INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT

Title: Risk Integrated System of Closure (RISC), Technical Guide and Users Guide
Identification Number: W-0046
Date Originally Effective: February 15, 2001
Dates Revised: None
***Other Policies Repealed or Amended:** 1) LUST portion of the1994 UST Branch Guidance Manual 2) Hazardous Waste Management Unit Closure Guidance, Nonrule Policy Document 3) Voluntary Remediation Program Resource Guide, July 1996
Brief Description of Subject Matter: Provides a description of the Agency's policy on the application of risk assessments to obtain closure of sites in the voluntary remediation program, leaking underground storage tank program, state cleanup program and RCRA closure and corrective action program.
Citations Affected: None

This nonrule policy document is intended solely as guidance and does not have the effect of law or represent formal Indiana Department of Environmental Management (IDEM) decisions or final actions. This nonrule policy document shall be used in conjunction with applicable laws. It does not replace applicable laws, and if it conflicts with these laws, the laws shall control. This nonrule policy document may be put into effect by IDEM thirty days after presentation to the appropriate board and after it is made available to public inspection and comment, pursuant to IC 13-14-1-11.5. If the nonrule policy is presented to more than one board, it will be effective thirty days after presentation to the last. IDEM will submit the policy to the Indiana Register for publication. Revisions to the policy will follow the same procedure of presentation to the board and publication.

Risk Integrated System of Closure
Technical Guide
Users Guide

*There is a 1 year transition period during which time applicants may choose to use RISC or previous guidance.

THIS DOCUMENT IS LOCATED ON THE WEB AND BY CALLING THE OFFICE OF LAND QUALITY

INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT

Title: F006 Recycled Wastes: Allowing LQGs 180 (or 270) Days Accumulation
Identification Number: Waste-0044-NPD
Date Originally Effective: February 15, 2001
Dates Revised: None
Other Policies Repealed or Amended: None
Citations Affected: 329 IAC 3.1-7-1, 40 CFR 262.34(a) & (b)
Brief Description of Subject Matter: The March 8, 2000 Federal Register promulgated regulations to amend 40 CFR 262 to allow large quantity generators (LQGs) of recycled F006 waste up to 180 days (or 270 days, under certain circumstances) for on-site accumulation provided specific parameters are met.

This nonrule policy document is intended solely as guidance and does not have the effect of law or represent formal Indiana Department of Environmental Management (IDEM) decisions or final actions. This nonrule policy document shall be used in conjunction with applicable laws. It does not replace applicable laws, and if it conflicts with these laws, the laws shall control. This nonrule policy document may be put into effect by IDEM thirty days after presentation to the appropriate board and after it is made available to public inspection and comment, pursuant to IC 13-14-1-11.5. If the nonrule policy is presented to more than one board, it will be effective thirty days after presentation to the last. IDEM will submit the policy to the Indiana Register for publication. Revisions to the policy will follow the same procedure of presentation to the board and publication.

This policy is **an enforcement discretion policy** to allow compliance with the above federal regulation, in lieu of the state's requirements, during the interim period it takes the state to adopt the federal standard, thus **demonstrating IDEM's immediate support for a new federal rule to promote metals recovery from F006 wastes**.

Policy Statement

Background

Section 1003 of RCRA establishes a national objective of "minimizing the generation of hazardous waste and the land disposal of hazardous waste by encouraging process substitutions, materials recovery, properly conducted recycling and reuse, and treatment." In response to these provisions, EPA has endeavored to develop regulations that promote legitimate recycling of solid and hazardous waste while protecting human health and the environment against the development and use of unsafe or sham recycling practices.

In the March 8, 2000 Federal Register, EPA promulgated regulations to amend 40 CFR 262 to allow additional time to large quantity generators of F006 waste (wastewater treatment sludges from electroplating operations) for on-site accumulation if the waste is destined for recycling. In order to ensure that on-site accumulation is protective of human health and the environment, the management standards for the extended accumulation of F006 being recycled are the same as those that currently apply to 90-day on-site accumulation.

This final rule stems primarily from activities conducted under the EPA's Common Sense Initiative (CSI) for the metal finishing industry sector. These activities, including further work on F006 issues, are continuing as part of the Agency's Standing Committee on Sectors of the National Advisory Council for Environmental Policy and Technology (NACEPT). The goal of the CSI was to use multi-stakeholder consensus decision-making to recommend policy and program changes to the CSI Council and the EPA Administrator. As part of its work under CSI, the metal finishing subcommittee developed a set of ambitious voluntary performance goals to promote pollution prevention and environmental management beyond what is currently required for the industry under federal regulations (known as the Strategic Goals Program, SGP). The goals address resource utilization, hazardous emissions, economic paybacks, and compliance costs. Indiana is one of twenty-one states participating in the Strategic Goals Program. By encouraging metals recovery from hazardous wastewater treatment sludge, this new RCRA final rule will help the metal finishing industry meet voluntary waste-reduction goals as part of its SGP.

This rule allows a cost-saving opportunity for affected generators. The longer accumulation time will mean that generators can accumulate increased amounts of wastes and will be able to send larger shipments of the waste off-site for metals recovery less often. In the Regulatory Impact Analysis for this rulemaking, the EPA estimated that 72% to 89% of the 1,483 generators affected by this rule will take advantage of the flexibility provided. This rule also promotes resource conservation because metals recovered from the sludges may serve as alternative feedstocks for primary metals in production and manufacturing processes.

Policy:

This policy is an enforcement discretion policy to allow compliance with the EPA regulations promulgated on March 8, 2000 to amend 40 CFR 262 to allow large quantity generators to accumulate F006 waste (wastewater treatment sludges from electroplating operations) up to 180 days (or up to 270 days if transport to the metal recovery facility is 200 miles or more) on-site in tanks, containers or containment buildings without a RCRA permit or interim status, provided that the generator:

(1) has implemented pollution prevention practices that reduce the amount of any hazardous substance, pollutant, or contaminant entering F006 or otherwise released into the environment prior to its recycling,

(2) recycles the F006 waste by metals recovery,

(3) accumulates no more than 20,000 kilograms of F006 waste at any one time, and

(4) complies with the applicable management standards.

Facilities must verify that these four standards are being met when taking advantage of this additional accumulation time.

If you need additional information, or have any questions or concerns, please contact the staff of the Compliance and Response Branch, Office of Land Quality, at 317-308-3103. The IDEM toll-free telephone number is 1-800-451-6027.

DEPARTMENT OF STATE REVENUE

04920704.LOF

LETTER OF FINDINGS NUMBER: 92-0704
Sales and Use Tax
For Years 1988 through 1990

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. Use Tax – Imposition of use tax on hotel supplies purchased by the taxpayer.

Authority: Ind. Admin. Code tit. 45, r. 1-1-151 (repealed Jan. 1, 1999); Ind. Admin. Code tit. 45, r. 2.2-5-24; Ind. Admin. Code tit. 45, r. 2.2-5-25.

The taxpayer protests the imposition of use tax on it purchases of supplies for its hotel.

STATEMENT OF FACTS

The taxpayer is a state university located in Indiana. The taxpayer owns and operates a hotel on its campus. The taxpayer primarily rents rooms in the hotel to students, parents of students, alumni, and guests of the university. The hotel is also used for meetings involving university personnel as well as outside businesses. Additionally, the hotel is used as a learning laboratory for the taxpayer's Hospitality and Tourism Management classes. More information will be provided as needed.

I. Use Tax – Imposition of use tax on hotel supplies purchased by the taxpayer.

DISCUSSION

The taxpayer was assessed use tax on its purchases of supplies for its hotel. The auditor found that the operation of the hotel was a proprietary activity by the taxpayer and therefore did not qualify for an exemption. Therefore, proposed assessments of use tax were made on the taxpayer's purchases of hotel supplies. As Ind. Admin. Code tit. 45, r. 2.2-5-25 instructs:

(a) There is not a blanket exemption from the sales tax for purchases by governmental agencies and units. It provides that only the purchase of tangible personal property used by the governmental agency in connection with a governmental function may

be purchased exempt from sales tax.

(b) Purchases by a governmental agency or subdivision to be used in connection with or for a proprietary activity are subject to the sales tax.

(c) Proprietary activities by governmental agencies and subdivisions include:

....

(2) Activities in connection with the rental of tangible personal property made to the general public.

(d) In every case in which a governmental agency engages in a proprietary type activity as defined above, the agency must pay sales tax on the purchase of all tangible personal property used in connection therewith.

"'Private and proprietary activities' are those customarily considered as being competitive with private enterprise." Ind. Admin. Code tit. 45, r. 1-1-151 (repealed Jan. 1, 1999).

While the hotel does occasionally let rooms to the general public, the taxpayer argues that the operation of the hotel is not a proprietary activity and is, instead, performance of a governmental function and therefore exempt. The taxpayer has submitted evidence indicating that the hotel was used more than 80% of the time for the performance of the taxpayer's governmental function (e.g. accommodations for alumni, students, corporate recruiters, and campus visitors; holding conferences; and conducting university classes). The Administrative Code provides that purchases of tangible personal property by an agency or instrumentality of the state is exempt from the retail sales tax if the property is predominantly used, i.e. more than 50% of the time, in the performance of governmental functions. Ind. Admin. Code tit. 45, r. 2.2-5-24. Since the hotel supplies purchased by the taxpayer were predominantly used in the performance of governmental functions, these purchases qualify for a 100% exemption.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

28930771.LOF

LETTER OF FINDINGS NUMBER: 93-0771 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 dealing and possession of marijuana. The Indiana Department of Revenue issued a record of Jeopardy Finding, Jeopardy Assessment Notice and Demand on July 20, 1993 in a base tax amount of $41,808.00. Taxpayer filed a protest to the assessment. A hearing on the protest was scheduled for 10:00 a.m. on December 13, 2000. Taxpayer was notified of the hearing at his last known address. Taxpayer did not appear for the hearing. Further facts will be provided as necessary.

