DEPARTMENT OF STATE REVENUE

28930878.LOF

LETTER OF FINDINGS NUMBER: 93-0878 CSET
Controlled Substance Excise Tax
For Tax Periods: 1993

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

1. Controlled Substance Excise Tax – Imposition

Authority: IC 6-7-3-5; IC 6-8.1-5-1(b)

Taxpayer protests the assessment of Controlled Substance Excise Tax.

STATEMENT OF FACTS

Taxpayer was arrested for possession of marijuana. The Indiana Department of Revenue issued a record of Jeopardy Finding, Jeopardy Assessment Notice and Demand on September 2, 1993 in a base tax amount of $108,856.00. Taxpayer filed a protest to the assessment. A hearing on the protest was held by telephone on April 13, 2000. Taxpayer was represented by his attorney. Further facts will be provided as necessary.

DISCUSSION

IC 6-7-3-5 imposes the Controlled Substance Excise Tax on the possession of marijuana in the State of Indiana. Taxpayer has the burden of proving that the assessment is incorrect. IC 6-8.1-5-1(b). The Police Incident Report indicates that Taxpayer possessed the marijuana upon which tax was assessed. The U.S. Postal Inspection Service Crime Laboratory Examination Report verifies the amount of marijuana on which tax was assessed. Taxpayer did not present any evidence which would sustain his burden of proving that the assessment is incorrect. Therefore, the tax properly applies to Taxpayer in this situation.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

28940797.LOF

LETTER OF FINDINGS NUMBER: 94-0797 CSET
Controlled Substance Excise Tax
for Tax Periods: 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

1. Controlled Substance Excise Tax – Imposition

Authority: IC 6-7-3-5; IC 6-8.1-5-1(b)

Taxpayer protests the assessment of Controlled Substance Excise Tax.

STATEMENT OF FACTS

Taxpayer was arrested for possession of marijuana. The Indiana Department of Revenue issued a Record of Jeopardy Finding, Jeopardy Assessment Notice and Demand on September 12, 1994 in a base tax amount of $3508.00. Taxpayer filed a protest to the assessment. A hearing on the protest was held by telephone on April 10, 2000. Taxpayer requested additional time to submit additional evidence or pay a settlement. Further facts will be provided as necessary.

DISCUSSION

IC 6-7-3-5 imposes the Controlled Substance Excise Tax on the possession of a controlled substance in the State of Indiana. Taxpayer bears the burden of proving that the assessment of tax is incorrect. IC 6-8.1-5-1(b). The arresting officer's report and Indiana State Police Laboratory report indicate that Taxpayer was in possession of marijuana. Since Taxpayer did not offer any additional evidence to contradict the evidence of the file, Taxpayer did not sustain his burden of proving that the assessment was incorrect.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02970250.LOF

LETTER OF FINDINGS NUMBER: 97-0250
Adjusted Gross Income Tax
For Years 1992, 1993, and 1994

NOTICE: Under 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax – Investment Income as Non-Business Income: Mutual Fund Proceeds

Authority: IC 6-3-20; IC 6-3-1-21; IC 6-8.1-5-1; 45 IAC 3.1-1-29; 45 IAC 3.1-1-30; 45 IAC 3.1-1-59; Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980)

Taxpayer protests the auditor's determination that dividend income, received from taxpayer's mutual fund investment, is properly classified as business income.

II. Adjusted Gross Income Tax – Computation of Income Tax Addback: Taxes Based on Income

Authority: IC 6-3-2-1(b); IC 6-3-1-3.5(b); IC 6-3-1-3.5(b)(3); I.R.C. § 63

Taxpayer protests the auditor's determination that taxpayer did not properly compute Indiana adjusted gross income because taxpayer did not include in the computation of the income tax addback all taxes based on income expensed in computing federal income tax.

STATEMENT OF FACTS

Taxpayer is a wholly owned subsidiary of a German corporation. Taxpayer's principal production facilities are located in South Carolina. During the audit period, taxpayer had no Indiana location or operations. Taxpayer maintains inventory in the state on consignment or for further processing by unrelated operations. The inventory is eventually shipped to taxpayer's warehouse out of state or sold out of state by the consignor. Taxpayer manufactures automobile parts and car radios. Taxpayer's subsidiary groups operate vehicle repair shops, build high technology packaging machinery, manufacture small household appliances, and manufacture thermal and electro-chemical deburring and deflashing equipment for the plastics industry.

I. Adjusted Gross Income Tax – Investment Income as Business / Non-Business Income: Mutual Fund Proceeds

DISCUSSION

In September of 1987, taxpayer's executive vice-president received a First Eagle Fund of American prospectus. After reviewing the information, the vice president instructed the treasurer to wire transfer $1,000,000 in cash to purchase approximately 85,000 shares of the fund. Taxpayer has since maintained its long-term position in the fund for ten years. Taxpayer contends that the dividend income derived from the First Eagle Fund is non-business income for the purpose of computing Indiana Adjusted Gross Income Tax. Taxpayer argues that the dividend income arises from the acquisition and holding of a passive investment in a mutual fund unrelated to the taxpayer's primary business of manufacturing and distributing automotive component parts.

The auditor found that taxpayer had treated interest income from the First Eagle Mutual Fund as non-business income for two years of the audit period. The receipts were included in the denominator of the sales factor as filed by the taxpayer. The auditor determined that, because the interest income had been earned upon funds generated by taxpayer's business operations, the income should be treated as business income pursuant to 45 IAC 3.1-1-59.

IC 6-3-1-21 defines the term "non-business income" as "all income other than business income."

Under 45 IAC 3.1-1-59, interest income is non-business income if the intangible with respect to which the interest was received did not arise out of or was not created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible was not related to or incidental to such trade or business operations.

IC 6-3-1-20 defines "business income" as all "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations."

For the purpose of determining where interest was created in the "regular course" of taxpayer's business, (*See* 45 IAC 3.1-1-59, IC 6-3-1-20) the expression "trade or business" is not limited to the taxpayer's corporate charter purpose of its principal business activity. 45 IAC 3.1-1-30. A taxpayer may be in more than one trade or business and derive business therefrom depending but not limited to some or all of the following: (1) The nature of the taxpayers' trade or business. (2) The substantiality of the income derived from activities and transactions and the percentage that income is of the taxpayer's total income for a given tax period. (3) The frequency, number, or continuity of the activities and transactions involved. (4) The length of time the property producing income was owned by the taxpayer. (5) The taxpayer's purpose in acquiring and holding the property producing income. From the above language, it is apparent that the criteria to be used in determining a taxpayer's trade or business is not limited by what the taxpayer purports its business to be but rather on what the particular facts and circumstances show.

45 IAC 3.1-1-29 provides further guidance. The initial classification of income by common labels is of no aid in determining whether income is business or non-business income. Instead, "[i]ncome of any type or class and from any source is business income

if it arises from transactions and activity occurring in the regular course of a trade of business. Accordingly, the critical element in determining whether income is 'business income' or 'non-business income' is the identification of the transactions and activity which are the elements of a particular trade or business."

