DEPARTMENT OF STATE REVENUE

04-20130477.LOF

Letter of Findings: 04-20130477
Use Tax
For the Years 2011 and 2012

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 This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUE

I. Sales/Use Tax – Imposition.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-1-2; IC § 6-2.5-1-5; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-1 et. seq.; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dep't of State Revenue v. Belterra Resort Indiana, LLC, 935 N.E.2d 174 (Ind. 2010); Gregory v. Helvering, 293 U.S. 465 (1935); Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570 (2d Cir. 1949), cert. denied, 338 U.S. 955 (1950); Horn v. Comm'r, 968 F.2d 1229 (D.C. Cir. 1992); Lee v. Comm'r, 155 F.3d 584 (2d Cir. 1998); 45 IAC 2.2-3-4; 45 IAC 15-5-7; Sales Tax Information Bulletin 28WC (August 2008).

Taxpayer protests the Department's assessments on purchases of nine (9) vehicles and one (1) watercraft, claiming that the purchases were either not subject to Indiana use tax or the Department's assessments were overstated.

STATEMENT OF FACTS

Taxpayer, an individual, resides in Indiana and maintains an Indiana driver's license. Taxpayer purchased nine (9) motor vehicles and one (1) watercraft without paying Indiana sales tax or use tax. They are: (1) a 1954 Kaiser Darrin Convertibles, (2) a 1956 Chev Bel Air, (3) a 1995 Dodge Viper, (4) a 1998 Corvette, (5) a 1999 Jaguar, (6) a 2004 Cadillac, (7) a 2005 Ford GT Coupe, (8) a 2007 Mercedes, (9) a 2009 Spyker Spyder, and (10) a 2011 Watercraft.

In 2013, the Indiana Department of Revenue ("Department") conducted an audit of vehicles and watercrafts purchased by Indiana residents and which were delivered/shipped into Indiana, but titled under a limited liability company that was incorporated in the State of Montana and no sales or use tax was paid. Pursuant to the audit, the Department determined that Taxpayer's purchases were subject to Indiana use tax. As a result, the Department assessed Taxpayer additional use tax, interest, and negligence penalty.

Taxpayer protested the assessments. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales/Use Tax – Imposition.

DISCUSSION

The Department imposed use tax on various vehicles/watercrafts Taxpayer purchased, based on the best information available at the time of the audit.

Taxpayer protested the assessments. First, Taxpayer admitted that the use tax was due on his purchase of the watercraft. Taxpayer, however, claimed that the Department's assessment on the estimated amount of $47,700 was overstated. Taxpayer stated that his actual purchase price was $42,296. Taxpayer also claimed that he was not responsible for the use tax on the vehicle purchases because those vehicles were titled under a limited liability company that was incorporated in the States of Montana ("Montana LLC") and thus were not required to be registered with the State of Indiana and not subject to Indiana use tax. Alternatively, Taxpayer asserted that the

Department's assessments were overstated because some of the Department's estimated purchase prices were higher than his actual purchase prices.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

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). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" 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." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Rhoade, 774 N.E.2d at 1048; USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466, 468 – 69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a); USAir, Inc., 623 N.E.2d at 468 – 69. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b) and (c); IC § 6-2.5-3-2(a).

Use of tangible personal property in Indiana could be exempt from Indiana use tax if the sales tax is paid or collected at the time of the purchase pursuant to IC § 6-2.5-3-4 and 45 IAC 2.2-3-4. There are also various tax exemptions available outlined in IC § 6-2.5-5-1 et seq. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 101 (internal citations omitted). Thus, in applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

During the administrative hearing, Taxpayer raised several issues related to its purchases from various sellers. This Letter of Findings addresses each issue, as follows:

A. Purchase of 2011 Watercraft.

The Department determined that Taxpayer purchased the 2011 watercraft at issue from an out-of-state dealer, in the amount of $47,700, and subsequently stored or used the watercraft in Indiana without paying Indiana sales/use tax. Taxpayer agreed that the sales/use tax was due on the watercraft, but claimed that the Department's assessment was overstated. Taxpayer maintained that the taxable selling price was $42,296, not $47,700. To support his protest, Taxpayer submitted a copy of the "Marine Purchase/Sales Contract."