1. Controlled Substance Excise Tax: Imposition

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). Since Taxpayer did not appear at the hearing or offer any written information in lieu of a hearing, the Department must rely on the contents of the file in making a decision on the matter. The Police Incident Report indicates that Taxpayer possessed the marijuana upon which tax was assessed. Therefore, the tax properly applies to Taxpayer in this situation.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

28940895.LOF

LETTER OF FINDINGS NUMBER: 28-940895 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 December 8, 1994 in a base tax amount of $5084.00. Taxpayer filed a protest to the assessment. In lieu of a hearing, Taxpayer submitted additional information in writing. Further facts will be provided as necessary.

1. CONTROLLED SUBSTANCE EXCISE TAX-IMPOSITION

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

04960467.LOF

LETTER OF FINDINGS NUMBER: 96-0467
SALES AND USE TAX
FOR THE PERIOD 1992 – 94

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

At the protest hearing, the taxpayer withdrew one issue from consideration. The remaining two issues are as follows:

I. Sales and Use Tax — Exemptions — Tangible Personal Property Consumed in Direct Production — Water Treatment Chemicals and Anti-Scale Water Treatment Chemicals

Authority: IC § 6-2.5-3-4(a)(2) (1988 and 1993), IC § 6-2.5-5-5.1(b) (Supp. 1992 and 1993); 45 IAC § 2.2-5-12 (1992)

The taxpayer argues that the auditor erred in assessing use tax on certain water treatment chemicals that it claims are exempt from that tax.

II. Sales and Use Tax — Exemptions — Tangible Personal Property Used to Produce Machinery, Tools or Equipment — Computers, Art and Graphics Software and Peripheral Equipment

Authority: IC §§ 6-2.5-3-4(a)(2) and -5-4 (1988 and 1993); IC § 6-2.5-5-3(b) (Supp. 1992 and 1993); *Indiana Dep't of State Revenue v. Cave Stone, Inc.,* 457 N.E.2d 520 (Ind. 1983); *Indiana Dep't of State Revenue v. Colpaert Realty Corp.*, 109 N.E.2d 415 (Ind. 1952); *Department of Revenue v. United States Steel Corp.,* 425 N.E.2d 659 (Ind. Ct. App. 1981); *Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc.*, 338 N.E.2d 698 (Ind. Ct. App. 1975); 45 IAC §§ 2.2-5-8(c) and (g), -5-11(c) and (d) (1992)

The taxpayer also asserts that the auditor erred in assessing use tax on certain computers, art and graphics software and peripheral equipment, which, the taxpayer contends, are exempt.

STATEMENT OF FACTS

During the audit period the taxpayer, a Delaware corporation, operated two plants, one of which was in Indiana, at which it manufactured plastic products for sale to other manufacturers or retailers as component packaging for their products. The taxpayer's products included containers, lids, overcaps for aerosol spray products, cups and specialty items (e.g., plastic Halloween pumpkins and Easter baskets).

The taxpayer created the product by injecting hot plastic into a mold, the cooling of which the taxpayer accelerated by circulating water through the mold and production equipment, hardening the product in the process. Once the temperature of the production equipment, the mold and the product dropped to a pre-set level, the mold opened automatically and the product was ejected. The taxpayer bought a computer during the audit period that monitored the production equipment and sounded an alarm if it malfunctioned. However, the computer did not control the operation of the production equipment.

A chemical put into the water in the circulatory system for the molds and molding production equipment insured that they cooled consistently. A separate chemical minimized corrosion of or sedimentation buildup in that system's water pipes. The taxpayer also used the same two chemicals in the water circulated through the chillers in an air conditioning system that it installed in the molding building during the audit period. (The latter system was on a separate loop from those used to cool the molds and mold production equipment and the air conditioning system of the room in which the taxpayer conducted the printing process, discussed below.) The auditor identified these chemicals in the Audit Summary as "water treatment chemical" and "anti-scale water treatment chemical," respectively, and the Department will hereafter use the same terms to identify them in this Letter of Findings.

A buyer of containers, lids, overcaps and cups usually wanted its logo, advertising, ingredient descriptions or some other specialty design to appear on these plastic products. To do so, the taxpayer had to prepare a set of plates, almost always customized, for the artwork the buyer wanted on the product.

The buyer submitted the desired artwork to the taxpayer, either by hard copy or digital data file. The taxpayer then transferred the artwork into its computers, either by use of a scanner in the case of hardcopy or by disk if the artwork or graphics was in a digital file. Next, the taxpayer used art and graphics software to manipulate and, if necessary, to modify, the artwork to fit the surface area available on the plastic product on which it was to appear (including a factoring-in of any tapering of that product), and to separate the colors. Then the taxpayer prepared a proof of the manipulated artwork or graphics for the buyer's review. Once the taxpayer received the buyer's approval, the digital file or files containing the modified artwork were transferred to an imager for the preparation of a set of photographic negatives, one for each of the separated colors. (During the audit period the taxpayer contracted out this task because it did not own an imager.) The taxpayer then used those negatives to prepare a black-and-white proof of the artwork for comparison to the buyer-approved proof to insure accuracy and quality. The negatives were then used to create a set of plates, one for each color, and to replace any plates that were damaged or worn out during production.

Finally, the taxpayer used the plates to put the artwork on the plastic product. The taxpayer put the graphics or artwork on the product in a black-and-white proof and a black-and-white template on which the colors were superimposed one by one until the completed color artwork appeared on the plastic product. The plates are flexible pieces of metal on which the image in question appears in direct, rather than reversed- or mirror-image, form, and has identical sets of holes punched on either end. These plates were bent around and fastened onto a circular drum. The ink from the plate was then transferred in reverse- or mirror-image to another drum with which it was in contact. The second drum then applied the reverse image directly onto the plastic product.

The field auditor assessed use tax on 14.1% of all of the water treatment and anti-scale water treatment chemicals used in the mold cooling system and the air conditioning system for the building in which the plastic production equipment was located. The auditor arrived at this percentage from a summary analysis the taxpayer provided of its water usage through the two systems, which indicated that it used 14.1% of its water in the air conditioning cooling towers. Additionally, the auditor assessed use tax on the computers, peripheral equipment and supplies used in the pre-printing design modifications to the artwork printed on the product. The taxpayer timely protested the parts of the assessments concerning the computers, peripheral equipment and supplies used to modify the artwork, as well as the parts of the assessments concerning the water treatment chemicals.

I. Sales and Use Tax — Exemptions — Tangible Personal Property Consumed in Direct Production — Water Treatment Chemicals and Anti-Scale Water Treatment Chemicals

DISCUSSION

IC § 6-2.5-3-4(a)(2) (1988 and 1993) exempts from use tax the storage, use and consumption of any tangible personal property that is wholly or partly exempt from sales tax under any part of IC ch. 6-2.5-5 (except IC § 6-2.5-5-24(b), which is not in issue in this dispute). IC § 6-2.5-5-5.1(b) (Supp. 1992 and 1993) states in relevant part that

> [t]ransactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture.

Id. The taxpayer argues that its use and consumption of the water treatment and anti-scale water treatment chemicals were tax-exempt because these items were essential to its production of a final plastic product. It claims that both chemicals insured consistent water flow through the cooling system for the molds and molding production equipment and for the air conditioning systems in both the

molding and printing buildings. The taxpayer contends that by insuring such consistent water flow, both chemicals minimized not only humidity buildup in the molds, but also any variances in product from the buyer's specifications and any consequential increases in rejections of such non-conforming product on quality control grounds.

The Department observes at the outset that the auditor by necessary implication found 85.9% of the water treatment and anti-scale water treatment chemicals to be exempt by assessing use tax on only 14.1% of those chemicals. The auditor correctly indicated in the part of the Audit Summary that discussed the molding room air conditioning and ventilation systems that neither of the latter was essential or integral to the molding process. The same logic applies to the 14.1% of the water treatment and anti-scale water treatment chemicals that the taxpayer's own summary analysis found were used and consumed in the molding room air conditioning system.

FINDING

The taxpayer's protest is denied as to this issue.

II. Sales and Use Tax — Exemptions — Tangible Personal Property Used to Produce Machinery, Tools or Equipment—Computers, Art and Graphics Software and Peripheral Equipment

DISCUSSION

The taxpayer argued to the auditor, and argues again in this protest, that the computers, software and peripheral equipment used to modify the buyers' respective artwork are essential and integral to the taxpayer's production process. The field auditor disagreed, finding the computers, software and peripheral equipment used in this process to be taxable. The auditor cited 45 IAC § 2.2-5-8(g), Example (7), which states that "computer-aided design is a non-exempt function[,]" *id.,* as supporting authority. That provision is part of the regulation that interprets IC § 6-2.5-5-3(b). Thus, both the taxpayer and the auditor have framed the issue concerning these items on the assumption that IC § 6-2.5-5-3(b) is the controlling law. As the Department will explain below, that assumption was only indirectly correct. However, IC § 6-2.5-5-4 (1988 and 1993), the exemption statute that most nearly applies to the present issue, is similarly worded to, refers to and requires nearly the same analysis as IC § 6-2.5-5-3(b). The regulation that implements IC § 6-2.5-5-4, 45 IAC § 2.2-5-11, incorporates IC § 6-2.5-5-3(b) as interpreted by parts of 45 IAC § 2.2-5-8. When all of these authorities are applied to the use of the present items they show that this property remains taxable.

IC § 6-2.5-5-3(b) states that

> [t]ransactions 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.