The significance of the business/non-business distinction lies in the method of calculating taxpayer's adjusted gross income tax. For purposes of determining that tax, if taxpayer's mutual fund income constitutes business income, that income is apportionable to Indiana. If the income is non-business income it is not allocable to Indiana because taxpayer is not commercially domiciled in Indiana.

Applying the five determinative factors provided in 45 IAC 3.1-1-30 yields the following results:

1) Taxpayer is in the business of manufacturing car parts, operating car repair shops, producing manufacturing equipment, and manufacturing small appliances. In contrast, the circumstances surrounding the initial decision to make the First Eagle Mutual Fund investment tend to support a conclusion that the decision to make this long term investment was outside of taxpayer's normal business practices and procedures. The investment decision was a unilateral executive decision, made without consideration of taxpayer's business aims or needs, and without regard to how the investment would necessarily affect taxpayer's business goals.

2) The $1,000,000 investment represents an investment of approximately 1% of taxpayer's annual taxable income.

3) Taxpayer's initial decision to make the investment represents one of the few "transactions" which occurred during the ten years taxpayer has maintained that investment. Except for presumptive periodic decisions to retain the investment, the nature of any mutual fund investment precludes the possibility that taxpayer managed, participated in, or played any decision making role in the day-to-day operation of the investment.

4) Taxpayer has maintained an uninterrupted investment in the First Eagle Mutual Fund for ten years.

5) Although taxpayer offered no specific purpose underlying its decision to invest in the mutual fund, the available information would tend to support a conclusion that the investment's purpose was ancillary to taxpayer's primary business goals.

Therefore, given the nature and purpose of taxpayer's business operations, the relatively small size of the investment, the passive role taxpayer played in managing the investment, and the long-term commitment taxpayer made to the investment, the circumstances surrounding taxpayer's mutual fund investment tend to support a conclusion that the interest derived from that investment is properly classified as non-business income.

45 IAC 3.1-1-59 Example 7 is instructive and would support that conclusion. In that example, a multi-state manufacturer purchased and maintained a portfolio of interest bearing securities for investment purposes. The interest from those securities was deemed non-business income. Similarly, taxpayer made an investment in securities, the investment was ancillary to taxpayer's business goals, and the investment was maintained without day-to-day participation on the part of taxpayer.

The burden of proving that the proposed assessment is erroneous rests with taxpayer. The auditor's adjustment is accorded prima facie validity. *See* IC 6-8.1-5-1. The Supreme Court places the burden of proof on the taxpayer to show by "clear and cogent evidence," Exxon Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207, 221 (1980), that "the income was earned in the course of activities unrelated to [those carried out in the taxing] state." Id. 223. Taxpayer has met its burden of demonstrating that the income derived from its mutual fund investment is properly classified as non-business income.

FINDING

Taxpayer's protest is sustained.

II. Adjusted Gross Income Tax – Computation of Income Tax Addback: Taxes Based on Income

DISCUSSION

Taxpayer protests the auditor's determination that taxpayer did not properly compute Indiana adjusted gross income because it did not include in the computation of the income tax addback all taxes on income expensed in computing federal income tax.

Indiana adjusted gross income tax is imposed upon the adjusted gross income of a corporation derived from Indiana sources. IC 6-3-2-1(b). Under IC 6-3-1-3.5(b), Indiana adjusted gross income, in the case of corporations, is same as taxable income as defined by I.R.C. § 63 and adjusted according to IC 6-3-1-3.5(b)(3). IC 6-3-1-3.5(b)(3) requires the addback of taxes based on or measured by income and levied at the state level.

In particular, taxpayer argues that taxes it paid in Arizona, California, Delaware, Georgia, Illinois, Iowa, Massachusetts, Michigan, Minnesota, New Jersey, Pennsylvania, South Carolina, Tennessee, and Virginia were taxes not assessed on the basis of taxpayer's income and, therefore, should be excluded from the computation of Indiana adjusted gross income tax. Taxpayer characterizes these taxes as either filing fees, or taxes based on capital stock, gross receipts, apportioned net worth, state property, payroll, or sales. To the extent that these individual state taxes were not based on measured by taxpayer's income, taxpayer's protest is sustained. Audit is requested to conduct a supplemental audit to verify that these taxes were not assessed on the basis of taxpayer's income.

FINDING

Subject to verification by audit, taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

04970369.LOF

LETTER OF FINDINGS NUMBER: 97-0369
Sales and Withholding Tax

Responsible Officer Liability
For Years 1994 through 1996

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Responsible Officer Liability – Duty to Remit Sales and Withholding Taxes

Authority: Ind. Code § 6-8.1-5-1; Indiana Department of State Revenue v. Safayan, 654 N.E.2d 270 (Ind. 1995)

The taxpayer protests the assessment of sales and withholding tax liability as a responsible officer.

STATEMENT OF FACTS

The taxpayer was an officer of an Indiana corporation that provided retail sales and service associated with hair styling. The taxpayer's husband was also an officer of the corporation. Insufficient sales and withholding taxes were remitted to the Department of Revenue for the period October 31, 1994 through August 31, 1996. In March 1995, the taxpayer and her husband divorced. A property settlement agreement was approved by the court in August 1995. The agreement provided that the husband would be responsible for all past, current, and future tax liabilities of the corporation. The Department assessed liability for the taxes to the taxpayer as a responsible officer. No administrative hearing has been held. This Letter of Finding is based entirely on the information and evidence contained in the Department of Revenue file.

I. Responsible Officer Liability – Duty to Remit Sales and Withholding Taxes

DISCUSSION

The taxpayer protests the assessment of sales and withholding tax as a responsible officer. Information and evidence submitted by the taxpayer, and contained in the Department of Revenue file, indicates that the taxpayer was an officer of the corporation. Information in the file also shows that the taxpayer was only minimally involved in the operation of the corporation and did not have responsibility for the financial affairs of the corporation, including retail sales and employee wages. "An individual is personally liable for unpaid sales and withholding taxes if she is an officer, employee, or member of the employer who has a duty to remit the taxes to the Department." Indiana Department of Revenue v. Safayan, 654 N.E.2d 270, 273 (Ind. 1995). Although the taxpayer was an officer of the corporation, she was not the officer with the duty to remit taxes to the Department.

"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." Ind. Code § 6-8.1-5-1(b). The taxpayer has provided sufficient evidence to prove that she is not a responsible officer and that, therefore, the proposed assessment is wrong.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

04-980298.LOF

LETTER OF FINDINGS NUMBER: 98-0298
Sales and Use Tax
For Tax Periods: 1994, 1995, and 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales Tax Adjustments – Sales Tax Billed for Unitary Transactions: Installation Charges

Authority: IC 6-2.5-1-1(a); IC 6-2.5-1-2(b); IC 6-2.5-2-1; IC 6-2.5-4-1(b); 45 IAC 2.2-1-1(a).

