utility commodities or services means the public utility commodities and services which are invoiced in a single bill or statement for payment by the consumer.

Taxpayer believes that the *Howland* court's explanation that services rendered in retail unitary transactions are taxable only if the transfer of property and the rendition of services are inextricable and indivisible confirms its position that the documentary fees are not subject to sales tax, since it listed those fees as a separate line item on its invoices.

Of equal relevance in the *Howland* decision is the court's reiteration of the requirement that, in order to be considered a unitary transaction, the transfer of property and the rendition of services are inextricable and indivisible when the services are performed before the property was transferred to the transferee. Services provided after a transfer of property, however, indicate a divisible transaction in which the sale is taxed but the services are not. The importance of the timing of transfer is the reason that the Department provided instructions in Sales Tax Information Bulletin 28S stating that the dealer must maintain adequate records to show which services pertain to the fees charged *and* that the services were performed after the transfer of the vehicle or trailer to be exempted from sales tax. Additionally, the Department notes that the decision in *Howland* sustained the Department's imposition of sales tax on unitary transactions.

In the instant case, Taxpayer provided samples of the invoices it gave to its customers. Those invoices list, in order: 1) Cash Price of Vehicle & Accessories; 2) State and Local Taxes (if any); 3) *Documentary Fee*; 4) License, License Transfer, Title, Registration Fee; 5) Total Price of Unit; 6) Total Credit; and 7) *Unpaid Cash Balance Due on Delivery*. The final entry is "Unpaid Cash Balance Due on Delivery", which indicates that delivery has not yet taken place. Taxpayer has provided no documentation to establish that possession and control of a vehicle by its customer occurred prior to the payment of the invoice. Therefore, since the final invoice amount which includes documentary fees is listed as "Unpaid Cash Balance Due on Delivery", the documentary fee was included with the total of "Unpaid Cash Balance Due on Delivery" and was imposed prior to delivery to the customer.

Taxpayer's argument that IC § 9-32-13-7 and the Indiana Attorney General's decision not to investigate documentary fees of $200 or less establishes that documentary fees cover both pre- and post-delivery activities and are therefore not subject to sales tax is not convincing. IC § 9-32-13-7 only provides a definition of what is and what is not an unfair business practice when a dealer imposes a documentation fee. It does not in any way define when that fee is imposed or the sales tax consequences of the imposition. Whether that fee is fair or unfair is not a relevant factor in determining whether or not it is subject to sales tax. The determining factor under IC § 6-2.5-4-1(e), which is the appropriate Indiana sales tax statute, is when the fee is imposed by a retail merchant upon its customer. This is the same explanation provided by the court in *Frame Station* and confirmed in *Howland*. In the instant case, the documentation shows that Taxpayer imposed the fees prior to delivery. Therefore, as explained above in Sales Tax Information Bulletin 28S, documentation fees charged for services performed prior to the customer taking physical possession of the vehicle or trailer are subject to sales tax. Taxpayer has not met the burden of proving this portion of the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

Taxpayer's third point of protest is in regard to seven transactions in which Taxpayer states vehicle delivery occurred outside Indiana's borders. Upon review during the audit, the Department found that the sales invoices did not list out-of-state delivery locations. In such cases, Department policy resulted in the Department sending letters to the seven customers asking for confirmation of the vehicle's delivery location. Of those seven letters, four were returned listing the delivery site as Taxpayer's Indiana dealership, one was returned to the Department as undeliverable, and the other two were never returned to the Department. The Department therefore concluded that Taxpayer's delivery forms were unreliable and considered that all seven transactions were Indiana transactions subject to Indiana sales tax.

Taxpayer states that it kept records sufficient to establish the delivery site of the vehicles and that the Department's determination of tax due on those sales is incorrect. The records to which Taxpayer refers consist of forms which Taxpayer prepared and which Taxpayer's customers signed and dated stating the location and time that the vehicles were delivered to the customers. Those forms list out-of-state locations as the delivery sites.

Regarding the transactions at issue, Sales Tax Information Bulletin (March 2017) 28S *20170426 Ind. Reg. 045170210NRA* provides that, "Terms and method of delivery must be indicated on the sales invoice. The dealer must document terms of delivery and must keep a copy of such terms of delivery to substantiate the interstate sale." Therefore, as provided by Sales Tax Information Bulletin 28S, to be relieved of the duty to collect Indiana sales tax, a taxpayer must provide a sales invoice or purchase order which lists the delivery terms in order to prove that the vehicle was sold outside of Indiana.