Id (emphases added). The statute imposes what reported Indiana judicial opinions have come to call the "double direct" test. The machinery, tools or equipment for which a taxpayer claims this exemption product, but also must be "*direct[ly]* use[d] in the *direct* production" of the finished product. IC § 6-2.5-5-3(b) (emphases added). The Indiana Supreme Court defined the adjective "direct" nearly fifty years ago in a gross income tax opinion as meaning "*immediate*; proximate; without circuity." *Indiana Dep't of State Revenue v. Colpaert Realty Corp.*, 109 N.E.2d 415, 422 (Ind. 1952) (emphasis added) (hereafter "*Colpaert Realty*"). After the General Assembly enacted the sales and use taxes, the Indiana Court of Appeals extended this definition to "direct" as used in the terms "direct use" and "direct production" in former IC § 6-2-1-39(b)(6) (1971) (repealed 1980), from which current IC §§ 6-2.5-5-2 to -4 derive. *E.g., Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc.*, 338 N.E.2d 698, 700 (Ind. Ct. App. 1975) (quoting *Colpaert Realty*; hereafter "*American Dairy*").

Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983) (hereafter "*Cave Stone*") used these opinions to establish the definitions of "direct use" and "direct production" that are still used to interpret and apply IC § 6-2.5-5-3(b). The "direct use" to which the statute refers must be "by the purchaser, not some other entity[.]" 457 N.E.2d at 525. Concerning "direct production" *Cave Stone* goes on as follows:

> We believe that the Court of Appeals, Fourth District, in *Department of Revenue v. U.S. Steel [Corp.]*, (1981) Ind.App., 425 N.E.2d 659 (transfer denied) [hereafter "*U.S. Steel*"], has determined the correct analysis for construing the statute in question. The court therein strictly construed the meaning of "direct production" and stated that the test for directness requires the equipment to have an "*immediate link* with the product being produced." [*Id.* at 662.] The court reasoned:
>
> > "Manufacturing equipment may be either directly or indirectly used in production, and the legislature plainly intended to limit the exemption to those items directly a part of production.... Our decisions hold the logical and practical distinction between directness and indirectness can be found where the equipment actually exercised some *immediate effect* on the product." (citations omitted). "We do not believe this strict construction has defeated the intention of the statute." (citations omitted). *Id*. at 662.
>
> 457 N.E.2d at 525 (emphases added by the Department; omissions by the Supreme Court).

The year after the Court of Appeals decided *U.S. Steel*, the Department included that opinion's "immediate effect" requirement in the recodified regulations for the production-related exemptions, including 45 IAC § 2.2-5-8, which implements IC § 6-2.5-5-3(b). LSA Doc. No. 82-86(F), sec. 1, 6 Ind. Reg. 8, 29-37 *passim* (1983), codified as further amended as 45 IAC §§ 2.2-5-6 to-5-13. Specifically, those regulations require that tangible personal property claimed as exempt "have an *immediate effect* on the article being produced." *E.g.,* 45 IAC § 2.2-5-8(c) (emphasis added).

The rules of statutory interpretation also apply in construing regulations. *Miles, Inc. v. Indiana Dep't of State Revenue,* 659 N.E.2d 1158, 1164 (Ind. Tax 1995). "In construing statutes [and regulations], words and phrases will be taken in their plain or ordinary and usual sense unless a different purpose is clearly manifest by the statute [or regulation] itself, …." *Colpaert Realty,* 109 N.E.2d at 418-19 (quoting a predecessor to IC § 1-1-4-1(1) (1988, 1993 and 1998)). "A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, *contemporary*, common meaning." *Perrin v. United States,* 100 S.Ct. 311, 314 (U.S. 1979)(emphasis added). The ordinary, contemporary, common meaning of a non-technical word is the meaning found in English-language dictionaries in existence at the time the statute was enacted or the regulation was promulgated. *See id.* The Department's analysis of Indiana Tax Court opinions indicates that that court is most likely to refer to WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (hereafter "WEBSTER'S THIRD") to define a non-technical word or phrase in a statute or regulation. WEBSTER'S THIRD defines "immediate" in relevant part as "acting or being without the intervention of another object, cause, or agency: DIRECT, PROXIMATE <the [immediate] cause of death>." *Id.* at 1129, definition 1a (1976 ed.). "Immediate" as used in the regulation is thus synonymous with "direct" as defined by *Colpaert Realty* and *American Dairy* and as used in former IC § 6-2-1-39(b)(6) and in IC § 6-2.5-5-3(b). The term "direct production" as used in those statutes and as construed in *U.S. Steel* and *Cave Stone* therefore means "production without the intervention of another object, cause or agency."

Lastly, for the machinery, tools or equipment used in direct production to be exempt under IC § 6-2.5-5-3(b), such production must be of "other tangible personal property," *id. Cave Stone* interpreted former IC § 6-2-1-39(b)(6), which included language substantially identical to that in the present statute, as "circumscrib[ing] all of the operations by which *the finished product* is derived." 457 N.E.2d at 524 (emphasis added). The term "other tangible personal property" as used in the context of the statute thus refers to that finished product.

When these definitions of "immediate effect," "direct production" and "other tangible personal property" are applied to the computers, software and peripherals used in the art and graphics process, it becomes clear that these items are not exempt under IC § 6-2.5-5-3(b). The taxpayer employed the claimed items in the first three steps of the art and graphics process. The taxpayer first used the computers and software to convert the graphics or artwork its customer supplied into a digital data file or files. Second, it manipulated or modified the file/s to fit the artwork or graphics within the dimensions of the surface area available on the plastic product. Third, it prepared a proof of the modified graphics or artwork for the customer's approval. Fourth, after getting that approval, the taxpayer during the audit period contracted for a third party to prepare a set of photographic negatives from the data file/s. Fifth, these negatives were in turn used to produce a set of direct-image plates. Sixth, these plates were then used to apply the various colors of ink used in the artwork to a drum in reverse image, which in turn applied that ink to the plastic product in direct image. Machinery, tools and equipment that the taxpayer used at six degrees of separation from the finished product had no "immediate effect" on that product and were not used in its "direct production."

Thus, both the taxpayer and the field auditor were wrong to assume that IC § 6-2.5-5-3(b) and 45 IAC § 2.2-5-8 were the primary authorities governing whether the art and graphics computers, software and peripherals were taxable or exempt. Those authorities did not directly apply to this question because the taxpayer did not use the disputed items in the direct production of the finished product. However, this is not to say that IC § 6-2.5-5-3(b) and 45 IAC § 2.2-5-8 were wholly inapplicable; they were and are *indirectly* applicable under another exemption. IC § 6-2.5-5-4 states that

> [t]ransactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his *direct* use in the *direct production of the machinery, tools, or equipment* described in section 2 or 3 of this chapter[i.e., IC §§ 6-2.5-5-2 or -3].

Id (emphases added). In other words, if a taxpayer itself produced the machinery, tools or equipment that it in turn used in the direct production of its finished product, then not only are the machinery, tools or equipment exempt, but so is the tangible personal property used to produce them. Thus, a taxpayer's claim that tangible personal property is exempt under IC § 6-2.5-5-4 indirectly depends on the taxpayer's ability to claim the exemption under IC § 6-2.5-5-3(b) for the product of the taxpayer's use of that property. As discussed above, the taxpayer's entitlement to claim the latter exemption depends on whether its use of that product satisfies the *Cave Stone/U.S. Steel* "immediate effect" test, as codified in 45 IAC § 2.2-5-8, concerning the finished product.

However, the "double direct" and "immediate effect" tests apply directly under IC § 6-2.5-5-4 as well. The above quotation of IC § 6-2.5-5-4 shows that it, like IC § 6-2.5-5-3(b), uses the terms "direct use" and "direct production[.]" Like 45 IAC § 2.2-5-8(c), subsection (c) of 45 IAC § 2.2-5-11, the regulation implementing IC § 6-2.5-5-4, requires that the tangible personal property claimed as exempt "have an *immediate effect* upon the article being produced or manufactured.

"[T]he same word[s] used in the same manner in different places in the same statute [or rule are] presumed to be used with the same meaning[.]" *Department of Treasury v. Muessel,* 32 N.E.2d 596, 599 (Ind. 1941). The General Assembly originally enacted what became IC §§ 6-2.5-5-2 to -4 as different clauses within the same paragraph. Gross Retail and Use Tax Act, ch. 30 (Spec. Sess.), sec. 4, 1963 Ind. Acts 60, 64 (adding para. 39(b)(6) to the Gross Income Tax Act, 1933 Ind. Acts ch. 50), formerly codified as IC § 6-2-1-39(b)(6) (1971 and 1976) (repealed 1980). Each clause of the former exemption required that the property claimed as exempt "be directly used by the purchaser in the direct production" of the finished product or property to be used in the direct making of that product. *Id.* They were also each part of the same section of the 1980 law that recodified the Gross Retail and Use Tax Act, although the legislature did change "directly used" to "direct use" and separated the exemptions into their present sections in the Indiana Code.

P.L. No. 52, sec. 1, 1980 Ind. Acts 590, 601. Similarly, the Department added the reference to "immediate effect" to 45 IAC § 2.2-5-11(c) in 1982, in the same regulatory promulgation in which the Department made the same respective changes to 45 IAC § 2.2-5-8. *Compare* LSA Doc. No. 82-86(F), sec. 1, 6 Ind. Reg. at 31-33 *passim with id.* at 35. As discussed earlier, the use of these terms in 45 IAC § 2.2-5-8, and other regulations that interpret the exemptions for tangible personal property used to produce finished products, administratively codified the *Cave Stone/U.S. Steel* "immediate effect" test. The use of the same terms in 45 IAC § 2.2-5-11 thus indicates that the Department intended, and intends, these judicial rules also to apply directly under IC § 6-2.5-5-4 to the production of machinery, tools or equipment that a taxpayer then uses to produce a finished product. However, as noted above, IC § 6-2.5-5-4 also uses the "double direct" test indirectly through IC § 6-2.5-5-3(b).