Taxpayer protests the imposition of sales tax on that portion of taxpayer's invoices purportedly attributable to installation charges.

STATEMENT OF FACTS

Taxpayer is the sole proprietor of a business which manufacturers and installs household and commercial cabinets. Taxpayer builds and installs cabinets primarily for customers in Indiana although some sales are made to customers located in Illinois.

I. Sales Tax Adjustments – Sales Tax Billed for Unitary Transactions: Installation Charges

Taxpayer protests the assessment of the gross retail tax on that portion of taxpayer's invoices purportedly attributable to the cost of installing cabinets. Taxpayer maintains that its invoices properly distinguished between the taxable charges for the sale of its cabinets and the non-taxable charges for the installation of those cabinets. The audit disagreed and proposed an additional assessment on that portion of the taxpayer's invoices for which sales tax had not been collected or remitted. The audit determined that taxpayer's invoices represented a combined lump sum charge and should be interpreted and assessed as a unitary transaction.

Under IC 6-2.5-2-1, the state imposes a state gross retail (sales) tax on retail transactions made in Indiana. A retail transaction, the prerequisite to the imposition of the tax, is the transfer, in the ordinary course of business, of tangible personal property for consideration. IC 6-2.5-4-1(b). Therefore, absent the transfer of tangible personal property, the transfer of services alone is not subject to the state gross retail tax.

However, the transfer of services is taxed if it is part of a retail "unitary transaction." IC 6-2.5-1-2(b). A retail "unitary transaction" is one in which items of personal property and services are furnished under a single order or agreement and for which a total combined charge or price is calculated. IC 6-2.5-1-1(a). A unitary transaction includes all items of property and services for which a total combined selling price is computed irrespective of the fact that the cost of services, which would not otherwise be taxable, is included in the selling price. 45 IAC 2.2-1-1(a).

At the hearing, the taxpayer produced sample invoices demonstrating the manner in which the taxpayer billed his customers. A typical customer invoice stated the cost of the various items for which the customer was being charged. This list might include items such as the base cabinets, cabinet tops, or special hardware. The cost of each item was separately listed and then subtotaled. At this point, the taxpayer would make a separate notation (described by taxpayer as a "memo item") stating that portion of the subtotal subject to tax and the applicable tax rate. After using those noted figures to calculate the amount of sales tax, taxpayer would add that amount to the previously determined subtotal in order to arrive at the final total owed by the customer. On the sample invoices the amount charged for sales tax was labeled as "tax" or "sales tax." Although taxpayer's invoices did not systematically differentiate between the cost of the finished cabinets and the installation charge, the total charged for the cabinets and the total charged for the installation can be determined precisely from the information given on each invoice.

The evidence presented by the taxpayer demonstrates that taxpayer's invoices do not represent unitary transactions but represent transactions in which the exempt and taxable costs of the installation and cabinets are properly distinguished.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

02990114P.LOF

LETTER OF FINDINGS NUMBER: 99-0114P
Income Tax
Fiscal Year December 29, 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the negligence penalty.

STATEMENT OF FACTS

The negligence penalty was assessed on an income tax assessment resulting from an audit conducted for the fiscal year ended December 29, 1994.

The taxpayer is a manufacturer of food flavoring with operations in the U.S. and foreign countries. The taxpayer has a manufacturing plant in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues they were compliant with Indiana tax regulations. The audit assessment dealt with a Federal RAR adjustment and the misapplication of throwback rules.

The taxpayer says they were compliant with regard to the Federal RAR adjustment in that the taxpayer and the auditor agreed

prior to the completion of the Federal audit that any Federal adjustment would be included in the Indiana audit report.

With regard to the throwback rules, the taxpayer says the misinterpretation happened as the taxpayer had a shortage of employees as a result of a merger.

The Department agrees with the taxpayer that the taxpayer was in compliance with regard to the Federal RAR adjustment. However, the majority of the assessment was a result of the misapplication of throwback rules. The Department feels the taxpayer was inattentive in that the taxpayer did not have enough employees to perform tax duties.

45 IAC 15-11-2(b) states, "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 Department finds the taxpayer was inattentive. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

04990285P.LOF

LETTER OF FINDINGS NUMBER: 99-0285P
Sales and Use Tax
Calendar Years 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the penalty assessed.

STATEMENT OF FACTS

The penalty was assessed on a use tax assessment resulting from a Department audit for the calendar years 1995, 1996, and 1997.

The taxpayer is in the landscape business. The taxpayer is an S-Corp owned by two Indiana residents. The company employs 40 to 50 people. The business operates year round with snow removal in the winter. There is one location that is in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the penalty should be waived as the error in the audit report was a result of unintentional misinterpretation of Indiana tax regulations and unintentional clerical errors.

45 IAC 15-11-2(b) states, "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 Department finds the taxpayer was inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

01990373.LOF

LETTER OF FINDINGS NUMBER: 99-0373 AGI
Adjusted Gross Income Tax
For Tax Period: 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

Adjusted Gross Income Tax – Imposition on Gambling Income

Authority: IC 6-3-2-1

Taxpayer protests the imposition of the adjusted gross income tax on gambling receipts.

STATEMENT OF FACTS

Upon review of Taxpayer's 1997 Indiana Adjusted Gross Income Tax return, the Indiana Department of Revenue disallowed Taxpayer's claimed gambling losses. Taxpayer protested the disallowance. More facts will be provided as necessary.

Adjusted Gross Income Tax – Imposition on Gambling Income

DISCUSSION

An adjusted gross income tax is imposed upon all Indiana residents. IC 6-3-2-1. During 1997 Taxpayer received income from gambling. Taxpayer reported that income on page one of his 1040. The gambling winnings were reflected in Taxpayer's Federal Adjusted Gross Income which was entered on line 1 of his IT-40. Taxpayer took a deduction for gambling losses on the federal itemized deductions schedule, Schedule A. Indiana does not recognize Schedule A itemized deductions. Indiana law does not allow a deduction for gambling losses.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990417P.LOF

LETTER OF FINDINGS NUMBER: 99-0417P
Sales and Use Tax
Calendar Years 1996, 1997, and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the negligence penalty.

STATEMENT OF FACTS

The negligence penalty was assessed on a sales and use tax assessment resulting from an audit conducted for the calendar years 1996, 1997, and 1998.

The taxpayer is an affiliate of several tanning parlor chains owned by the shareholder of this corporation. This corporation exists to purchase from primary suppliers, some of which will not directly sell to end users. The taxpayer is located in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the penalty should be waived as the taxpayer has been compliant with tax reporting over the years. In this audit, the error in the audit resulted from a confusing tax compliance policy that resulted from a shortage of employees.