As mentioned earlier, Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-2-1; IC § 6-2.5-3-2. The Indiana Supreme Court, in Indiana Dep't of State Revenue v. Belterra Resort Indiana, LLC, 935 N.E.2d 174 (Ind. 2010), explained that "[t]he use tax is complementary to the sales tax because it ensures non-exempt transactions that have escaped sales tax liability are nonetheless taxed. In fact, Indiana's use tax is primarily designed to reach out-of-state sales of tangible personal property that is subsequently used in Indiana." Id. at 177. (internal citations omitted).

IC § 6-2.5-1-5 (effective July 1, 2010 to June 30, 2013), in relevant part, provides:

> (a) Except as provided in subsection (b), **"gross retail income" means the total amount of consideration**, including cash, credit, property, and services, **for which tangible personal property is sold**, leased, or rented, **valued in money**, whether received in money or otherwise, without any deduction for:

(1) the seller's cost of the property sold;
(2) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
(3) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
(4) **delivery charges**; or

. . .

For purposes of subdivision (4), **delivery charges are charges by the seller for preparation and delivery of the property to a location designated by the purchaser of property, including but not limited to transportation, shipping**, postage, handling, crating, and packing.

(b) "Gross retail income" does not include that part of the gross receipts attributable to:
(1) the value of any tangible personal property received in a like kind exchange in the retail transaction, if the value of the property given in exchange is separately stated on the invoice, bill of sale, or similar document given to the purchaser;

. . .

(**Emphasis added**).

The Department's Sales Tax Information Bulletin 28WC (August 2008), 20081001 Ind. Reg. 045080728NRA, further addresses issues related to Indiana Sales & Use Tax on Watercraft & Boat Trailers and explains which charges are subject to tax, in relevant part, as follows:

INTRODUCTION

. . .

The selling price upon which the tax will be based will be the actual amount of consideration tendered for the watercraft after deducting all cash discounts and trade-in allowances. The deduction for trade-in allowance applies only to a "like-kind" trade and does not apply to other property, either personal or real, that is traded.

I. TAXABLE SELLING PRICE

The dealer's actual selling price, for which the dealer receives gross retail income, is the amount subject to sales tax.

A **manufacturer's rebate** is not an allowable deduction from the taxable selling price if the dealer receives payment for such rebate, as shown on the customer's purchase agreement. A manufacturer's rebate, as shown on the written purchase agreement, is a form of payment. It is not a reduction in the dealer's gross retail selling price.

A **manufacturer's price reduction** is considered deductible for sales tax purposes. This is because the manufacturer is actually reducing the selling price of the watercraft or trailer. The dealer does not receive the amount of the price reduction as consideration for the sale from the manufacturer.

A **dealer's price discount** is also considered deductible in determining the amount on which sales tax is charged. The selling price is reduced by the dealer's price discount. The dealer does not receive the amount of the price discount as consideration for the sale.

All types of discounts, regardless of the terminology used to describe the price adjustment, either remain as part of the taxable selling price or are deductible from the amount subject to sales tax based on whether the selling dealer receives "gross retail income" for the sale or lease.

Documentation fees for services performed **after the transfer** of a watercraft or trailer are not considered part of the sales price and, therefore, are not subject to sales tax. Transfer of a watercraft 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 watercraft or trailer to be exempted from sales tax. Documentation fees charged for services performed **prior to the customer taking physical possession** of the watercraft or trailer are subject to sales tax.

Like-Kind trade values are deductible in determining the amount subject to sales tax. An exempt trade must be of like-kind. This means only a watercraft may be traded for another watercraft or a trailer may be traded for another trailer. Any other type of trade is merely a payment (consideration) from the buyer, the value of which does not reduce the taxable sales price of the purchase.

The selling price upon which the tax is based for purposes of calculating the sales tax is indicated by the following examples:
(T =Taxable, Amount Subject To Tax; E = Exempt, reduces taxable selling price)

A.	**1. Boat Sticker Price**	**$12,000 T**
	2. Dealer Discount	**$ 500 E**
	3. Used Boat Trade	**$ 4,000 E**
	4. $1,000 Rebate Assigned as Down Payment by Purchaser	**$ 1,000**
	5. Taxable Selling Price	**$ 7,500**

In the above example, items number 2 and 3 reduce the selling price subject to sales tax. The dealer discount is deductible, as is the like-kind trade of a boat for a boat. The rebate in this example is used as a down payment but does not decrease the taxable selling price.
. . .
(**Emphasis in original**).

