DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS: 01-0025
Sales and Use Tax
For the Tax Years 1997, 1998, and 1999

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ISSUES

I. Applicability of the State's Gross Retail Tax to Rental of Mailing Lists.

Authority: IC 6-2.5-3-2; 45 IAC 2.2-4-2; 45 IAC 2.2-4-2(b); 45 IAC 2.2-4-3; 45 IAC 2.2-4-3(a).

Upon rehearing, taxpayer argues that certain items, included within its invoices for the rental of mailing lists, are not subject to the state's gross retail tax.

II. Prospective Treatment of Gross Retail Tax Liability.

Authority: IC 6-8.1-3-3; City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax Ct. 1998).

Having determined that charges for the rental of mailing lists are subject to the gross retail tax, taxpayer argues that it is entitled to prospective treatment of any additional assessment.

III. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1(a); IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer renews its argument that it is entitled to abatement of the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer conducts industrial training seminars. In order to attract participants to those seminars, taxpayer sends information to targeted individuals. Taxpayer deals with a list broker to assemble the names of individuals who would be likely participants in its seminars. The list broker

acquires the raw address data from "list managers." The list broker then processes that raw data – sorting and assembling addresses which meet the taxpayer's specification and eliminating duplicative addresses – and transmits the completed address information to an independent mailing house.

The taxpayer originally protested the assessment of sales tax on the invoices it received from the list broker. The original Letter of Findings determined that the rental of the customized mailing lists was subject to the gross retail tax; that the taxpayer was not entitled to prospective treatment of the additional assessments; and that the taxpayer was not entitled to abatement of the ten-percent negligence penalty assessed at the time of the original audit.

The taxpayer submitted a request for rehearing in which the taxpayer maintained that it could present new evidence relative to the determinations made within the original Letter of Findings. The request for rehearing was granted, and this Supplemental Letter of Findings revisits certain of the issues.

DISCUSSION

I. Applicability of the State's Gross Retail Tax to Rental of Mailing Lists.

Taxpayer deals with a list broker to acquire lists of names which meet the taxpayer's specific criteria. The original Letter of Findings determined that the taxpayer's rental of mailing lists, delivered in the form of magnetic tape, was subject to the state's gross retail tax. The Letter of Findings found that the taxpayer contracted with the list broker for the purchase of "tangible personal property." Whatever services were performed by the list broker were subsumed within the cost of each mailing list invoice rendering the entire transaction taxable.

The invoices received by taxpayer from the list broker detail various costs. Those costs include: mailing addresses; data processing; inbound and outbound freight costs; and magnetic tape – the means by which the completed mailing address is transmitted to the independent mailing house.

The fact that the purchase of the mailing addresses is subject to the gross retail tax is uncontested. However, taxpayer now argues that the cost of the list broker's services can be differentiated from the cost of the mailing lists. According to taxpayer, the charges for those services are not subject to the gross retail tax.

Under IC 6-2.5-3-2, "[a]n 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."

List Broker's Service Charges: However, 45 IAC 2.2-4-2 distinguishes the sale of tangible personal property from the purchase of services which are not subject to the tax. The regulation states that "[p]rofessional 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." Clearly then, the bare purchase of a service does not fall within the ambit of the gross retail tax.

It is also apparent that the invoices, received by taxpayer from the list broker, differentiate charges for the mailing addresses from services which are performed as an adjunct to the delivery of those addresses.

However, even though the services are clearly delineated on the invoices, those service charges are also subject to the gross retail tax. The regulation states in relevant part "[s]ervices 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." 45 IAC 2.2-4-2(b). Accordingly, because the charges are made for services integral to preparation of the mailing addresses and are performed "prior to delivery" of the addresses, the cost of services – such as "data processing" – are subject to the gross retail tax.

Delivery Costs: The address broker included on the invoices presented to taxpayer the costs for inbound and outbound freight. Presumably the inbound freight costs are the costs of shipping the addresses from the list managers – the originators of the raw address data – to the list broker. The outbound freight costs are those costs incurred by the list broker in sending the processed lists to the independent mailing house. The list broker has passed along both the inbound and outbound freight costs to the taxpayer.

The inbound freight charges are subject to the gross retail tax because they are costs incurred by the list broker in acquiring, managing, processing, and preparing the address information. The regulation states "[s]eparately stated delivery charges are considered part of selling at retail and subject to sales and use tax if the delivery is made by or on behalf of the seller or property not owned by the buyer." 45 IAC 2.2-4-3(a). In effect, the inbound freight charges are integral to creation of the finished mailing lists and represent a portion of the costs incurred in preparing those completed lists.

The outbound freight costs are indicated on taxpayer's invoices as "shipping and handling" charges. These outbound freight costs do not fall within the ambit of any exception to the gross retail tax. *See* 45 IAC 2.2-4-3. The phrase "shipping and handling" charges indicates freight and preparation costs incurred by the list broker in forwarding the completed mailing lists to the independent mailing house and are merely one of the numerous costs incurred by the list broker. The audit properly determined that the outbound freight costs were subject to the gross retail tax.

Magnetic Tape: The list broker billed taxpayer for the cost of the magnetic tape used to transfer the completed address lists to the independent mailing house. Taxpayer argues that the cost of the magnetic tape represents a service performed by the list broker, on behalf of taxpayer, and that the cost is not subject to the gross retail tax. However, even if the cost of the magnetic tape somehow represents a "service," that "service" falls within the purview of 45 IAC 2.2-4-2(b). The list broker's transfer of the encoded mailing addresses to magnetic tape, the cost of the magnetic tape itself, and the cost incurred in shipping the magnetic tape to the independent mailing house are all "[s]ervices performed or work done in respect to property . . . performed prior to delivery . . . [and] included in the taxable gross receipts of the retail merchant." 45 IAC

2.2-4-2(b). The magnetic tape is analogous to the blank paper used to produce a book. There can be no dispute that a book publisher's blank paper costs – the means by which the written material is transferred – are properly included in the taxable price of the book. The mere fact that the publisher could potentially sever its blank paper costs, would not render those costs a non-taxable service.