The Department has concluded that the products of the use of the arts and graphics computers, software and peripherals are not "machinery, tools or equipment. The Gross Retail and Use Tax Act does not include any definitions of the words "machinery," "tools" or "equipment." The Department has examined definitions of these words, or of terms in which they appear, in statutes and judicial opinions dealing with other areas of substantive law, and has concluded that these definitions would be of at best limited use in interpreting IC §§ 6-2.5-5-3(b) and -4. Accordingly, the Department must give "machinery," "tools" or "equipment" their plain, or ordinary and usual, meanings as they were understood when the General Assembly passed the Gross Retail and Use Tax Act in 1963. The original, 1961 edition of WEBSTER'S THIRD had been published shortly before. The relevant definitions in that dictionary for the nouns "equipment," "machine," "machinery" and "tool" appear at 768, 1353, 1354 and 2408 thereof, respectively. It is plain to the Department that color proofs and computer data files, whether provided to the third-party preparer of the negatives via floppy disks or modem, do not fit any of these definitions. This is the case because the common denominator of equipment, machines and tools, which the definitions in WEBSTER'S THIRD impliedly articulate, is that people use them in economic *activities*. In the production context in particular, people use them as a means to *act upon* other tangible personal property. By contrast, the role of the data files was passive; they were *acted upon* to create the negatives. That is to say, they are intermediate objects, rather than the means, of production.

It is also important to remember that the taxpayer did not use the arts and graphics computers, software and peripherals for which it claims exemption to prepare the sets of negatives and plates. Even assuming that either of the latter items would fit the definitions of "equipment" or a "tool" and meet the "double direct" test as to the finished product, those items were created later in the production process, using other tangible personal property (e.g., an imager) to do so. The arts and graphics computers, software and peripherals therefore were not used in the direct production of the sets of negatives and plates. Rather, those direct products were the color proofs of its buyers' modified artwork, and any computer disks the taxpayer may have prepared containing data files of that artwork, used to prepare the sets of negatives and plates.

Even if the data files somehow did qualify as machinery, tools or equipment, they would still fail to meet the "double direct" test as to the finished product. During the audit period any data files of modified artwork were used by a third-party contractor, rather than directly by the taxpayer. The data files were not used in the direct production of the finished product. Instead, the files were used to prepare sets of negatives, which the taxpayer in turn used to prepare sets of plates. In this connection, the Department notes that subsection (d) of the same regulation refers to 45 IAC § 2.2-5-8 for the criteria to apply, and examples to which to refer, as to whether an activity meets the immediate effect test under IC § 6-2.5-5-4. The latter regulation includes 45 IAC § 2.2-5-8(g), Example (7), on which the field auditor relied, and which states in substance that computer-aided design has no immediate effect on the article being produced and that such use of computers and peripheral equipment remains taxable. The arts and graphics computers, software and peripherals therefore had no immediate effect on the immediate product, as 45 IAC § 2.2-5-11(c) also requires. Thus, the auditor's application of 45 IAC § 2.2-5-8(g), Example (7) was right in substance. Accordingly, the Department finds that the arts and graphics computers, software and peripherals were not exempt under IC § 6-2.5-5-4.

FINDING

The taxpayer's protest is denied as to this issue.

DEPARTMENT OF STATE REVENUE

049700411.LOF

LETTER OF FINDINGS: 9700411
WITHHOLDING AND GROSS RETAIL TAXES
For the 1992 to 1996 Tax Years

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Unpaid Withholding Tax Levied Against Taxpayer as Responsible Corporate Officer.

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

The taxpayer has protested the imposition of personal liability for unpaid withholding taxes based upon the taxpayer's status as a responsible corporate officer.

II. Liability for Unpaid Gross Retail Taxes Levied Against Taxpayer as a Responsible Corporate Officer.

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

The taxpayer has protested the imposition of personal liability for unpaid gross retail taxes based upon the taxpayer's status as a responsible corporate officer.

STATEMENT OF FACTS

Following receipt of a proposed assessment for unpaid taxes, the taxpayer submitted a protest letter to the Department on July 16, 1997. In that letter, the taxpayer indicated that he did not dispute the fact that he owed taxes but that he questioned the amount of taxes claimed by the Department. The taxpayer requested and received information suggesting the manner in which a written brief could be prepared and submitted to the Department in lieu of a face-to-face hearing. The taxpayer was given a deadline by which to submit the written information or by which to request an extension of time. Taxpayer declined to respond. The taxpayer was given a second deadline by which to submit the information, request an in-person hearing, or request an extension of time. The taxpayer declined to respond. The taxpayer was given a third deadline by which to submit the information, request an in-person hearing, or request an extension of time. The taxpayer declined to respond. Accordingly, this Letter of Findings has been prepared based upon the limited information contained within the taxpayer's initial 1997 protest letter.

DISCUSSION

I. Unpaid Withholding Tax Levied Against Taxpayer as Responsible Corporate Officer.

Taxpayer apparently protests the assessment of levies for unpaid withholding taxes on the ground that he was not a responsible officer and that the amount of the levies is incorrect.

Withholding taxes may be assessed against a responsible corporate officer under the provisions of IC 6-3-4-8(g) which states that "[i]n 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."

Under the provisions of IC 6-3-4-8(g), any individual can be held personally liable for unpaid withholding taxes if (1) he was an officer, employee or a member of the employer, and (2) he had a duty to remit taxes to the Department. Indiana Dept. of State Revenue v. Safayan, 654 N.E.2d 270, 273 (Ind. 1995). In determining whether a taxpayer had the authority to see that withholding taxes were paid, the court will look at three relevant factors. The court will look to the person's position within the power structure of the corporation. Where that person is a high ranking officer within the corporate power structure, that person is presumed to have had sufficient control over the company's finances sufficient to give rise to a duty to remit trust taxes. That presumption may be rebutted by a showing the officer did not in fact have such authority.

Second, the court will look to the authority of the officer as established by the articles of incorporation, bylaws, or the officer's employment contract.

Third, the court will consider whether the person actually exercised control over the finances of the business including whether the person controlled the corporate bank account, signed corporate checks and tax returns, or determined when and in what order to pay corporate creditors.

Taxpayer bears the burden of demonstrating that the proposed assessment has been incorrectly levied against a person who is not a responsible officer. Similarly, the taxpayer bears the burden of demonstrating that the amount of the proposed levy is incorrect. Under IC 6-8.1-5-1(b), 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."

The taxpayer has presented no evidence regarding his authority within the business for which withholding taxes remain unpaid. Taxpayer has submitted no evidence regarding the degree of control taxpayer was empowered to exercise over the finances of the business. The taxpayer has submitted no evidence regarding the degree of authority conferred on him by his employment contract, the articles of incorporation, or the business by-laws. Accordingly, the taxpayer has failed to meet the burden of proof necessary to avoid responsible officer liability for unpaid withholding taxes.

FINDING

Taxpayer's protest is respectfully denied.

II. Liability for Unpaid Gross Retail Taxes Levied Against Taxpayer as a Responsible Corporate Officer.

The taxpayer has protested the imposition of liability for unpaid gross retail taxes. Under the provisions of IC 6-2.5-9-3, "[a]n 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 is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state."

The standard for establishing responsible officer liability for unpaid gross retail taxes is also set out in Safayan, 654 N.E.2d at 273 which states that "[t]he method of determining whether a given individual is a responsible person is the same under the gross retail tax and the withholding tax." Similarly, in order for the taxpayer to avoid responsible officer liability for the unpaid gross retail

tax, taxpayer must meet the burden of proof and the presumptions as set out in IC 6-8.1-5-1(b). Similarly, the taxpayer has failed to set out any factual basis upon which to rebut the presumption of correctness afforded the proposed assessment for unpaid gross retail taxes. Therefore, consistent with the Department's finding concerning taxpayer's liability for unpaid withholding taxes, the taxpayer cannot avoid liability for unpaid gross retail taxes held in trust for the state of Indiana.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02970477.LOF

LETTER OF FINDINGS NUMBER 97-0477
STATE GROSS INCOME TAX
For Years 1992, 1993, 1994, and 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on the 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. Whether Taxpayer is a Manufacturer Entitled to Claim Exemption From the Gross Income Tax Under the Interstate Commerce Clause.

Authority: U.S. Const. art. I, § 8; IC 6-2.1-3-3; International Harvester Co. v. Department of Treasury, 322 U.S. 340, 346 (1940); Department of Treasury v. Ingram-Richardson Mfg. Co., 313 U.S. 252 (1940); Ware & Leland v. Mobile County, 209 U.S. 405 (1908); Indiana Creosoting Co. v. McNutt, 5 N.E.2d 310, 312 (Ind. 1930); State of Indiana Dept. of Revenue v. Apex Steel and Supply, Inc., 375 N.E.2d 598 (Ind. App. 1978); 45 IAC 1.1-2-5(a); 45 IAC 1.1-2-5(d); 45 IAC 1.1-3-3(a).

The taxpayer protests the auditor's determination that the taxpayer derived its gross income from the performance of industrial processing rather than, as the taxpayer maintains, from the manufacture of plastic products. The taxpayer maintains that, as a manufacturer of plastic products, it was entitled to claim the Interstate Commerce Clause exemption for gross income derived from sales not completed in Indiana.

II. Abatement of Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(a)(3); IC 6-8.1-10-2.1(b)(2), (4); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer protests the assessment of the 10% negligence penalty and requests that the penalty be abated. The taxpayer maintains that its failure to pay the assessed gross income tax was due to reasonable cause and not due to willful neglect.

STATEMENT OF FACTS

The taxpayer is engaged in the processing of raw plastic materials at its Indiana facility. The taxpayer's activity involves the processing of raw plastic materials, supplied by the taxpayer's customers, for which the customer is charged a processing fee as well as additional charges for various additives and pigments consumed during the processing. Most of the raw plastic materials are shipped to the taxpayer's facility in especially designed rail cars. The taxpayer invoices, where applicable, a separate charge for the unloading of each customer's plastic materials. The plastic material provided by taxpayer's individual customers is not fungible. The plastic material supplied by customer "A" is processed and returned to customer "A" and is not intermingled with or exchanged with the plastic material supplied by customer "B." Additionally, the taxpayer bears the risk of loss or damage for each customer's raw materials. If an error is made in the processing of the customer's raw plastic material or if the finished material does meet the customer's specifications, the taxpayer reimburses the customer and retains possession of the damaged raw material until it can be resold to an alternate customer.