45 IAC 15-11-2(b) states, "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 Department finds the taxpayer was inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

02990452P.LOF

LETTER OF FINDINGS NUMBER: 99-0452P
Income Tax
Fiscal Year August 10, 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the negligence penalty.

STATEMENT OF FACTS

The negligence penalty was assessed on an income tax assessment resulting from an audit conducted for the fiscal year ended August 10, 1994.

The taxpayer manufactures and distributes ductwork. On August 10, 1994, the taxpayer sold out to another company. The taxpayer has one location that is in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be waived. The penalty was assessed as the taxpayer did not file an amended income tax return within 120 days of completion of the Federal audit as required by Indiana tax regulations.

45 IAC 15-11-2(b) states, "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 Department finds the taxpayer was inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

04990559.LOF

LETTER OF FINDINGS NUMBER: 99-0559
Responsible Officer
Sales Tax and Withholding Tax
For Tax Periods: 1995-1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

ISSUES

1. Sales Tax – Responsible Officer Liability

Authority: IC 6-2.5-9-3; IC 6-8.1-5-1(b); Indiana Department of Revenue v. Safayan, 654 N.E. 2nd 270 (Ind.1995)

Taxpayer protests the assessment of responsible officer liability for unpaid sales taxes.

2. Withholding Tax – Responsible Officer Liability

Authority: IC 6-3-4-8(f); IC 6-8.1-5-1(b); Indiana Department of Revenue v. Safayan, 654 N.E. 2nd 270 (Ind.1995)

Taxpayer protests the assessment of responsible officer liability for unpaid withholding taxes.

STATEMENT OF FACTS

Taxpayer was an officer of a corporation which did not remit the proper amount of sales taxes and withholding taxes to Indiana. Taxpayer was personally assessed for the taxes and protested this assessment. Taxpayer protested the assessment. More facts will be provided as necessary.

1. Sales Tax – Responsible Officer Liability

DISCUSSION

The proposed sales tax liability was issued under authority of IC 6-2.5-9-3 which provides as follows:

An individual who:

(1) is an individual retail merchant or is an employee, officer, or member of a corporate or partnership retail merchant; and

(2) has a duty to remit state gross retail or use taxes to the department;

holds those taxes in trust for the state and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state.

The issue to be determined is whether or not Taxpayer had the statutory duty to remit the sales taxes. Taxpayer has the burden of proving that he did not have the statutory duty to see that the taxes are properly remitted to Indiana. IC 6-8.1-5-1(b).

Pursuant to Indiana Department of Revenue v. Safayan 654 N.E. 2nd 270 (Ind.1995) at page 273: "The statutory duty to remit trust taxes falls on any officer or employee who has the authority to see that they are paid. " Taxpayer submitted documentation which indicated that he was a minority shareholder in the corporation which owned and operated the restaurant franchises with unremitted sales tax liabilities. Another officer's resume indicated that the other officer oversaw all of the operations of the corporation. That officer also had the "ultimate responsibility" for the restaurants and oversaw accounts payable. Depositions and court documentation indicate that another officer used corporation funds on a regular basis to pay that officer's personal and family liabilities. Documentation also indicates that the Internal Revenue Service found that Taxpayer was not responsible for unpaid federal trust taxes arising from the Indiana restaurants involved in the subject assessments. Taxpayer's employment by the corporation was terminated August 6, 1997. His stock was transferred to another officer. Taxpayer has sustained his burden of proving that he did not have the statutory duty to see that the sales taxes were properly remitted to Indiana.

FINDING

Taxpayer's protest is sustained.

2. Withholding Tax – Responsible Officer Liability

DISCUSSION

The proposed withholding taxes were assessed against Taxpayer pursuant to IC 6-3-4-8(f), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest." The issue to be determined is whether or not Taxpayer was under a duty to remit the corporate withholding taxes to the state.

Pursuant to Indiana Department of Revenue v. Safayan 654 N.E. 2nd 270 (Ind.1995) at page 273: "The statutory duty to remit trust taxes falls on any officer or employee who has the authority to see that they are paid. " Taxpayer submitted documentation which indicated that he was a minority shareholder in the corporation which owned and operated the restaurant franchises with unremitted withholding tax liabilities. Another officer's resume indicated that the other officer oversaw all of the operations of the corporation. That officer also had the "ultimate responsibility" for the restaurants and oversaw accounts payable. Depositions and court documentation indicate that another officer used corporation funds on a regular basis to pay that officer's personal and family liabilities. Documentation also indicates that the Internal Revenue Service found that Taxpayer was not responsible for unpaid federal withholding taxes arising from the Indiana restaurants involved in the subject assessments. Taxpayer's employment by the corporation was terminated August 6, 1997. His stock was transferred to another officer. Taxpayer has sustained his burden of proving that he did not have the statutory duty to see that the withholding taxes were properly remitted to Indiana.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0120000099.LOF

LETTER OF FINDINGS NUMBER: 00-0099 AGI
Adjusted Gross Income Tax
For Tax Periods: 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

Adjusted Gross Income Tax – Imposition

Authority: IC 6-3-2-1; 26 U.S.C.A. Sec. 61(a); Thomas v. Indiana Department of Revenue, 675 N.E.2d 362 (Ind. Tax 1997); Snyder v. Indiana Department of Revenue, 723 N.E.2d 487 (Ind. Tax 2000)

Taxpayer protests the imposition of the adjusted gross income tax.

STATEMENT OF FACTS

The Indiana Department of Revenue issued Taxpayer a refund. After a determination that the refund was issued in error, the Indiana Department of Revenue assessed Indiana Adjusted Gross Income Tax, penalty and interest against Taxpayer. Further facts will be provided as necessary.

Adjusted Gross Income Tax – Imposition

DISCUSSION

An adjusted gross income tax is imposed upon all Indiana residents. IC 6-3-2-1.Taxpayer argues that he has no Indiana Adjusted Gross Income for 1997 and therefore does not owe any tax. Taxpayer notes that the Indiana Code borrows some of its definitions from the Internal Revenue Code. For instance, "gross income" is defined at IC 6-3-1-8 as having the meaning as defined by section 61(a) of the Internal Revenue Code." Section 61 (a) which states in part:

> Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items...

Taxpayer contends that since the word "wages" is not listed in Section 61, wages are not taxable income. Therefore he amended his federal return to enter "zero" on the line titled "Wages, Tips, other Compensation." He then entered his federal adjusted gross income of "zero" on his Indiana amended return. Following this erroneous logic, Taxpayer protested the assessment of additional tax, penalty and interest for 1997.

The Indiana Tax Court has disposed with arguments that wages do not constitute income. In Thomas v. Indiana Department of Revenue, 675 N.E.2d 362 (Ind. Tax 1997), the Tax Court stated:

> [e]ven assuming the validity of Thomas's legal framework, monetary payments made in exchange for labor are clearly severed from labor and received or drawn by the recipient for his separate use, benefit, or disposal.

