

**Letter of Findings Number: 04-20120708**  
**Use Tax**  
**For Tax Years 2009-11**

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**ISSUE**

**I. Use Tax—Imposition.**

**Authority:** Indiana Dep't of State Rev. v. AOL, LLC, 963 N.E2d 498 (Ind. 2012); IC § 6-8.1-5-1(c); IC § 6-2.5-2-1; [45 IAC 2.2-3-4](#); IC § 6-2.5-3-2; IC § 6-2.5-1-2; IC § 6-2.5-4-1; IC § 6-2.5-5-6; IC § 6-2.5-5-9; [45 IAC 2.2-4-2](#).

Taxpayer protests the imposition of use tax.

**STATEMENT OF FACTS**

Taxpayer is an Indiana business that receives materials from its customers, packages these materials and ships the packaged items to its customer's end users. As the result of an audit for the tax years 2009, 2010, and 2011, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax for items it purchased to package the items it received from its customer. The Department, therefore, issued proposed assessments for use tax and interest. Taxpayer protested the inclusion of certain items in years 2009-2011 and a hearing was held. An administrative hearing was conducted and this Letter of Findings results. Further facts will be provided as required.

**I. Use Tax—Imposition.**

**DISCUSSION**

Taxpayer protests including certain items in the assessment for use tax. Taxpayer claims that the assessment included packaging materials exempt from use tax. Taxpayer would receive bulk packages of materials from its customer and would transfer those materials to smaller, customized packages for Taxpayer's customer's clients. Taxpayer argues that these packaging materials are exempt from use tax because they were incorporated as a material part of a product Taxpayer assembled for sale. Taxpayer also claims that the assessment included nonreturnable packaging used to ship the packaging to Taxpayer's customer's clients should have been exempt from sales and use tax. Taxpayer argues that lumber which was used to make containers to ship packaged items is exempt because it adds contents to the containers and sells those contents. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5.1(c).

The 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).

When tangible property has not been subject to sales tax it may be subject to use tax, according to [45 IAC 2.2-3-4](#), which states:

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).

The use tax is imposed by IC § 6-2.5-3-2, which states:

- (a) 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.

(Emphasis added).

A retail transaction is defined in IC § 6-2.5-1-2:

- (a) "Retail transaction" means a transaction of a retail merchant that constitutes selling at retail as described in [IC 6-2.5-4-1](#), that constitutes making a wholesale sale as described in [IC 6-2.5-4-2](#), or that is described in any other section of [IC 6-2.5-4](#).

A retail transaction is further defined in IC § 6-2.5-4-1:

- (b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:

- (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.

(Emphasis added).

Taxpayer acquired packaging materials in a retail transaction and did not pay retail sales tax on those materials. Use tax was assessed for these packaging materials but Taxpayer argues that these materials fall within an exemption. Taxpayer argues that the packaging materials that it acquired to package the items it received from its customer are exempt under IC § 6-2.5-5-6, which states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

Taxpayer argues that IC § 6-2.5-5-6 applies because it acquired packaging materials that were a material part of Taxpayer's product: a packaged item. However, the Department determined that Taxpayer did not in fact sell a product but rather provided a service. Since the Department determined that Taxpayer provided a service, the Department also determined that Taxpayer should have paid sales tax on the purchase of those items.

The Department refers to [45 IAC 2.2-4-2](#), which states:

(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.

(b) 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.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

(Emphasis added).

Therefore, the value of tangible personal property transferred in the provision of a service must not exceed ten percent of the service charge in order for the exemption provided by [45 IAC 2.2-4-2](#) to apply.

Taxpayer states that it sold a product, but was unable to provide any documentation to establish that it ever took title to the materials which it packaged. Taxpayer states that it "takes possession" of the materials. The Department notes that Taxpayer has provided no documentation to suggest, let alone establish, that Taxpayer ever owns the materials. There are no invoices to show that it paid for the materials. Neither are there any invoices to show that it charged anyone for the materials.

Taxpayer states that the Indiana Supreme Court's decision in *Indiana Dep't of State Rev. v. AOL, LLC*, 963 N.E2d 498 (Ind. 2012), supports its position that it is a retail merchant selling at retail and that the materials used in the packages are eligible for exemption. In *AOL*, the Court wrote:

Here, we think the assembly houses and letter shops were selling at retail. The assembly houses and letter shops acquired tangible personal property when they took possession of the individual components. That they did so for the purpose of resale is clear not only from the fact that neither AOL nor any third-party contractors ever paid any sales or use taxes on the raw materials, but also—and more importantly—from the fact that the assembly houses and letter shops completely consumed the raw materials, regardless of who provided them, to produce a separate and distinct final product that previously did not exist at all. AOL may have had title in the raw materials, but it could not have title in the final products until they came into existence. As AOL paid consideration and received title to goods in which it previously had none, we think a sale of goods occurred. The assembly houses and letter shops transferred that property to a person for consideration, its changed form notwithstanding, when they mailed the CD-ROM packages and promotional materials to AOL's prospective and current members at AOL's request and in exchange for payment from

AOL.

Id at 504.

Taxpayer misunderstands the court's explanation in AOL. AOL and/or the assembly houses had purchased raw materials without paying either sales or use tax on those purchases. The assembly houses then, ". . . [C]ompletely consumed the raw materials, regardless of who provided them, to produce a separate and distinct final product that previously did not exist at all." Id. at 504. In the instant case, taxpayer did not consume the raw materials provided by its customer. Rather, Taxpayer repackaged the raw materials without any change in the character of those materials. Taxpayer did not produce a distinct final product. Also, the assembly houses and letter shops in AOL transferred the property to a person for consideration, its changed form notwithstanding, when they mailed the CD-ROM packages and promotional materials to AOL's prospective and current members at AOL's request and in exchange for payment from AOL. In the instant case, Taxpayer did not provide any evidence that it transferred the property to a person for consideration.

In conclusion, Taxpayer provided a service to its customer. Taxpayer did not produce a product. Taxpayer repackaged its customer's product. Taxpayer's reference to the decision in AOL does not support its protest. 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.

*Posted: 07/31/2013 by Legislative Services Agency*  
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