DISCUSSION

I. Whether Taxpayer is a Manufacturer Entitled to Claim Exemption From the Gross Income Tax Under the Interstate Commerce Clause.

The taxpayer has protested the auditor's determination that it was "engaged in providing industrial processing services." The taxpayer maintains that it is in the business of performing work which constitutes manufacturing. The significance in the distinction is that, as a manufacturer, the taxpayer would be entitled to claim the Interstate Commerce Clause exemption for income derived from sales to its out-of-state customers.

The auditor determined that the taxpayer was performing a service because it was processing customer-owned raw plastic stock and returning the identical stock to the customer. The auditor characterized taxpayer's activity as performing services, within Indiana, that fell within the requirements for treatment as industrial processing.

The code section upon which the taxpayer predicates its claim is found at IC 6-2.1-3-3 which states, "[g]ross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross

income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution." The code section is an indirect reference to the limitations placed upon the individual states by the Interstate Commerce Clause. U.S. art. I, § 8. 45 IAC 1.1-3-3(a) complements the code section and states that "[g]ross income derived from business conducted in interstate commerce is exempt from the gross income tax to the extent such taxation is prohibited by the United States Constitution."

It is not disputed that the taxpayer contracts with out-of-state companies to process the companies' raw plastic, that the out-of-state companies ship their plastic material into Indiana, and that, upon completion, the customer's finished plastic is returned to the originating state. While the particular details surrounding the taxpayer's operations are important, "[i]n determining whether commerce is interstate or intrastate, regard must be had to its essential character." Indiana Creosoting Co. v. McNutt, 5 N.E.2d 310, 312 (Ind. 1930) citing Pennsylvania R.R. Co. v. Clark Coal Co., 238 U.S. 456, 465-66 (1915). In particular, the United States Supreme Court has held that the Commerce Clause does not prohibit the state from imposing a tax on the proceeds of an otherwise interstate transaction as long as a "local transaction is made the taxable event and that event is separate and distinct from the transportation or intercourse which is interstate commerce." International Harvester Co. v. Department of Treasury, 322 U.S. 340, 346 (1940).

The Indiana Gross Income tax may be constitutionally imposed on income derived from the performance of a service in Indiana. The performance of a service, with or without the incidental furnishing of tangible personal property, on goods belonging to others is taxable if it takes place in Indiana regardless of whether the property moved in interstate commerce before or after the service was provided. Department of Treasury v. Ingram-Richardson Mfg. Co., 313 U.S. 252 (1940). In State of Indiana Dept. of Revenue v. Apex Steel and Supply, Inc., 375 N.E.2d 598 (Ind. App. 1978), the court defined "servicing" as "performing some act upon a material in order to render it in a condition for further use, or sale or into a finished state. Id. at 600.

The Department's own regulations reflect the precedents set by these cases and the principles thereby established. In regard to the concerns raised by the taxpayer, 45 IAC 1.1-2-5(a) specifically addresses those issues when it states that "[g]ross income derived from the provision of a service of any character within Indiana is subject to the gross income tax. This is true even when a service contract calls for the furnishing of tangible personal property in the performance of the contract." 45 IAC 1.1-2-5(d) further explains that "[g]ross income derived from the provision of a service within Indiana, with or without the incidental furnishing of tangible personal property, *on goods belonging to another*, is subject to the gross income tax even though such property is moved in interstate commerce before or after the performance of the service." (Emphasis added).

However, even if the taxpayer's activities could not be properly characterized as services, it is clear that the taxable events, at issue here, occur entirely within the state of Indiana and are subject to the state's gross income tax because the performance of the contract occurs entirely within Indiana. The United State Supreme Court in Ware & Leland v. Mobile County, 209 U.S. 405 (1908) stated that, "Contracts between citizens of different states are not subjects of interstate commerce simply because they are negotiated between citizens of different states... when the contract itself is to be completed and carried out wholly within the border of a state, although such contracts incidentally affect interstate trade."

The taxpayer receives gross income from various services, performed at its Indiana situs, for its out-of-state customers. These services are performed entirely within the state of Indiana. No transfer of title to the raw material occurs but rather, title remains always within the possession of the customer. The Indiana activities are related to the critical transaction. Taxpayer's services are more than minimally related to the substance of the transaction and are not remote or incidental to the total transaction. The taxpayer may find it "inconceivable" that as an owner of a facility containing 20 million dollars worth of production equipment it "would not be considered a manufacturer" (Taxpayer Letter, Aug. 20, 1997) but the "essential character" of what taxpayer performs consists of accepting the customer's plastic material, processing that material, and returning that same material to the individual customer – a most worthwhile service, but nonetheless, a service. "The evidence and the contract in the instant case clearly show that work or service done by the appellant... was exclusively a local and intrastate business, and not interstate; and, therefore, the appellant is not exempt from the Gross Income Act." Indiana Creosoting, 5 N.E.2d at 313.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of Ten-Percent Negligence Penalty.

The taxpayer has requested that the ten-percent negligence penalty, assessed under the authority of IC 6-8.1-10-2.1, be abated. IC 6-8.1-10-2.1(a)(3), imposes on the taxpayer a penalty for "a deficiency that is due to negligence." The penalty is limited to ten-percent of the amount of the tax that was not timely remitted. IC 6-8.1-10-2.1(b)(2), (4). The standards under which negligence is determined and the penalty imposed is found at 45 IAC 15-11-2(b) which states that "`[n]egligence' 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 taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to the duties placed upon the taxpayer by the Indiana Code or department regulations." The regulation goes on to state that the Department shall determine negligence "on a case by case basis according to the facts and circumstances of each taxpayer." Id.

The Department is authorized to waive the penalty "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." 45 IAC 15-11-2(c). The regulation provides a non-exclusive list of factors, which go toward establishing reasonable cause, but

concludes that "[r]easonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case. Id.

In its defense and in an attempt to affirmatively establish the reasonable cause necessary to justify abatement of the penalty, taxpayer argues that there is "nothing in Indiana case law or department published material to give guidance." Taxpayer Protest Letter, Sept. 8, 1999. From the above discussion, it would appear that the taxpayer is mistaken. In the absence of a more substantive reason to justify abatement of the penalty, the Department must decline the opportunity to do so.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

01980152.LOF

LETTER OF FINDINGS: 980152
STATE INDIVIDUAL INCOME TAX
For the 1993 Tax Year

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Imposition of the Indiana Individual Income Tax.

Authority: Ind. Const. art. X, § 8; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; New York v. Graves, 300 U.S. 308 (1937); McKeown v. Ott, No. H 84-169, 1985 WL 11176 (N.D. Ind. Oct. 30, 1985). Richey v. Ind. Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994);

Taxpayer protests the imposition of the Indiana Individual Income Tax on the taxpayer's income.

STATEMENT OF FACTS

Taxpayer received a notice of Proposed Assessment from the Department for unpaid individual income taxes. In response the taxpayer drafted a self-styled "COUNTER DEMAND." Within that counter demand the taxpayer asked the department to "[p]lease exhibit the instrument(s) that I have knowingly, intentionally, and voluntarily signed obligating me to your demand, under agreement." Taxpayer Letter, Feb. 20, 1998. After giving the Department a thirty-day deadline in which to respond and apparently satisfied that the Department would not comply, the taxpayer indicated that "[a] lack of response on your part means a fault exists, creating fraud through material misrepresentation which vitiates all forms, contracts, agreements, etc., express or implied from the beginning." Id.

In taxpayer's subsequent correspondence, noting that the Department had declined the opportunity to produce documentary evidence of the taxpayer's voluntary acceptance of an obligation to pay Indiana Income Tax, the taxpayer set forth the following rhetorical question:

> "Just what instrument did I sign to obligate myself to any demand that you or your department, in any way shape or form, has? Produce this instrument or state to me any implied contract that I have knowingly, willingly, and voluntarily entered into with your corporation." Taxpayer Letter, May 14, 2000.

A hearing was held on September 26, 2000, during which the issues raised by the taxpayer were reviewed and discussed.

I. Imposition of the Indiana Individual Income Tax.

DISCUSSION

The taxpayer's protest letter and subsequent correspondence would seem to open a number of discussion possibilities. However, setting aside certain rarefied but ancillary issues, the taxpayer apparently predicates his protest on the presumption that the obligation to pay the Indiana Individual Income Tax requires the voluntary and formal acquiescence on the part of the taxpayer.

Taxpayer errs. As set forth in the Indiana Constitution, "The general assembly may levy and collect a tax upon income, for whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art. X, § 8. It should be presupposed that the drafters of the Indiana Constitution chose their words with care and, in the quoted section above, selected the word "levy" to describe the relationship between the state, the state's income tax, and the state's taxpayers. When the constitutional provision gave the general assembly the right to "levy" an income tax, it did so with the notion that the state had the right to "impose or assess by legal authority" that tax. Black's Law Dictionary 919 (7th ed. 1999). In IC 6-3-1-3.5 et seq., the general assembly exercised its constitutional prerogative by imposing the adjusted gross income on both individuals and corporations. In doing so it defined an individual, subject to the adjusted gross income tax as "a natural born person, whether married or unmarried, adult or minor." IC 6-3-1-9. And, although the assembly has provided for numerous exemptions to the state's adjust gross income tax, one will search in vain for a statutory exemption covering those persons who decline to step forward and "voluntarily" submit

themselves to the tax's imposition.