Taxpayer did not provide sales invoices which listed the terms and method of delivery. Taxpayer relies on non-invoice forms it supplied, signed and dated by its customers, to support its position. After review, the Department concludes that this documentation is not sufficient by itself to establish that the vehicles were delivered out-of-state pursuant to the published Department requirements listed in Sales Tax Information Bulletin 28S. Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) to prove the proposed assessment was incorrect.

Taxpayer's fourth point of protest is in regard to automotive protection packages sold concurrently with the sale of a vehicle. The Department considered the sale of these protection packages to constitute unitary transactions under IC § 6-2.5-1-1 since they called for the provision of TPP and services for a single price. Also, since these protection packages were sold with the vehicle, the Department determined that the TPP became part of the vehicle prior to transfer to the customer. As previously discussed, under *Frame Station* and *Howland*, all services conducted prior to transfer of TPP to the customer are part of the amount subject to sales tax.

Taxpayer argues that the value of the TPP involved in the protection packages is de minimis. Taxpayer also states that it receives the TPP free of charge and that no charge for TPP is passed on to its customers. The amount that is charged, according to Taxpayer, represents a service fee for the application of and warranty on the product applied. Taxpayer did not supply any documentation in support of this position.

The Department's position in the audit is that Taxpayer's customers purchase the protection package with the understanding that they are paying for TPP in the form of paint sealant, fabric sealant, leather sealant, etc., along with the application services for a single price. This is the definition of a unitary transaction under IC § 6-2.5-1-1. While Taxpayer disagrees with the Department's positon *[sic]*, without verifying documentation of Taxpayer's position, the Department cannot agree with Taxpayer's protest on this point. Taxpayer has not met the burden imposed under IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

The next three points of Taxpayer's protest are part of the Parts, Service, and Body Shop compliance calculations. Taxpayer's fifth point of protest is in regard to sales it made to exempt customers. As provided above for vehicles sales, Taxpayer provided several exemption certificates. Since Taxpayer was able to provide exemption certificates for several of its customers, under the provisions of IC § 6-2.5-3-7(b) Taxpayer is not required to produce evidence of nontaxability. Therefore, Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong. Transactions with the customers who provided exemption certificates will be removed from the Parts, Service, and Body Shop compliance calculations of sales tax due to the extent there are transactions with those customers in the sample population.

Taxpayer's sixth point of protest is in regard to prepaid maintenance contracts. The Department considered these contracts to be subject to sales tax on the basis that the contracts called for normal factory scheduled services such as a minimum of two oil and filter changes per year, tire rotation, plus inspection and adjustment of fluid levels. The Department therefore considered the maintenance contracts to constitute bundled transactions. Taxpayer argues that the services are clearly broken out on the invoices and that they collect sales tax on the parts supplied in the course of performing the services. Also, Taxpayer states that it sold zero maintenance contracts in 2014, three in 2015, and 18 in 2016. Of that total of twenty-one, Taxpayer states that ten had sales tax collected at the time of sale. Of the remaining eleven, Taxpayer states that sales tax was collected on the "back end" where materials were sold with labor.

The first relevant statute is IC § 6-2.5-1-11.5, which states:

(a) This section applies to retail transactions occurring after December 31, 2007.
(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[percent]) of the total purchase price or the total sales price of the bundled products; or
(3) includes both exempt tangible personal property and taxable tangible personal property:
(A) any of which is classified as:

(i) food and food ingredients;
(ii) drugs;
(iii) durable medical equipment;
(iv) mobility enhancing equipment;
(v) over-the-counter drugs;
(vi) prosthetic devices; or
(vii) medical supplies; and

(B) for which:
(i) the seller's purchase price; or
(ii) the sales price;

of the taxable tangible personal property is fifty percent (50[percent]) or less of the total purchase price or the total sales price of the bundled tangible personal property.

The determination under clause (B) must be made on the basis of either individual item purchase prices or individual item sale prices.

Next, Sales Tax Information Bulletin 2 (March 2013) *20130327 Ind. Reg. 045130126NRA* states on pages 2-3:

> 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.

Therefore, as explained by Sales Tax Information Bulletin 2, the Department generally considers maintenance contracts to be bundled transactions as defined by IC § 6-2.5-1-11.5 which are wholly subject to sales tax.

Taxpayer disagrees with the Department's conclusion and states that the prices of TPP which were included in the transactions were separately stated and were de minimis amounts. Taxpayer again refers to the Tax Court's *Howland* opinion which states, "As this Court has previously explained, services rendered in retail unitary transactions are taxable only if the transfer of property and the rendition of services are inextricable and indivisible" confirms its position that the maintenance contracts are not subject to sales tax, since it listed the TPP and labor as separate line item on its invoices. *Howland,* at 629. Taxpayer provided documentation in support of its position.