List Broker's Markup Charge: Taxpayer argues that 20 percent of the mailing address costs are not subject to the gross retail tax. When taxpayer places an order with the list broker, the list broker turns to "list managers" to acquire unprocessed and unsorted mailing addresses. The list broker purchases – on behalf of taxpayer – certain of this raw data. It is then the list broker's responsibility to process, organize, and arrange that raw address data into the form specified by taxpayer. In the final invoice, the list broker passes along the costs of purchasing the raw data from the list mangers. In that final invoice, the list broker marks up its original costs by 20 percent. For example, if the list broker purchased $ 1,000 in raw data from a list manager, the list broker will charge the taxpayer $1,200 for that same data. The $1,200 is distinct from the additional costs charged for data processing, freight costs, and magnetic tape. Taxpayer argues that the 20 percent markup – in this example, $ 200 – represents a "service" performed by the list broker and is not subject to the gross retail tax. In effect, the taxpayer argues that it is entitled to accumulate the downstream "service" costs and to exclude those costs from the tax.

IC 6-2.5-3-2 imposes the tax "on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction . . . ." In taxpayer's situation, the previous Letter of Findings determined that the rental of the mailing lists constituted the acquisition of tangible personal property, and the transaction was subject to the gross retail tax. Indisputably, the price charged for the mailing lists represents an accumulation of various expenses. However, there is simply no legal basis upon which *any* taxpayer is entitled to parse out the components of a final purchase price, exempt those components which represent a service, and pay the tax on only those components which possess an inherent physicality. In the same way that the purchaser of an automobile must pay sales tax on the price of the automobile and not simply on the nuts, bolts, and sheet metal which form that vehicle, taxpayer is liable for use tax on the rental price *it* pays for the mailing lists.

FINDING

Taxpayer's protest is respectfully denied.

II. Prospective Treatment of Gross Retail Tax Liability.

Taxpayer argues that any additional assessment of gross retail tax should be given prospective effect only. Taxpayer states that it is entitled to prospective treatment because it was unaware of its gross retail tax liability in the past and that it would be inequitable for the Department to impose the tax "after-the-fact." Taxpayer argues that no one in the training seminar industry was aware of sales tax being imposed on the rental of mailing lists. Given the apparent novelty of attributing sales tax liability on the rental of mailing lists, taxpayer maintains that the Department had a responsibility to inform members of the training seminar industry of that potential liability.

Under IC 6-8.1-3-3, the Department is without authority to reinterpret a taxpayer's tax liability without promulgating and publishing a regulation giving taxpayer notice of that reinterpretation. IC 6-8.1-3-3(b) states that "[n]o change in the department's interpretation of a listed tax may take effect before the date the change is: (1) adopted in a rule under this section; or (2) published in the Indiana Register . . . ." However, taxpayer is unable to point to any change by the Department, in its interpretation or application of the gross retail tax, during the time in which taxpayer's liability accrued. Absent any indication that the Department has altered the tax regulations upon which the taxpayer depended, or that the Department has reinterpreted those regulations, the Department – under IC 6-8.1-3-3 – is without any authority to impose the gross retail tax assessment on a prospective basis. *See* City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax Ct. 1998).

Despite taxpayer's purported good faith past efforts to comply with the tax regulations, and despite taxpayer's assertion that "no one has ever heard of [mailing lists] being taxable," the Department is unable to accede to taxpayer's request for prospective treatment of the gross retail tax assessment.

FINDING

Taxpayer's protest, requesting prospective treatment of the gross retail tax assessment, is respectfully denied.

III. Abatement of the Ten-Percent Negligence Penalty.

The original Letter of Findings determined that the taxpayer was not entitled to abatement of the ten-percent negligence penalty.

IC 6-8.1-10-2.1(d) states that if a person, subject to the negligence penalty, imposed under IC 6-8.1-10-2.1(a) can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the Department, was due to reasonable cause and not due to willful neglect, the Department shall waive the penalty. 45 IAC 15-11-2(b) defines "negligence" as the failure to use reasonable care, caution or diligence as would be expected of an ordinary, reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard, or inattention to duties placed upon the taxpayer by the Indiana Code or Department regulations. Id.

In order to waive the negligence penalty, the taxpayer must prove that its failure to pay the full amount of its tax liability was due to "reasonable cause." 45 IAC 15-11-2(c). Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ." In determining whether reasonable cause exists, the Department may consider the nature of the tax involved, previous judicial precedents, previous Department instructions, and previous audits. Id.

At the rehearing level, the taxpayer has asked that the Department review the issue and agree to abatement of the penalty. The taxpayer's argument is based on its assertion that its failure to pay gross retail tax was not attributable to its carelessness, thoughtlessness, or inattention to duties

placed on it by the Indiana Code or the Department's regulations. Instead, the taxpayer was unaware of any potential liability and the Department failed to inform members of the training seminar industry of their potential liability for use tax.

Taxpayer fails to set out any basis entitling it to abatement of the negligence penalty. As 45 IAC 15-11-1 in relevant part states, "Ignorance of the listed tax laws, rules and/or regulations is treated as negligence."

FINDING

Taxpayer's protest is respectfully denied.

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