The taxpayer raises a threadbare argument which has been addressed in numerous jurisdictions and under numerous circumstances. In each case the argument has been definitely rebutted. "[A]rguments about who is a 'person' under the tax laws, the assertion that 'wages are not income', and maintaining that *payment of taxes is a purely voluntary function do not comport with common sense - let alone the law.*" McKeown v. Ott, No. H 84-169, 1985 WL 11176 at *2 (N.D. Ind. Oct. 30, 1985) (Emphasis Added). Such arguments "have been clearly and repeatedly rejected by this and every other court to review them." Id. at *1. As stated in Richey v. Ind. Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994), "The constitutional legitimacy of the general assembly's decision to tax income is beyond dispute."

The right of the individual states to impose a tax on the income of its residents was addressed by the Supreme Court in New York v. Graves, 300 U.S. 308, 312-313 (1937). In that decision Justice Stone stated "[t]hat the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords the basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws *are inseparable from responsibility for sharing the costs of government. 'Taxes are what we pay for civilized society.'"* (Emphasis added).

Given that taxpayer had taxable income, is an "individual" as defined by IC 6-3-1-9, was a resident of Indiana for the years at issue (IC 6-3-1-12), is a taxpayer (IC 6-3-1-15), the statutes imposing the state's individual income tax are applicable to the taxpayer.

Taxpayer's argument that, absent his voluntary acquiescence, he is not subject to the state's individual income tax, does not comport with the law or with common sense.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02980267.LOF

LETTER OF FINDINGS NUMBER: 98-0267 ITC
GROSS AND ADJUSTED GROSS INCOME TAX
For Years 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. Adjusted Gross Income Tax – Sales Factor

Authority: IC § 6-3-2-2; IC § 6-3-2-12

Taxpayer protests exclusion of foreign dividends from sales factor denominator.

II. Adjusted Gross Income Tax – Negligence Penalty

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

Taxpayer protests imposition of 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation with some operations in Indiana. Taxpayer receives income from sources within Indiana, national, and foreign investments. The Department removed taxpayer's foreign dividends from the denominator of the sales apportionment formula and taxpayer is protesting said removal and the imposition of the negligence penalty.

I. Adjusted Gross Income Tax – Sales Factor

DISCUSSION

Taxpayer receives foreign dividends from its subsidiaries. The auditor removed this dividend income from the taxpayer's sales factor. Taxpayer argues that the denominator of the sales factor includes total sales for everywhere during the year, based on IC § 6-3-2-2(e), which states:

> The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. Sales include receipts from intangible property and receipts from the sale or exchange of intangible property. However, with respect to a foreign corporation, the denominator does not include sales made in a place that is outside the United States. Receipts from intangible personal property are derived from sources within Indiana if the receipts from the intangible personal property are attributable to Indiana under section 2.2 of this chapter…

Taxpayer does not cite or establish that the definition of sales includes foreign dividends and even if taxpayer could, such sales would be excluded from taxpayer's sales denominator pursuant to IC § 6-3-2-2(e). The statutory reference given only extends to "include receipts from intangible property and receipts from the sale or exchange of intangible property." In this circumstance, this

does not encompass the receipt of foreign dividends.

Additionally; taxpayer does not reference IC § 6-3-2-12, which states in relevant part:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of:

(1) the amount of the foreign source dividend included in the corporations adjusted gross income for the taxable year; multiplied by

(2) the percentage prescribed in subsections (c), (d), or (e), as the case may be.

In this instance, the foreign dividends at issue are completely deducted from taxpayer's business income based on IC § 6-3-2-12. It follows that the exclusion of foreign income in apportionment calculations is required, inasmuch as taxpayer's Indiana adjusted gross income (as required in IC § 6-3-2-12) does not include foreign dividends. Using foreign income receipts to weight taxpayer's domestic income apportionment has no logical or statutory basis.

Taxpayer has failed to establish a statutory requirement to include the foreign dividends in the apportionment calculation and has not demonstrated why -given the absence of foreign dividend income in the income to be apportioned- foreign source dividends should be used to weight the denominator in the apportionment calculation.

FINDING

Taxpayer protest is denied.

II. Adjusted Gross Income Tax – Negligence Penalty

DISCUSSION

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10. The Indiana Administrative Code further provides:

(b) "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.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;

(2) judicial precedents set by Indiana courts;

(3) judicial precedents established in jurisdictions outside Indiana;

(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;

(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case. 45 IAC 15-11-2.

While taxpayer's position was not upheld, it was based, at least in part, on reasonable interpretations of Indiana's tax statutes. Consequently, the negligence penalty will be waived for the tax years at issue.

FINDING

Taxpayer protest sustained.

DEPARTMENT OF STATE REVENUE

18980338.LOF

LETTER OF FINDINGS NUMBER: 98-0338
INDIANA FINANCIAL INSTITUTIONS TAX
For Years 1993, 1994, 1995, and 1996

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. Add Back of State Taxes Based On Or Measured by Income: Michigan Single Business Tax.

Authority: IC 6-5.5-1-2(a)(1)(C); First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999); 45 IAC 17-3-1(3).

Taxpayer protests the auditor's determination that the Michigan Single Business Tax is a tax sufficiently based on and measured by income such that the tax must be added back for purposes of determining taxpayer's liability under Indiana's Financial Institutions Tax. Taxpayer argues that the tax does not meet the definition of a tax based on or measured by income and therefore, no addback of the Michigan Single Business Tax is required to calculate taxpayer's adjusted gross income.

II. Determining Bad Debt Addback.

Authority: 26 U.S.C.S. § 63; 26 U.S.C.S. § 166; Montgomery v. State Bd. Of Tax Comm'rs, 708 N.E.2d 936, 939 (Ind. Tax Ct. 1999); Fort Wayne Nat'l Corp. v. Indiana Dept. of State Revenue, 621 N.E.2d 688, 671 (Ind. Tax Ct. 1993); IC 6-5.5-1-2(a)(1)(A); IC 6-5.5-1-2(a)(2)(C).

Taxpayer protests the auditor's determination that taxpayer, in calculating the Financial Institutions Tax, understated the amount of the bad debt addback. Taxpayer maintains that in determining the amount of bad debt addback, it should be allowed to net the amount of bad debt against any amount of that bad debt recovered during the tax year.

STATEMENT OF FACTS

The taxpayer is a bank holding company with a number of subsidiaries located in Michigan, Illinois, and Indiana. The taxpayer is currently headquartered in Ohio. During the period in which the audit was conducted, taxpayer owned two Indiana banking subsidiaries which were later merged.

DISCUSSION

I. Addback of State Taxes Based On Or Measured by Income: Michigan Single Business Tax.

In calculating the taxpayer's adjusted gross income under the Financial Institutions Tax, the starting point is "taxable income" as defined in 26 U.S.C.S. § 593. IC 6-5.5-1-2(a). Under IC 6-5.5-1-2(a)(1)(C), a taxpayer is required to add back to "taxable income" an amount equal to a deduction allowed or allowable under I.R.C. § 63. (*See also* IAC 17-3-1(3)). Specifically, the regulation calls for the addback "for taxes based on or measured by income and levied at the state level by a state of the United States...." IC 6-5.5-1-2(a)(1)(C). The auditor determined that the amount of taxes taxpayer paid pursuant to the Michigan Single Business Tax was "sufficiently based on and measured by income" (Ind. Dept. of Revenue Explanation of Adjustments, p. 7) such the taxpayer was required to add back those taxes in arriving at Indiana adjusted gross income. The taxpayer disagreed arguing that the Michigan Single Business Tax did not meet the definition of a tax based on or measured by income.

In First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999), the court held that the Michigan Single Business Tax was a value added tax which used taxable income as one component in its base calculation. Id. at 633-34. However, because of the extensive adjustments which were made to the individual taxpayer's taxable income in arriving at the Michigan Single Business Tax, the tax "becomes an entirely different tax, one that cannot be fairly read to fit under the 'based on or measured by income' language chosen by the Indiana General Assembly." Id. at 635.

FINDING

Taxpayer's protest is sustained.

DISCUSSION

II. Determining Bad Debt Addback.

The taxpayer protests the means by which the auditor determined the amount of bad debt added back in calculating taxpayer's adjusted gross income under the Financial Institutions Tax.

IC 6-5.5-1-2(a) states that, in determining a financial institution's adjusted gross income, the starting point is "taxable income" as defined by I.R.C. § 63. (26 U.S.C.S. § 63). To that amount of taxable income a number of adjustments, peculiar to Indiana, are then made. In particular, the taxpayer is concerned with the application of two of these adjustments – one of which is an "addback" while the other is a subtraction provision. The first adjustment, relevant here, is the addback provision found at IC 6-5.5-1-2(a)(1)(A) which states that the taxpayer must add "[a]n amount equal to a deduction allowed or allowable under Section 166, Section 585, or Section 593 of the Internal Revenue Code." Id. Therefore, if the taxpayer was permitted to deduct a bad debt loss to calculate its federal tax, Indiana requires the bad debt loss be added back in order to determine the Indiana adjusted gross income.

The second adjustment is found at IC 6-5.5-1-2(a)(2)(C) which states, in relevant part, that the taxpayer is required to subtract "[a]n amount equal to a debt or part of a debt that becomes worthless, as permitted under Section 166(a) of the Internal Revenue Code."

The calculation of the addback amount, under IC 6-5.5-1-2(a)(1)(A), is the point at which the Department and the taxpayer part ways. The auditor determined that the amount of addback should be equal to the amount previously deducted on the taxpayer's federal returns for bad debt loss. The taxpayer disagrees and states that the amount of addback should be the *net* of the bad debt loss together with any amount recovered on those bad debts.

Taxpayer maintains that its method of netting bad debt and bad debt recovery is consistent with Treasury Regulations. For example, taxpayer cites Treasury Regulation 1.469-2T(b)(1) for the proposition that income and loss items are to be netted in order to derive the passive activity loss deduction. The taxpayer further argues that the Department's own application of the bad debt statute, adding and then subtracting the same amount, produces an absurd and illogical result because the Department's interpretation of the statute results in a zero tax affect. According to taxpayer, applying the rules of statutory construction, taxpayer's method becomes meaningful because the amount of addback and the corresponding amount subtracted does not simply reverse itself because

the two amounts, assuming some amount of bad debt recovery, are necessarily different.