In Snyder v. Indiana Department of Revenue, 723 N.E.2d 487 (Ind. Tax 2000), the Court specifically states at page 491 that "wages are income for purposes of Indiana's adjusted gross income tax." Taxpayer's income is subject to the Indiana Adjusted Gross Income Tax.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

4120000171.LOF

LETTER OF FINDINGS NUMBER: 00-0171 IRP
International Registration Plan (IRP)
For Years 1996, 1997, and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. IRP – Estimated Mileage

Authority: IRP 4010; IRP 5020

Registrant protesting auditor's assessment based on estimated mileage.

II. IRP – Classification of Registrant's Records

Authority: 1999 IRP Information Handbook; IRP 232

Registrant protests auditor's classification of his records as "Marginal."

STATEMENT OF FACTS

Registrant is in the business of selling and delivering sand, stone, and gravel. Inasmuch as registrant's base of operations is located on Indiana's border with an adjoining IRP jurisdiction, numerous jobs included multiple interstate deliveries. The auditor determined that registrant's records were inadequate for apportionment of mileage between the jurisdictions and registrant's records were classified as marginal by the auditor. Additionally; the auditor found no actual miles in Illinois despite miles being reported; consequently, registrant was assessed estimated Illinois mileage. Registrant is protesting these adjustments.

I. IRP – Estimated Mileage

DISCUSSION

Registrant reported actual miles in Illinois but the Department could not confirm these. Auditor assessed an apportionment fee based on estimated miles for Illinois. IRP 4010 states in relevant part:

If the operation of a registrant is expanded to include an additional IRP jurisdiction into which the registrant has not generated miles during the previous mileage reporting period, the base jurisdiction shall calculate the mileage percentage for the added jurisdiction(s) in the following manner:

The estimated miles for the jurisdiction(s) to be added are totaled. Add the Total Estimated Miles to the Total Fleet Miles to obtain the new Total Fleet Miles. The estimated miles are then divided by the New Total Fleet Miles to obtain the mileage percentage for the added jurisdiction(s).

….

Additionally IRP 5020 states in relevant part:

…

If a registrant seeks to apportion its vehicles in a jurisdiction where there was no mileage experience in the previous mileage reporting period, apportionment shall be permitted for one year by including the estimated miles in the denominator of the apportionment factor (total fleet miles) and shall be permitted for a second consecutive year if there are no actual operations in the mileage reporting year.

…

Registrant reported actual miles in Illinois, which the audit could not confirm. Registrant did receive IRP authorization for Illinois. As noted by the above citations, the IRP agreement contemplates such arrangements and inasmuch as registrant did receive the benefit of IRP authorization for travel in the state of Illinois, registrant cannot argue *ex post facto* that his failure to avail himself of said benefit relieves him of the responsibility of payment for it.

FINDINGS

Registrant protest denied.

II. IRP – Classification of Registrant's Records

DISCUSSION

The issue is based on IRP 232, which states:

"Operational Records" means documents supporting miles traveled in each jurisdiction and total miles traveled such as fuel reports, trip sheets and logs.

The audit and protest both referenced the 1999 IRP Information Handbook as supporting their position. The reference on record keeping requirements is found on page 21, which states in relevant part:

Your operational records must be documents that support the miles traveled in each jurisdiction, and the total miles traveled.

Registrant protested the classification of his records based on the theory that a "A driver going in and out of a state on numerous trips in one day does not have time to stop and record the mileage each time." Registrant's protest letter of March 3, 2000. Without commenting on the merit of this argument, the auditor's determination of marginal records and recommendation did not require these actions by the driver. The auditor's report stated the registrant's "recordkeeping was evaluated as marginal due to the fact that all IVMR's (Individual Vehicle Mileage Records) did not have information that would allow for routing of miles." and in "the IVMR's the number of trips to the various destinations was not listed." IRP audit page 2.

If the registrant's records had included either route information or number of trips, a calculation of the miles traveled in each jurisdiction would have been possible. Absent information on both of these variables, no means exist to make a determination of the miles traveled in each jurisdiction. Consequently, the classification of the records as marginal was supported by the audit findings.

FINDINGS

Registrant protest denied.

DEPARTMENT OF STATE REVENUE

0220000198.LOF

LETTER OF FINDINGS NUMBER: 00-0198
Gross, Adjusted Gross and Supplemental Net Income Tax

For the Period 1996 through 1999

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

Gross, Adjusted Gross, and SNIT – Unrelated Business Income

Authority: IC 35-45-5-3; IC 6-2.5-5-25; IC 6-2.1-3-23; IC 6-3-2-3.1(a); IC 6-3-1-17(a); 45 IAC 3.1-1-68

The taxpayer protests the imposition of gross, adjusted gross, and supplemental net income tax on proceeds from illegal gambling machines.

STATEMENT OF FACTS

As a result of a charity gaming investigation conducted by the Department's Criminal Investigation Division, and an interview with the taxpayer's Quartermaster, four (4) "cherry master" illegal gambling machines were discovered in the taxpayer's location.

Gross, Adjusted Gross, and SNIT – Unrelated Business Income

DISCUSSION

Under Indiana Code section 35-45-5-3 the four (4) gambling machines operated in taxpayer's establishment constitute illegal gambling. Proceeds from illegal gambling are considered unrelated business income and subject to Indiana gross, adjusted gross, and supplemental net income tax. The amount of gross income from illegal gambling machines is estimated yearly at $104,000 per machine. However, the Department only attributed $26,000 per machine for a total of $104,000. As a result, the amount of tax due and owing is $4,030 per year.

First, the taxpayer contends that the machines are not illegal and are for amusement purposes only. Second, taxpayer protests the imposition of gross, adjusted gross, and supplemental net income tax on proceeds from the machines. Third, the taxpayer states that the amount of money attributable to the machines was significantly less according to their records.

According to the Department's criminal investigation division, the four (4) gambling machines found in taxpayer's establishment were what the industry calls "cherry master" machines.

IC 35-45-5-3 provides in pertinent part:

> A person who knowingly or intentionally: … (3) maintains, in a place accessible to the public slot machines, one-ball machines or variants thereof… commits professional gambling, a Class D felony.

The Department determined that activities of taxpayer were unrelated to taxpayer's exempt purpose. Exemption from tax for exempt organizations is tied to the gross income tax provisions with respect to exempt organizations. IC 6-2.5-5-25. As provided under IC 6-2.1-3-23, exempt organizations are not entitled to exemption from gross income received by a taxpayer that is derived from an unrelated trade or business, as defined in Section 513 of the Internal Revenue Code. Thus, the Department's determination was guided by I.R.C. § 513, which provides, in part, the following:

> …The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501.