Specifically, Taxpayer provided an invoice dated December 9, 2016 in support of its argument that the maintenance contracts were not bundled transactions. The December 9 invoice lists the parts and labor for an oil change along with an entry stating, "Oil service was performed at this time. [Manufacturer] Prepaid." This, Taxpayer argues establishes that any TPP transferred in the course of providing service pursuant to a maintenance agreement is separately billed and taxed and that the maintenance agreements are not bundled transactions.

After review of the facts in the instant case, the Department does not agree with Taxpayer's position. The sample population for the sample and projection calculations only contains one maintenance contract transaction, dated July 27, 2016. For that specific transaction, the Department considered the sale of the maintenance contract to be a bundled transaction as defined by IC § 6-2.5-1-11.5(b) and taxable as describe in Sales Tax Information Bulletin 2.

The Department notes that there is no documentation tying the December 9 invoice to the July 27 maintenance agreement purchase. While the customer name is the same for both transactions, there is no information to establish that the July 27 maintenance agreement was for the vehicle which was serviced on December 9. Further, the December 9 invoice shows charges for labor and parts. It is not clear why there would be any charges for labor and parts for factory scheduled maintenance under a maintenance agreement such as the one purchased on July 27. In short, the Department is not convinced that the documentation supplied establishes that the Department's inclusion of the maintenance agreement purchased on July 27 was incorrect, as required by IC § 6-8.1-5-1(c).

Taxpayer's seventh point of protest is in regard to nitrogen installations. The Department found instances in which Taxpayer installed nitrogen in its customers' tires for a single price. The Department therefore considered these to be unitary transactions and subject to sales tax on the entire amount charged. Taxpayer protests that the nitrogen was generated out of the ambient air by a machine at the dealership. No tanks of nitrogen gas were involved. Therefore, Taxpayer argues, the installations were really just service provided for a charge and not subject to sales tax.

The Department disagrees with Taxpayer's protest on this point. The Department refers to IC § 6-2.5-1-27, which states:

> "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*).

Nitrogen, from whatever source it is derived, is "tangible personal property" as defined by IC § 6-2.5-1-27. Therefore, when nitrogen gas is installed in Taxpayer's customers' tires under a single order for a total combined price, it is a unitary transaction as provided by IC § 6-2.5-1-1. Taxpayer has referred to no statute, regulation, or court case which supports its position that nitrogen gas generated on-site is somehow not TPP. Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

In conclusion, Taxpayer met the burden imposed by IC § 6-8.1-5-1(c) and was sustained on its protest of sales to exempt customers. The Department will adjust the sample and projection calculations for both parts, service, and body shop sales and for vehicle sales to reflect that any sales to customers for whom exemption certificates have been supplied are not subject to sales tax. Taxpayer is denied on all other points of protest regarding the sales tax assessments. Taxpayer did not meet the burden imposed by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained in part and denied in part, as provided above.

II. Use Tax–Demonstrator Vehicles and Capital Assets.

DISCUSSION

Due to the large number of transactions in which Taxpayer purchased TPP for its own use as a consumer, the Department used a sample and projection calculation to determine Taxpayer's use tax compliance rate. The Department then applied that rate to Taxpayer's total purchases upon which use tax would have been due to arrive at a total of use tax which should have been remitted. The Department then subtracted the amount of use tax which Taxpayer did remit and arrived at its proposed assessments of additional use tax. Among the items upon which the Department determined use tax to be due were the use of demonstrator vehicles from Taxpayer's inventory by Taxpayer's employees.

The audit report states that Taxpayer did remit use tax for four months of 2016 on three vehicles used as demonstrators using the two percent method described in Sales Tax Information Bulletin 28S. The Department imposed use tax for the remaining thirty-two months of the tax years by averaging the use tax which Taxpayer did remit for four months of 2016. Taxpayer protests the imposition of use tax on the use of some of these vehicles used by a single employee. Taxpayer states that these vehicles included as taxable by the Department were actually demonstrator vehicles used by salesman and, as such, were exempt from use tax.

Taxpayer also protests the imposition of use tax on capital assets that were reviewed individually and were not part of the sample and projection calculations described above. Specifically, Taxpayer states that the capital assets were either not subject to sales and use taxes at all, or that the transactions had sales tax charged and paid at the time of the transactions. Therefore, Taxpayer argues, use tax is not due on these purchases.

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 as a complementary excise tax 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.