In this instance, Taxpayer asserted that his actual purchase price for the watercraft was $42,296 and he was only responsible for the use tax on $42,296. Upon reviewing Taxpayer's supporting documentation, however, the Department is not able to agree. First, Taxpayer's "Marine Purchase/Sales Contract" demonstrated that the total cash price of the watercraft at issue, including the optional equipment and documentation fee, was $60,648. Second, the "Marine Purchase/Sales Contract" showed that the seller imposed a $247.50 delivery charge, which was also subject to tax pursuant to IC § 6-2.5-1-5(a)(4). The "Marine Purchase/Sales Contract" further showed that Taxpayer was credited with a $12,599 "Trade-in Allowance." As a result, Taxpayer should have been responsible for the sales/use tax on the total amount of $48,296.50 ($60,648 plus $247.50 and minus $12,599). The Department actually under-estimated the selling price of the watercraft at $47,700. The fact that Taxpayer made a down payment of $6,000, which resulted in an "Unpaid [Balance] of Cash Sale Price" of $42,296.50, was irrelevant as to the total amount of consideration for which the watercraft was sold because the down payment "does not decrease the taxable selling price."

In short, the Department's proposed assessment determined the selling price subject to sales/use tax is $47,700. Since the sales tax was not paid, use tax is properly imposed.

B. Purchases of Various Vehicles.

Taxpayer claimed that he was not responsible for the use tax on the (1) 1954 Kaiser Darrin Convertible, (2) 1956 Chev Bel Air, (3) 1995 Dodge Viper, (4) 1998 Corvette, (5) 1999 Jaguar, (6) 2004 Cadillac, (7) 2005 Ford GT Coupe, (8) 2007 Mercedes, and (9) 2009 Spyker Spyder ("Vehicles at Issue") because the Vehicles at Issue were titled under the Montana LLC, that was incorporated in the State of Montana. Taxpayer stated that the Montana LLC was established to protect Taxpayer, individually, from personal liability for claims that might be made against him as he conducts his automobile collection business. Taxpayer asserted that the Vehicles at Issue were all acquired and registered under the Montana LLC, were acquired in isolated or occasional sales, and none are required to be titled, licensed or registered by the State of Indiana for use in Indiana. Taxpayer added that the Vehicles at Issue have not and "are not driven on the roads in Indiana." Thus, Taxpayer maintained that he was not responsible for the use tax on the Vehicles at Issue. To support his protest, in addition to a copy of the insurance policy, Taxpayer provided copies of Montana LLC's "Articles of Organization for Domestic Limited Liability Company," a "Certificate of Existence" issued by Montana's Secretary of State, as well as a January 31, 2011, Letter from the Montana Secretary of State to the Registered Agent and Organizer.

Upon review, Taxpayer's supporting documents represent the entire evidence of the Montana LLC's existence but there is no mention concerning the nature of the Montana LLC's business. The Montana LLC did not maintain meeting minutes, accounting books and records, assets, checking accounts, or any equivalent corporate records. The Montana LLC was not insured under any insurance policy and did not have any insurance coverage. Rather, Taxpayer purchased a "BUSINESS–MISC" insurance policy, in addition to his homeowner insurance policy, to cover the Indiana storage facility, owned by Taxpayer, where the Vehicles at Issue are stored. Taxpayer's supporting documentation also demonstrated that the activities of acquiring, transporting, storing, and using vehicles or watercrafts were primarily in Indiana. At the hearing, Taxpayer further stated that after he purchased the Vehicles at Issue, he would have the Vehicles at Issue transported to his Indiana storage facility, which is located at a place less than four (4) miles from where he resides.

This leads to consideration of the "sham transaction" doctrine, which is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a

legitimate corporate business purpose. Id. at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[T]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id. at 470.

The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570, 572 (2d Cir. 1949), cert. denied, 338 U.S. 955 (1950). "[T]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Comm'r, 968 F.2d 1229, 1236 (D.C. Cir. 1992). In determining whether a business transaction was an economic sham, two factors can be considered: "(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" Id. at 1237. (internal footnote omitted). The question of whether or not a transaction is a sham, for purposes of the doctrine, is primarily a factual one. Lee v. Comm'r, 155 F.3d 584, 586 (2d Cir. 1998).