Pursuant to IC 6-3-2-3.1(a) and IC 6-3-1-17(a), the Indiana General Assembly has expressly adopted the Code's tax treatment, with respect to Code section 501(c) organizations, for purposes of the Indiana adjusted gross and supplemental income tax analysis. Moreover, the Department's rule 45 IAC 3.1-1-68 defines an unrelated trade or business under the same guidelines as Code section 513, and the rule also subjects any unrelated business income to the Indiana taxes. Additionally, the rule cites taxpayers to Code sections 511 through 515 for guidance in determining whether income is subject to the taxes.

The taxpayer, in support of its protest, provided collection reports from June through December of 1999. These collection reports consist of carbon copy receipts showing the date, year, taxpayer's name, the net amount to divide, the merchant's share, and the balance due the operator. The receipts are signed by a representative of the taxpayer and the individual servicing the machines. The receipts allegedly show the following dates and net amounts for the four machines: 6-6, $400; 6-7, $164; 6-12, $450; 6-19, $300; 6-21, $500; 6-28, $400; 7-26, $100; 8-2, $300; 8-9, $506; 8-16, $108; 8-23, $166; 8-30, $246; 9-7, $686; 9-13, $508; 9-20, $450; 9-27,$504; 10-4, $300; 10-11, $450; 10-25, $200; 10-25, $300; 11-1, $770; 11-8, $250; 11-15, $450; 11-22, $100; 11-29, $150; 12-6, $450; 12-13, $1000; 12-20, $250; 12-27, $250.

According to the taxpayer, the reports show their one-half (1/2) share of the gross proceeds for the seven (7) months of 1999 to be $12,540 (on average $1,791.42 per month or $59.70 per day). The taxpayer only receives one-half (1/2) of the total proceeds pursuant to an agreement with the corporation that provides the machines. The taxpayer argues that these reports are accurate, since they are verified with affidavits by both employees of the taxpayer and of the corporation.

The Department's Charity Gaming Annual Report dated October 1, 1999, shows that the taxpayer reported approximately $431,467 in gross revenues from only pull tab sales. The taxpayer's affidavits state that the taxpayer averages ten (10) to fifteen (15) visitors a day. If the taxpayer is open 324 days a year (per affidavits) with 15 visitors a day (per affidavits) that would average out

to almost $89 per day spent by each person on pull tabs alone. It is obvious that the number of visitors to the taxpayer's establishment is greatly understated. This calls into question the accuracy of the receipts provided to the Department. A review of the receipts, showing identical signatures, also tends to support the Department's position that they were all written at the same time.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

28200000234.LOF

LETTER OF FINDINGS NUMBER: 00-0234 CSET
Controlled Substance Excise Tax
For Tax Periods: 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

1. Controlled Substance Excise Tax – Imposition

Authority: IC 6-7-3-5; IC 6-8.1-5-1(b)

Taxpayer protests the assessment of Controlled Substance Excise Tax.

STATEMENT OF FACTS

Taxpayer was arrested for possession of controlled substances. The local prosecutor requested in writing that the Indiana Department of Revenue assess the Controlled Substance Excise Tax. A Record of Jeopardy Finding, Jeopardy Assessment Notice and Demand was issued on March 13, 2000, in a base tax amount of $2,074.40. Taxpayer filed a protest to the assessment. A hearing on the protest was scheduled for June 26, 2000. Taxpayer was notified of the hearing at the last known address. Taxpayer did not appear for the hearing. Further facts will be provided as necessary.

DISCUSSION

IC 6-7-3-5 imposes the Controlled Substance Excise Tax on the possession of controlled substances in the State of Indiana. Taxpayer bears the burden of proving that the assessment of tax is incorrect. IC 6-8.1-5-1(b). The arresting officer's report and Indiana State Police Laboratory report indicate that Taxpayer was in possession of marijuana. Since Taxpayer did not appear at the hearing or offer any evidence to contradict the evidence in the file, Taxpayer did not sustain his burden of proving that the assessment was incorrect.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04970078.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0078 RST
Sales/Use Tax — Industrial Exemptions
For Tax Periods: 1992, 1993, and 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax – Industrial Exemptions

Authority: IC 6-2.5-5-3; 45 IAC 2.2-5-9; *Indiana Department of State Revenue v. Cave Stone, Inc*. (1983), 457 N.E.2d 520; *General Motors Corporation v. Department of State Revenue*, (Ind.Tax 1991) 578 N.E.2d 399

Taxpayer protests the Department's determination that use tax should have been self-assessed and remitted on purchases of certain equipment.

STATEMENT OF FACTS

Taxpayer's principal business activity involves the mining and selling of coal. In its business, Taxpayer works one underground and several surface mines. To facilitate the shipment of coal to customers, Taxpayer operates rail and barge loadout facilities.

Audit discovered that Taxpayer had failed to pay sales tax, or self-assess use tax, on certain items associated with mining operations. Specifically, Audit proposed assessments of use tax on equipment, Taxpayer contends, was "used to blend different grades of coal together so that the final product meets customer specifications." Taxpayer protested these proposed assessments.

At a subsequent administrative hearing, Taxpayer's protest was denied. Taxpayer then timely requested, and the Department granted, a rehearing.

I. Sales/Use Tax – Industrial Exemptions

DISCUSSION

The following narrative is taken from the initial letter of finding in which the Department denied Taxpayer's protest of use tax assessments on equipment used to "blend" coal.

Taxpayer mines coal from different locations. After the coal is mined, it is taken to a preparation ("wash" or "prep") plant where it is cleaned. The coal is then segregated by grade into stockpiles. Each stockpile has its own compositional makeup – as measured by ash fusion, temperature, hardness, heat content, moisture, sulfur content, BTU content, and size. This compositional makeup does not remain static. Taxpayer manipulates the characteristics of each stockpile by adding coal from other stockpiles.

Taxpayer's customers burn coal. Because of air quality standards tied to BTU and sulfur emission levels, taxpayer's customers require coal that, when burned, meets these specific emission standards. In order to supply the right mix of coal to its customers, taxpayer manipulates the composite characteristics of each stockpile prior to shipment. Taxpayer calls this manipulation "blending".

"Blending", for taxpayer, refers to any activity that results in the combination of different grades of coal. According to taxpayer, blending activities occur throughout its entire production process. Blending occurs when taxpayer combines, after cleaning, coal from one stockpile with coal from another. Blending occurs when taxpayer transfers coal from aboveground stockpiles to underground hoppers. And blending occurs when taxpayer loads coal from different stockpiles into trucks, and barges, and railway cars. As described, "blending" is a continuous, systematic, and integrated part of taxpayer's production process. To engage in these "blending" activities, taxpayer has purchased a variety of equipment and repair parts. Taxpayer paid neither sales nor use tax on these items.

The Department disagreed with Taxpayer's conceptualization of "blending" and characterization of its mining activities. As previously stated:

The Department…finds taxpayer's transportation of coal to loadout facilities and the subsequent loading of coal onto barges and railway cars, [should be] characterized as a function of shipping, and not production. As such, they are non-exempt post-production activities.