Also of relevance is IC § 6-2.5-3-5, which states:

> A person is entitled to a credit against the use tax imposed on the use, storage, or consumption of a particular item of tangible personal property equal to the amount, if any, of sales tax, purchase tax, or use tax paid to another state, territory, or possession of the United States for the acquisition of that property.

Use tax is due on the use, consumption or storage of tangible personal property in Indiana unless the taxpayer consuming the TPP is eligible for an exemption.

In Taxpayer's first point of protest regarding use tax, Taxpayer states that neither sales tax nor use tax was due on the use of its inventory vehicles by one individual. Specifically, Taxpayer argues that one of the dealership's owners was considered to be a salesman and that his use of those vehicles made them demonstrator vehicles which were not subject to sales or use tax. Taxpayer states that the individual spent at least fifty percent of his time engaged in selling cars for the dealership and that one hundred percent of his income is derived from selling cars directly or indirectly. Taxpayer refers to Indiana Sales Tax Information Bulletin 28S (March 2017) *20170426 Ind. Reg. 045170210NRA*, which states on pages 10 and 11:

> *Indiana sales and use taxes apply to both new and used automobiles and vehicles used as dealer demonstration vehicles*. "Automobile" or "vehicle" as used in this bulletin includes four-wheeled cars, trucks, and vans having a gross weight of not more than 8,500 pounds and motorcycles that are made primarily for use on public streets, roads, or highways. "Automobile" or "vehicle" does not include recreational vehicles. This bulletin is applicable to Indiana dealers as defined in IC 9-13-2-42(a) and all persons operating a vehicle with a dealer license plate. Vehicles made available to school driver-education programs or not-for-profit organizations are not subject to Indiana sales and use tax.
>
> Vehicles provided to other than full-time salespersons (e.g., family members, part-time salespersons, mechanics, managers of the dealership, and other individuals) are subject to use tax at a rate calculated as the Internal Revenue Service's optional business standard mileage rate times the Indiana sales tax rate. The vehicle dealer is required to pay the tax annually. *Dealers are required to keep records of each vehicle, the miles driven, and when use tax was paid for the miles driven*.
>
> *In lieu of accounting for the miles driven, the dealer can elect to report the use tax on 2 percent of the dealer's cost of purchasing the vehicle for each month (or fraction of a month) that the vehicle is used as a demonstrator, multiplied by the Indiana sales tax rate.*

The definition of "full-time salesperson" is synonymous with the definition provided in U.S. Treasury Reg. 1.132-5(o)(2), which requires that the salesperson spends at least one-half of a normal business day performing the function of a floor salesperson; works at least 1,000 hours per year; and derives 25 percent of his/her gross income from sales activities. Vehicles used by full-time salespersons for "qualified automobile demonstration use" are not subject to sales and use tax.

Vehicles that meet the criteria for "qualified automobile demonstration use" must:
- Be currently in the inventory of the dealership;
- Be available for test drives by customers during the normal business hours of the employer;
- Not contain personal possessions of any salesperson;
- Be driven within the dealer's sales area ("dealer's sales area" means an area within a radius of 75 miles from the dealership);
- Not be used by individuals other than the full-time salesperson (e.g., family members); and
- Not be used for personal trips.

Personal use of automobile demonstrators by full-time salespersons will be measured by the value reportable to the Internal Revenue Service or charged to the full-time salesperson in accordance with the provisions of Revenue Procedure 2001-56, times the sales tax rate.
(*Emphasis added*).

Treas. Reg. § 1.132-5(o)(2) states in relevant part:

(2) Full-time automobile salesman -
(i) Defined. The term "full-time automobile salesman" means any individual who -
(A) Is employed by an automobile dealer;
(B) Customarily spends at least half of a normal business day performing the functions of a floor salesperson or sales manager;
(C) Directly engages in substantial promotion and negotiation of sales to customers;
(D) Customarily works a number of hours considered full-time in the industry (but at a rate not less than 1,000 hours per year); and
(E) Derives at least 25 percent of his or her gross income from the automobile dealership directly as a result of the activities described in paragraphs (o)(2)(i) (B) and (C) of this section.
. . . .

In support of its position, Taxpayer states that the individual had 142 car sales directly attributed to him over the course of 2014, 2015, and 2016. Taxpayer did not provide documentation supporting this number. Neither did Taxpayer provide documentation supporting its position that the individual customarily spent at least half of a normal business day performing the functions of a floor salesperson or sales manager, directly engaged in substantial promotion and negotiation of sales to customers, customarily works a number of hours considered full-time in the industry (but at a rate not less than 1,000 hours per year), or derived at least 25 percent of his gross income from the automobile dealership directly as a result of the activities described in paragraphs (o)(2)(i) (B) and (C) of Treas. Reg. § 1.132-5(o)(2).