The taxpayer is correct in its assertion that the issue is one of statutory interpretation. In arriving at an interpretation of the statute the tax court has instructed that "[t]he cardinal rule of statutory interpretation is to ascertain and give effect to the intent of the legislature [with] all other rules of statutory interpretation... subservient to that cardinal rule." Montgomery v. State Bd. Of Tax Comm'rs, 708 N.E.2d 936, 939 (Ind. Tax Ct. 1999). In giving affect to the intent of the legislature and meaning of any statute the Indiana Tax Court has further stated "when construing a statute, the court is to give statutory words and phrases their plain ordinary, and usual meaning...." Fort Wayne Nat'l Corp. v. Indiana Dept. of State Revenue, 621 N.E.2d 688, 671 (Ind. Tax Ct. 1993).

IC 6-5.5-1-2(a)(1)(A), the relevant addback provision, provides that the taxpayer is required to add back to the amount of federal taxable income, "[a]n amount equal to a deduction allowed or allowable under Section 166, Section 585, or Section 593 of the Internal Revenue Code." Id. Because Section 585 and Section 593 are not applicable, the taxpayer must look to Section 166 (26 U.S.C.S. § 166) to determine the amount of the required addback.

Section 166 of the Internal Revenue Code provides in relevant part that as a "General Rule (1) Wholly worthless debts. There shall be allowed as a *deduction* any debt which becomes worthless within the taxable year. (2) Partially worthless debts. When satisfied that a debt is recoverable only in part, the Secretary may allow such debt, in an amount not in excess of the part charged off within the taxable year as a *deduction*." 26 U.S.C.S. § 166 (Emphasis added). By reading together 26 U.S.C.S. § 166 and IC 6-5.5-1-2(a)(1)(A), the meaning of the latter provision becomes apparent. Any deduction taken pursuant to 26 U.S.C.S. § 166 must be added back to the federal taxable income calculation in order to arrive at adjusted gross income for the purpose of determining Indiana's Financial Institutions Tax. IC 6-5.5-1-2(a)(1)(A) simply does not reference any procedure by which the taxpayer may apply a *reduction* to the *deduction* authorized under 26 U.S.C.S. § 166. This straightforward interpretation and application of the IC 6-5.5-1-2(a)(1)(A) accords with the Tax Court's admonition that we are "to give statutory words and phrases their plain ordinary, and usual meaning...." Fort Wayne Nat'l Corp. 621 N.E.2d at 671.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02980501.LOF

LETTER OF FINDINGS NUMBER: 98-0501
ADJUSTED GROSS INCOME TAX
For Years 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. Adjusted Gross Income Tax – Net operating loss limitations.

The taxpayer protested the auditor's procedure for importing IRS Section 382 net operating loss carryforward limitations to Indiana adjusted gross income calculations.

STATEMENT OF FACTS

Taxpayer corporation is the result of the merger of two corporations doing business in Indiana, with the new corporation continuing to file Indiana returns. As a result of the change in ownership of the two predecessor corporations, taxpayer's Federal net operating loss was limited to a percentage of the purchase price of the predecessor corporations under the Internal Revenue Code Section 382. Taxpayer corporation deducted as its Indiana net operating loss carryover the combined Indiana losses of its two predecessor corporations. The auditor reduced taxpayer corporation's net operating loss by a proportional percentage (said percentage being the percentage of taxpayer's adjusted gross income apportioned to Indiana) of the percentage of the purchase price of the predecessor corporations as allowed by the Internal Revenue Code Section 382. Taxpayer is protesting the auditor's reduction of its allowed net operating loss.

I. Adjusted Gross Income Tax – Net operating loss limitations.

DISCUSSION

Two Indiana statutes that specifically refer to IRS sections are at issue. IC § 6-3-1-3.5(b) which defines taxable income for corporations as:

> In the case of corporations, the same as "taxable income" (as defined in Section 63 of the Internal Revenue Code) adjusted as follows…

The remaining connection to the Adjusted gross income calculations deals with Net operating losses and is defined in relevant part by IC § 6-3-2-2.6 as:

(a) This section applies to a corporation or a nonresident person for a particular taxable year, if the taxpayer's adjusted gross income for that taxable year is reduced because of a deduction allowed under Section 172 of the Internal Revenue Coded for a net operating loss. For purposes of section 1 of this chapter, the taxpayer's adjusted gross income the particular taxable year, derived from sources within Indiana is the remainder determined under STEP FOUR of the following formula:

...

STEP TWO: Determine, in the manner prescribed in subsection (b), the amount of the taxpayer's net operating losses that are deductible for the taxable year under Section 172 of the Internal Revenue Code, as adjusted to reflect the modifications required by IC 6-3-1-3.5, and that are derived from sources within Indiana.

...

(b) For purposes of STEP TWO of subsection (a), the modifications that are to be applied are those modifications that are to be applied are those modifications required under IC 6-3-1-3.5 for the same taxable year during which each net operating loss was incurred. In addition, for purposes of STEP TWO of subsection (a), the amount of a taxpayer's net operating losses that are derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's income derived from sources within Indiana is determined, under section 2 of this chapter, for the same taxable year during which each loss was incurred...

...

Both the department and taxpayer corporation agree that this federal limitation is applicable to the taxpayer corporation at the federal level and that it applies to Indiana's adjusted gross income. Inasmuch as Internal Revenue Code Section 382- which serves to reduce the Federal net operating loss carryforward following a corporate ownership change or merger – is not explicitly referenced in either of the above statutes, the issue is how it effects the Indiana adjusted gross income tax computations.

Taxpayer corporation takes the position that absent explicit treatment by the above statutes, the Section 382 loss is an allowable unapportioned net operating loss derived from sources within Indiana and taken directly from Indiana adjusted gross income. The auditor took the position that the proportional percentage of the Section 382 amount is the percentage of taxpayer's adjusted gross income apportioned to Indiana in the loss years. Neither calculation is supported by the above statutes.

When calculating Indiana Adjusted gross income, IC § 6-3-2-2.6 requires a net operating loss amount brought in from the federal tax calculations based on the Internal Revenue Code Section 172. Code Section 172(j), "Cross References," states:

... (2) For special limitation on net operating loss carryovers in case of a corporate change of ownership, see section 382.

Thus, when IC § 6-3-2-2.6 explicitly requires the use of Internal Revenue Code Section 172, Internal Revenue Code Section 382 is explicitly required in Section 172 calculations. The Section 382 loss limitation effects will be treated as part of the IC § 6-3-2-2.6 calculation of Indiana adjusted gross income. After the Section 382 limitations are incorporated into the Section 172 net operating loss values, they are then incorporated into the Indiana adjusted gross income as required by step 2 of IC § 6-3-2-2.6, cited above, which requires the loss calculations be "losses that are deductible for the taxable year."

Consequently, rather than applying a percentage based on a ratio of historical losses, the audit should be calculated based on the apportionment percentage of the year of purchase applied to the federal section 382 limitation (which is long term tax exempt rate to the fair market value of the stock at date of purchase). This methodology parallels federal methodology in that it does not look to historical losses in calculating the loss limitation. Then, as required by IC § 6-3-2-2.6(b), the loss is to be calculated in the same manner that Section 2 of this chapter determines income derived from Indiana, which requires the adjusted gross income for corporations to be apportioned.

FINDINGS

Taxpayer protest denied in part and sustained in part. After the Section 382 limitations are incorporated into the Section 172 net operating loss values, they are then imported into the Indiana adjusted gross income calculation based on the methodology outlined above.

DEPARTMENT OF STATE REVENUE

04980560.LOF

LETTER OF FINDINGS NUMBER 98-0560
INDIANA SALES / USE TAX

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.

I. Abatement of Penalty and Interest Assessed for Late Payment of the Indiana Gross Retail Tax.

Authority: IC 6-2.5-2-1; IC 6-8.1-10-2.1(a); IC 6-8.1-10-2.1(a)(4); IC 6-8.1-10-2.1(d); 45 IAC 2.2-2-2; 45 IAC 15-11-2(b).

Taxpayer requests that the penalty and interest assessed for its late payment of Indiana gross retail tax liabilities be abated. Taxpayer maintains that the late payment was reasonable considering the pressing financial difficulties it was facing at the time the taxes became due. In addition the decision by the taxpayer's employee, otherwise responsible for making timely payment of tax liabilities, to defer payment of the taxes was not attributable to the taxpayer but was an independent and unauthorized decision by that employee for which taxpayer should not be held accountable.

STATEMENT OF FACTS

The taxpayer is an out-of-state clothing retailer. The taxpayer operates / operated 114 outlets in 22 states. According to the taxpayer, at the time it submitted its protest in August of 1998, taxpayer was emerging from Chapter 11 bankruptcy proceedings. A recent news item indicates that the taxpayer is now "defunct" having apparently filed a second Chapter 11 bankruptcy petition. The taxpayer has not communicated with the Department and has not responded to the Department's communications since the taxpayer filed its original protest.

I. Abatement of Penalty and Interest Assessed for Late Payment of the Indiana Gross Retail Tax.

DISCUSSION

Taxpayer protests the assessment of a penalty and associated interest for late payment of Indiana sales and use tax. Taxpayer argues that the failure to pay its sales and use tax liability is attributable to its preoccupation with existing financial and bankruptcy issues at the time the taxes became due. According to taxpayer, the decision to delay payment of its tax liability was the unilateral and unauthorized decision of a single employee who has since been discharged. Taxpayer argues that its late payment of sales and use tax was an isolated instance the discovery of which forced the taxpayer to rethink its policies and procedures in order to assure the accurate and timely reporting of taxes in the future. Since taxpayer lodged its original protest, the Department has received no further communication from the taxpayer. Taxpayer has failed to augment the information in its original protest, failed to respond to the Department's written communications, and failed to take part in the protest hearing.