In reaching this conclusion, the Department is guided by language found in 45 IAC 2.2-5-9. Subsection (g) states the general proposition that *"[t]ransportation equipment* used in mining or extraction is taxable unless it is directly used in the mining or extraction process." Example (3) of subsection (g) illustrates a particularly salient non-exempt activity: "*[f]ront-end loaders, cranes, and equipment used to load coal onto trucks, railroad cars, or barges for delivery to customers are taxable.*" Subsection (e)(1) gives examples of *taxable* machinery, tools, and equipment used in mining and extraction operations - including "*equipment used to load extracted and processed minerals from storage stockpiles to railroad cars.*" Additionally, subsection (j) states *shipping and loading of minerals are non-operational activities*; as such, machinery, tools, and equipment used in these activities are subject to tax. (Emphasis added.)

Taxpayer's conceptualization of blending is overbroad; blending is neither a subset of nor synonymous with loading. The language of 45 IAC 2.2-5-9 describes two mutually exclusive activities. To accept taxpayer's definition - that blending and loading can be concomitant activities - would nullify the language of 45 IAC 2.2-5-9(g) example 3, as well as subsection (e)(1), and subsection (j). As explicit as the language of 2.2-5-9(c)(4) *exempting* equipment used in blending operations, so to[o] is the language authorizing taxation of equipment used in loading and shipping activities.

* * * * * * * * * *

The Department finds the loading and transport of coal from mines and prep plants to loadout facilities, as well as the loading of coal onto rail cars and barges at loadout facilities, are functions associated with shipping - a taxable post-production activity. Consequently, items used in these activities do not qualify for any of the industrial exemptions. Taxpayer's protest is denied.

Taxpayer, in its *Request for Rehearing*, wrote:

[W]e disagree with the Department's decision to deny [taxpayer's] protest on the taxation of equipment used to blend coal. Under the Department's analysis, there would appear to be no type of blending practiced in the coal industry that would constitute exempt blending. The blending described in our protest is the blending of coal indicative of coal companies. The Department's regulations provide an exemption for the blending of coal. Given that a duly promulgated regulation carries with it the force of law, the Department is in error in its denial of [taxpayer's] argument.

Taxpayer refers to 45 IAC 2.2-5-9(c)(4), which provides in part:

The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product is not determinative.

(F) Equipment used to blend different grades of coal together so that the final product meets customer specifications regarding quality and sulfur content.

At rehearing, Taxpayer directed the Department's attention to previously submitted documents listing items used in the blending

of coal. These items, generally, can be classified as **(a)** machinery, **(b)** consumables, and **(c)** replacement parts. Specifically, Taxpayer lists oil, fuel (diesel), grease, tires, batteries, filters, headlamps, windows, block heaters, starters, alternators, tugs, barges, "dozers," loaders, bobcats, uniloaders, locomotives, and one CB radio.

Regulation 45 IAC 2.2-5-9 discusses the taxability of manufacturing machinery, tools, and equipment directly used in extraction and mining operations. Subsection (c)(4) exempts "[e]quipment used to blend different grades of coal…" Subsection (g) states '[t]ransportation equipment used in mining or extraction is taxable unless it is directly used in the mining or extraction process." Subsection (g)(3) exempts transportation equipment used to "transport work-in-process or semi-finished materials within the extraction or mining process…" Subsections (e)(1), (j), and (g)(Ex.3) instruct that equipment used in shipping and loading activities are taxable.

When 45 IAC 2.2-5-9 is read in its entirety, one realizes the taxing scheme is based on the assumption that "blending," "transport," and "shipping" are separate, mutually exclusive, activities. The Department, therefore, will neither endorse nor adopt a definition of "blending" inconsistent with this regulatory regime. Consequently, the Department must reaffirm the conclusions reached in its initial letter of findings.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980474.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 98-0474
Sales Tax
For Tax Periods 1995-1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales Tax – Material Handling System

Authority: IC 6-2.5-5-3; 45 IAC 2.2-5-8

Taxpayer protests the assessment of tax on its purchase of a material handling system.

II. Tax Administration – Negligence Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests the assessment of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is a plastic injection mold manufacturer. The Department of Revenue conducted an audit for the years of 1995-1997 and issued assessments for sales tax on various properties. Taxpayer paid the assessments and protested two of the items assessed, as well as a ten percent (10%) negligence penalty. An administrative hearing was held on the matter. The Letter of Findings (LOF) sustained one of the protested items, and denied the protests for a Material Handling System and the ten percent penalty. Taxpayer requested and was granted a rehearing.

I. Sales Tax—Material Handling System

DISCUSSION

Taxpayer protests the assessment of sales tax on a material handling system. At the initial hearing, taxpayer protested that the system did more than simply transport raw materials, but provided no documentation to support that position. At the rehearing, taxpayer provided documentation which explained the functions of the material handling system, and also provided documentation to show that it had already paid state sales tax at the time of purchase. Included among the system's functions are: transporting plastic pellets from the storage silos to the injection molding machines, mixing the different colored pellets with other additives to achieve proper end color and content, measuring the pellets, drying the pellets, and collecting dust from the vacuum system before it enters the vacuum pumps. These steps are controlled by a computer control station and occur before the pellets are melted and fed into the injection molds.

IC 6-2.5-5-3(b) states:

> Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

The documentation provided at the rehearing shows that the system is also directly used in direct production, not merely in pre-production activity.

Equipment involved in pre-production activity is subject to sales tax, as provided in 45 IAC 2.2-5-8(c)(4)(G), which lists an example of non-exempt equipment:

Equipment used to remove raw materials from storage prior to introduction into the production process or to move finished products from the last step of production.

As taxpayer's letter requesting rehearing states:

The equipment at issue (material handling system) consists of a series of hoppers that are attached to various raw material silos as well as feeding hoppers that are physically attached to injection molding presses.

The material handling system is used for both exempt and non-exempt purposes. The procedure to handle such equipment is found in 45 IAC 2.2-5-8(c)(7), which explains:

A computer is used 40% of the time to perform the functions described in Example (5) [exempt] and 60% of the time to perform the functions described in Example (6) [non-exempt]. The taxpayer is entitled to an exemption for the computer equipment, including related equipment such as that described in Example (5), equal to 40% of the gross retail income attributable to the transaction or transactions in which the computer equipment was purchased.

Here, since the system is used for both exempt and non-exempt purposes, taxpayer is entitled to an exemption equal to the portion of the equipment which is directly used in the direct production of tangible personal property. The percentage of the equipment which is used to remove raw materials from storage in the silos prior to introduction into the production process is taxable. The percentage of equipment which is used in the production process, such as blending, drying, and measuring is exempt. Since the vacuum system moves the material both before and during the production process, the dust collectors are exempt to the extent they remove dust generated by the production process, and taxable to the extent they remove dust generated prior the production.

FINDING

Taxpayer's protest is sustained for the portion of the material handling system and computer control station that is used for production and denied for the portion that is used for pre-production activity. The exempt amount of state sales tax paid at time of purchase will be applied against the remaining amount of the other assessments from the audit.