Neither did Taxpayer provide documentation to verify that the vehicles in question were available for test drives by customers during the normal business hours of the employer, did not contain personal possessions of any salesperson, were driven within the dealer's sales area (meaning an area within a radius of 75 miles from the dealership), were not used by individuals other than the full-time salesperson (e.g., family members), and were not used for personal trips. These criteria were listed by the Department in Sales Tax Information Bulletin 28S to inform taxpayers of what the Department would consider to qualify as demonstrator vehicles for Indiana sales tax and use tax purposes.

Without documentation to verify that the owner/employee's use of the vehicle qualified as the use of a demonstrator vehicle by a salesman, the Department cannot agree with Taxpayer's protest. As explained by Sales Tax Information Bulletin 28S, the Department requires that a dealership claiming use of its vehicles as demonstrators must keep records of qualifying use. Taxpayer has not provided such records and so has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

The other category of transactions which Taxpayer states are not subject to use tax are capital purchases. In the course of the audit, the Department reviewed Taxpayer's records and could not verify that either sales tax or use tax had been remitted on these transactions. In the course of the protest process, Taxpayer provided invoices to establish that sales tax was paid at the time of purchase on several of the capital asset transactions. For three

transactions, the installation of one wall and two gas furnaces, Taxpayer was able to produce sufficient documentation to establish that the purchases were actually improvements to realty. The relevant regulation is 45 IAC 2.2-3-8, which states:

> (a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.
> (b) *All construction material purchased by a contractor is taxable either at the time of purchase*, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt (see 6-2.5-5 [45 IAC 2.2-5]).

Along with invoices from the contractors who installed the additions to the realty of the dealership, Taxpayer provided documentation supporting its position that the contractors paid sales tax on the construction materials at the time it purchased the TPP. Therefore, Taxpayer has established that the contractor satisfied the requirements of 45 IAC 2.2-3-8 and so has met the burden imposed under IC § 6-8.1-5-1(c) of proving the proposed assessments wrong regarding the imposition of use tax on capital assets.

Of the remaining capital asset purchases, Taxpayer was able to provide invoices showing sales tax paid for: a Kyocera copier, two tables and eight chairs, a Dell server, an air compressor, a rotary hydraulic lift, Rhino spray equipment, a heavy workstation plus additional costs for the heavy workstation. One listed capital asset, an AC machine, did not have documentation supplied. Otherwise, Taxpayer has provided sufficient documentation to establish that all of the other listed capital assets had sales tax paid at the time of the transactions or that sales tax was not due at all. Therefore, Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) of proving the proposed assessments wrong for the eleven capital asset purchases for which documentation was supplied.

In conclusion, Taxpayer did not establish that the three vehicles were not subject to use tax. The Department's calculations for Taxpayer's use tax compliance rate will therefore not be recalculated. However, Taxpayer did establish that eleven out of twelve capital assets either had sales tax collected at the time of the transaction or were not subject to sales tax or use tax at all. Therefore, the Department will remove the amounts of use tax imposed on the eleven transactions for which documentation was provided.

FINDING

Taxpayer's protest is sustained in part and denied in part, as provided above.

III. Tax Administration–Negligence Penalties and Interest.

DISCUSSION

Taxpayer protests the imposition of penalties and interest. The Department notes that it is not permitted to waive interest, as provided by IC § 6-8.1-10-1(e). Taxpayer also protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> "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 standard for waiving the negligence penalty is given at 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.

Taxpayer protests the Department's assessment of penalties. Taxpayer states that the underpayment of sales tax and use tax was not intentional. After review of the documentation and analysis provided in the protest process, the Department does not agree with Taxpayer's position. While Taxpayer has been partially sustained on the imposition of sales tax and partially sustained on the imposition of use tax in Issues I and II above, it remains that Taxpayer had a significant amount of sales tax and use tax due for the Tax Years. It is not necessary for a taxpayer to intentionally fail to collect and/or remit the proper amount of taxes in order for such a failure to constitute negligence. Therefore, waiver of penalties is not warranted under 45 IAC 15-11-2(c). However, both penalties and interest will be recalculated after the base sales tax and use tax is recalculated to reflect the lower amount of those taxes due for the tax years.

FINDING

Taxpayer's protest to the imposition of penalties and interest is denied.

SUMMARY

Taxpayer is sustained in part and denied in part in Issue I regarding the imposition of sales tax. Taxpayer is sustained in part and denied in part in Issue I regarding the imposition of use tax. Taxpayer is denied in Issue III regarding the imposition of penalties and interest.

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