In this instance, Taxpayer's supporting documentation demonstrated that Taxpayer conducted the business of acquiring, transporting, using, and subsequently storing the Vehicles at Issue in Indiana. The Vehicles at Issue were insured by Taxpayer in connection with his other insurance policies. The Montana LLC, solely owned and managed by Taxpayer, is the title owner of the Vehicles at Issue. Titling the Vehicles at Issue by the Montana LLC had a significant impact on Taxpayer's sales/use taxes because the sales tax was not collected at the time of the purchases, and the State of Montana does not impose sales/use taxes on the Vehicles at Issue. Even if the Vehicles at Issue were not driven on the Indiana public roads, they were stored in Indiana. Therefore, Taxpayer exercised the right or power of ownership over the Vehicles at Issue in Indiana and thus used the Vehicles at Issue in Indiana. Given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer was not responsible for the use tax pursuant to IC § 6-2.5-3-2. Since sales tax was not paid, use tax was properly imposed.

Alternatively, Taxpayer asserted that several purchases were made in 2010. The Department made the assessments on July 2, 2013 and thus the assessments were beyond the three-year statute of limitations.

Taxpayer is mistaken on the applicability of the statute of limitations. The Indiana Administrative Code, 45 IAC 15-5-7, in relevant part, explains:

> (a) [T]he statute of limitations for the assessment of a listed tax liability is three (3) years from the due date of the annual return (including extensions of time granted by the department) or the date on which the annual return is filed for the tax year, whichever is later. . . .
> . . .
> (f) The running of the statute of limitations for purposes of assessing unpaid taxes will not start if the taxpayer fails to file a return which is required by any listed tax provision. Also, a substantially blank, unsigned or fraudulent return will not start the running of the statute of limitations.
>
> (1) A substantially blank return is one which does not furnish all the information necessary to determine a taxpayer's liability for the tax in question. In order for a return to be complete enough to determine the taxpayer's liability, the information does not have to be correct. Any denotion by the taxpayer which clearly indicates a positive denial of liability for any tax listed on the tax form shall constitute a completed return. Thus, a return which has "zero," or "-0-" or "none" written on a given line is not substantially blank. Also, if a taxpayer makes a positive indication of liability on a line which constitutes a total of one or more taxes, a return is deemed to be completed for all such taxes even if the particular line for the tax(es) is left blank.
>
> (2) An unsigned return is one which does not have the original hand written signature of the individual taxpayer or corporate officer or their authorized designee. The return also must be dated.
> . . .

Accordingly, for purchases that are subject to Indiana sales/use tax, an individual taxpayer is required to report the purchases on either the Indiana Individual Income Tax Returns (IT-40 or IT-40EZ) or Form ST-115. Thus, for the purchases which Taxpayer claimed to be made in 2010, he would have reported on his 2010 Indiana Individual Income Tax Returns (IT-40 and Schedule 4: Other Taxes), which was due April 15, 2011, or filed a Form ST-115 after the purchases were made and subsequently transported into Indiana, in order for the three-year statute of limitations to be applicable. Taxpayer did neither and, thus, the statute of limitations is not applicable. Even if, assuming that Taxpayer did timely file his 2010 return, IT-40, reporting the use tax on the

purchases made in 2010, three years from the filing due date, April 15, 2011, is April 15, 2014. The Department's proposed assessments were made July 2, 2013, and thus were timely.

Finally, Taxpayer asserted that the Department's assessments were overstated because some of the Department's estimated purchase prices of the Vehicles at Issue were higher than his actual purchase prices. To support his protest, Taxpayer submitted documentation related to his purchases, which include, but are not limited to, copies of purchase invoices, checks, "Retail Certificate of Sale," Vehicle Order Form," or "Bill of Sale" to demonstrate the actual purchase prices.

Upon review, Taxpayer is correct that the Department's proposed assessments were based on the best information available at the time of the audit and were estimated. Taxpayer's supporting documentation demonstrates the actual purchase prices concerning the Vehicles at Issue. Thus, the Department's Audit Division is instructed to review the supporting documentation and revise the assessments on the purchase prices that are substantiated by Taxpayer's documentation.

In short, Taxpayer's protest under Subpart A, purchase of 2011 Watercraft, is respectfully denied. Taxpayer's protest under Subpart B, purchases of Vehicles at Issue, is sustained pending a supplemental audit review. The Department's Audit Division is instructed to review the supporting documentation submitted and recalculate the assessments as appropriate.

FINDING

Taxpayer's protest under Subpart A, purchase of 2011 Watercraft, is respectfully denied. Taxpayer's protest under Subpart B, purchases of Vehicles at Issue, is sustained pending a supplemental audit review. The Department's Audit Division is instructed to review the supporting documentation submitted and recalculate the assessments as appropriate.

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