II. Tax Administration – Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty. The relevant regulation is 45 IAC 15-11-2(c), which states in part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] 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 our or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer has demonstrated that it exercised ordinary business care and prudence in carrying out its duty to pay sales tax. Therefore, taxpayer has affirmatively established reasonable cause, and the negligence penalty shall be waived.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF SATE REVENUE
REVENUE RULING #00-03 IT
August 2, 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

Adjusted Gross Income Tax, Supplemental Net Income Tax and Gross Income Tax – Classification of Delaware Business Trusts for Indiana Income Taxation

Authority: IC 6-3-1-11; IC 6-3-8-2; Rule 45 IAC 1.1-1-22; IC 23-5-1-2; IC 6-2.1-2-2

The Taxpayer requests the Department to rule on the correct classification of two Delaware Business Trusts for Indiana income taxation.

STATEMENT OF FACTS

The Taxpayer is a nation-wide lessor of motor vehicles. The Taxpayer plans on forming two new subsidiary entities that will be used to hold title to certain motor vehicles that will be leased throughout the United States. Both entities will be formed as Delaware business trusts, pursuant to Chapter 38 of Title 12 of the Delaware Code, Section 3801. Trust #1 will be a direct subsidiary

of the Taxpayer and will be the beneficial owner of Trust #2. Trust #2 will be a direct subsidiary of Trust #1 and will have beneficial ownership and legal title to the vehicles being leased. The Taxpayer will service the leases (i.e., to include the performance of all of the obligations of the lessor under the leases and the making of advances in respect of delinquent monthly payments and certain expenses relating to Trust #2).

Under the terms of a trust agreement, the Taxpayer will segregate certain portfolios of leased assets to Trust #2 representing special units of beneficial interest (each a "SUBI"). Under Delaware law SUBIs are not liable for the debt of other separate portfolios or for Trust #2 as a whole. Under the trust agreement, Trust #1 will have unlimited liability with respect to assets not assigned to a SUBI. The Taxpayer will form a special purpose entity ("SPE") that will be a Delaware business trust and a wholly owned subsidiary of the Taxpayer or one of its affiliates. Trust #1 will be the initial beneficiary of Trust #2 and the Taxpayer will be the sole beneficiary of Trust #1. From time to time, Trust #1 will cause beneficial interests in the leased assets owned by Trust #2 to be issued in the form of a SUBI. Trust #2 will issue the SUBIs to Trust #1, which in turn will assign/pledge them to the SPE. The SPE will assign/pledge the SUBI to a securitization trust which will issue securities, the payments on which are backed by payments made on or in respect of the related leases and leased vehicles. Although SUBIs will be pledged to investors, title and legal ownership of the vehicles will remain with Trust #2.

Currently, the Taxpayer receives a Manufacturer's Statement of Origin ("MSO") or Certificate of Origin ("CO") to represent ownership of the vehicles prior to procuring a title. Once the vehicle is either leased or sold, the back of the MSO is completed and the MSO is then assigned to the purchaser. Title to the vehicle is then issued to the purchaser.

As part of the new lease-financing program, the Taxpayer will assign the MSO for each vehicle to Trust #2. In addition, a certificate of title and registration will be issued in the name of Trust #2 as the owner of each motor vehicle. As beneficiary, Trust #1 will have the right to assign/pledge all or part of its beneficial interest in Trust #2 (represented by the SUBIs).

For Federal income tax purposes, Trust #1 and Trust #2 will not be classified as associations (or publicly traded partnerships) taxable as corporations under the Federal "check-the-box" regulations. Instead Trust #1 and Trust #2 will be classified as disregarded entities for Federal income tax purposes.

DISCUSSION

Pursuant to IC 6-3-1-11, the Indiana Adjusted Gross Income Tax Statutes incorporate by reference the Internal Revenue Code and Treasury Regulations in effect January 1, 1999 which include the "check-the-box" regulations. Such being the case, Trust #1 and Trust #2 will be classified as "disregarded entities" for Indiana adjusted gross income taxation and supplemental net income taxation (note that a determination applicable to adjusted gross income tax is, also, applicable to supplemental net income tax as provided by IC 6-3-8-2) to the extent they are, in fact, classified as same for federal income taxation.

The Indiana Gross Income Tax Code, unlike the Indiana Adjusted Gross Income Tax Code, does not incorporate by reference the Internal Revenue Code and Treasury Regulations. As a result, the Gross Income Tax Code (Regulations) is the sole authority for determining the gross income tax classification of Trust #1 and Trust #2. Trust #1 and Trust #2, therefore, will be classified for gross income taxation as formed, Delaware Business Trusts.

Rule 45 IAC 1.1-1-22 provides that a business trust defined in IC 23-5-1-2 is defined as a "taxpayer" for gross income taxation. A "taxpayer's" Indiana gross income is subject to gross income taxation pursuant to IC 6-2.1-2-2.

IC 23-5-1-2(a) states:

Sec. 2. For the purpose of this chapter:

> (a) A "business trust" is an unincorporated business association which is created by a trust instrument, pursuant to common law or enabling legislation, under which property is held, managed, administered, controlled, invested, reinvested, or operated, or business or professional activities for profit are carried on, by a trustee or trustees for the benefit and profit of such person or persons as are or may become the holders of transferable certificates, issued pursuant to the provisions of the trust instrument, which have either restricted or unrestricted transferability, evidencing beneficial interests in the trust estate, including but not limited to a trust of the type known at common law as a business trust, or Massachusetts trust, or a trust qualifying as a real estate investment trust under Section 856 of the Internal Revenue Code or under any similar statute. Such business trust may provide that the holders of such certificates are entitled to the same limitation of personal liability extended to stockholders of private corporations for profit. A business trust shall not be known as a land trust, under which a trustee or trustees holds the legal or equitable title to real estate, which does not issue transferable certificates of beneficial interest and which has less than one hundred beneficiaries. Nothing in the specific exclusion shall be construed to enlarge the operation or application of this chapter.

Here then, Trust #1 and Trust #2 will not be subject to Indiana gross income taxation to the extent they are not defined as "business trusts" under IC 23-5-1-2. Conversely, Trust #1 and Trust #2 will be subject to Indiana gross income taxation to the extent they are defined as "business trusts" under IC 23-5-1-2.

RULING

The Department rules that Trust #1 and Trust #2 will be classified for Indiana adjusted gross income taxation and supplemental net income taxation as "disregarded entities" to the extent that they are classified as such for federal income taxation.

The Department, further, rules that Trust #1 and Trust #2 will be classified as Delaware Business Trusts for Indiana gross

income taxation. Whether or not Trust #1 and Trust #2 will be subject to Indiana gross income taxation will be determined by whether or not Trust #1 and Trust #2 are defined as "business trusts" under IC 23-5-1-2.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in a statute, a regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.