Taxpayer provided little information as to the basis of its protest. Presumably, the taxpayer is protesting penalty and interest levied on the basis of taxpayer's failure to timely remit sales and use tax. Under IC 6-2.5-2-1, an excise tax known as the state gross retail tax is imposed on retail transactions made in Indiana unless a valid exemption is applicable to the transaction. Under 45 IAC 2.2-2-2, the gross retail tax is paid by the customer but the retail merchant acts as an agent for the state of Indiana and is responsible for collecting the tax. Acting as the state's agent, the seller is not only responsible for collecting the tax but must hold the tax receipts and pay them over to the state periodically. *See* IC 6-2.5-6 et seq.

Under IC 6-8.1-10-2.1(a)(4), if a person "fails to timely remit any tax held in trust for the state... the person is subject to a penalty." The Department is required to abate the negligence penalty if the taxpayer "can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust... was due to reasonable cause and not due to willful neglect." IC 6-8.1-10-2.1(d). 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Taxpayer negligence can be inferred from the taxpayer's "carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations." Id.

Additionally, under IC 6-8.1-10-1(a), upon taxpayer's failure to pay the full amount of tax due, the taxpayer "is subject to interest on the nonpayment."

The taxpayer does not meet its burden of demonstrating that its failure to pay its tax obligation was attributable to "reasonable cause." The fact that taxpayer was experiencing financial difficulties is insufficient justification for taxpayer's failure to forward tax receipts held in trust for the state of Indiana. Similarly, taxpayer cannot escape responsibility by attributing its failure to pay taxes to a single aberrant employee. Even if, given the scant factual information supplied by taxpayer, the taxpayer's failure to pay Indiana taxes could reasonably be attributable to a single rogue employee, taxpayer necessarily retains ultimate responsibility for the actions of that employee. Taxpayer is/was a large, multi-state, sophisticated retail business fully capable of understanding and meeting its statutory responsibilities for the payment of Indiana taxes.

Unlike the negligence penalty imposed under IC 6-8.1-10-2.1(a)(4), the interest assessed for late payment under IC 6-8.1-10-1(a) is not subject to the Department's discretionary review. Rather, IC 6-8.1-10-1(a) simply states that, upon a finding a payment deficiency, the taxpayer "is subject to interest on the nonpayment." Absent the statutory or equitable authority to abate the interest properly imposed under IC 6-8.1-10-1(a), the Department must decline the taxpayer's invitation to do so.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04990055.LOF

LETTER OF FINDINGS NUMBER: 99-0055
STATE GROSS RETAIL AND USE TAXES
For Years 1994, 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.

ISSUES

I. Sales / Use Tax - Bad Debt Deduction: Methods used in determining taxpayer's sales and use tax liability.

Authority: 45 IAC 2.2-6-12(a); 45 IAC 2.2-6-12(b).

Taxpayer protests the auditor's method of calculating the bad debt adjustment because the auditor included in the calculation sales made to large volume customers.

II. State Gross Retail Tax – Equipment Used in Retail Stores: Equipment used in preparation of consumer paint products.

Authority: IC 6-2.5-2-1; IC 6.2.5-5-3(b); 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(g); 45 IAC 2.2-5-12(a); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. Tax 1983).

Taxpayer protests the assessment of sales tax on items of certain equipment purchased for use in its retail stores.

III. State Gross Retail Tax – Quality Control Equipment Used at Powder Coatings Plant:

Authority: IC 6-2.5-5-3; 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(d); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 524; 45 IAC 2.2-5-8(c)(2)(G); 45 IAC 2.2-5-8(i)(2).

Taxpayer protests the assessment of sales tax on equipment and quality control equipment used at its powder coatings plant.

IV. State Gross Retail Tax – Dust Collection Installation at Powder Coatings Plant:

Authority: IC 6-2.5-1-3; IC 6-2.5-3; IC 6-2.5.5-30; 45 IAC 2.2-5-70; 326 IAC 6-3.

Taxpayer protests the assessment of sales taxes on a dust collection system used in its powder coatings plant.

V. State Gross Retail Tax – Safety Equipment and Supplies Used at Powder Coatings Plant:

Authority: IC 6-2.2-5-3(b); 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(c)(2); 45 IAC 2.2-5-8(c)(2)(F); Dept. of Revenue v. United States Steel Corp., 425 N.E.2d 659 (Ind. Ct. App.1981).

Taxpayer protests the imposition of sales tax on protective glasses, safety gloves, overalls and earplugs taxpayer purchased for use by its plant workers.

VI. State Gross Retail Tax – Wrapping Materials and Shipping Pallets Used at Warehouse:

Authority: IC 6-2.5-5-9; IC 6-2.5-5-9(d); 45 IAC 2.2-5-16(a); 45 IAC 2.2-5-16(d)(3).

Taxpayer protests the imposition of sales tax on shrink-wrap, pallets, tape, packaging adhesive, and drums purchased for use at its warehouse and distribution center.

VII. Abatement of Penalty:

Authority: IC 6-8.1-10-2(a); IC 6-8.1-10-2.1(d); IC 6-8.1-10-4; 45 IAC 15-11-2; 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer requests that the imposed 10% negligence penalty be abated.

STATEMENT OF FACTS

Taxpayer is an Ohio corporation headquartered in Ohio and authorized to do business in the state of Indiana. Taxpayer is a manufacturer, wholesaler, and retailer of paint, coatings (including powder coatings), and related products. Taxpayer operates approximately 30 primary manufacturing facilities located throughout the United States including a powder coatings manufacturing facility located in Indiana. During tax years 1994 and 1995, taxpayer operated a warehouse in Indiana, in which paint and paint related products were stored for shipment to locations within and outside of Indiana.

I. Sales / Use Tax - Bad Debt Deduction:

DISCUSSION

Taxpayer protests the auditor's calculation of bad debt relevant to determining taxpayer's sales and use tax liability. Under 45 IAC 2.2-6-12(a), in determining the taxpayer's sales and use tax liability, a retail merchant shall deduct from his gross retail income from retail transactions made during a particular reporting period, the retail merchant's bad debts or uncollectible receivables. In addition, 45 IAC 2.2-6-12(b) provides that "[in] order to qualify for this exemption the retail merchant must have: (1) previously reported the transaction and remitted the sales or use tax to the Department; (2) Not

collected the tax from the customer and (3) Written the receivable off for federal income tax purposes."

Taxpayer argues that the audit incorrectly determined the amount of its bad debt by including within its calculation those sales made to large volume retailers not administered through taxpayer's own retail outlets (hereinafter "wholesale"). Taxpayer maintains that these wholesale sales are made with customers who typically impose little or no risk of non-payment. Further, taxpayer maintains that because the bad debt adjustment only relates to retail store activity, wholesale sales must be subtracted from total sales.

Taxpayer maintains that an examination of the records of its individual retail outlets, on a store-by-store basis, would provide a more accurate account of its uncollectible receivables. To that end, taxpayer has supplied information ("The Taxpayer 1998 Bad-Debts Write-Off Calculation File March 2000") detailing its own method and figures for calculating net taxable write-offs for each of its individual retail stores for the year 1998.

To the extent that taxpayer is able to similarly substantiate net taxable write-offs for bad debt amounts at its individual retail stores for the years included in the audit, and to substantiate the net taxable write-offs for bad debt amounts for wholesale sales made to its large volume retailer customers, taxpayer is entitled to provide those figures to audit for consideration during the supplemental audit.

FINDING

Taxpayer's protest is sustained.

II. State Gross Retail Tax – Equipment Used in Retail Stores

DISCUSSION

Pursuant to IC 6-2.5-2-1, a sales tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Under IC 6-2.5-5-3(b), 45 IAC 2.2-5-12(a), an exemption from the state gross retail tax is provided for transactions involving manufacturing machinery, tools, and equipment 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. 45 IAC 2.2-5-8(c) defines "direct use" as use having an immediate effect on the article being produced. Property has such an immediate effect if it is an essential and integral part of an integrated process that produces tangible personal property. 45 IAC 2.2-5-8(g).

Taxpayer asserts that four items of equipment, installed at its retail outlets, come within the ambit of IC 6-2.5-5-3(b) and, therefore, the purchase of that equipment should be exempt from sales tax. The four items of equipment include: 1) Color Matching Systems, 2) Automatic Colorant Dispensers, 3) Shakers, and 4) Related Computer Equipment consisting of a CPU, monitor, keyboard, and printer.

Taxpayer produces a white base paint at its primary production facilities. This white base paint is then shipped to taxpayer's various retail outlets. Not all the white base is identical because different colors require the use of different bases having different chemical qualities. The "gallon" containers of white base actually contain less then a full 64 ounces in order to permit the eventual addition of colorants.

Retail customers may choose paint in one of two ways. The customer may select a paint color from one of the color cards provided by taxpayer. Alternatively, customer may bring in a color sample to be custom matched. Once the customer selects or provides the desired color, taxpayer's employee begins a process by which the specified paint is produced. If the customer has brought in a color sample, that sample is measured by the Color Matching System (a spectrophotometer or other color-sensing device). The resulting measurements are converted to a numerical value which is sent to the computer equipment. The computer equipment in turn produces a unique color formula which is sent to the Automatic Colorant Dispenser.

If the customer chooses a standard color from a color card, taxpayer's employee enters a color identification number into the computer which is transferred to the Automatic Colorant Dispenser.

The Automatic Colorant Dispenser meters out the appropriate amount of individual colorant's required to produce the customer's finished paint product. The attached printer is used to produce a label, listing the color identification number and colorant ingredients, which is attached to each container of finished product.

Once colorant has been added to each paint container, the containers are placed into the Shaker and paint is properly mixed. If this last step is not completed, customers would not obtain a useable product because the colorants would not be evenly dispersed throughout the can of paint. It is not possible for customers to mix their own paint by taking the paint home and stirring it themselves because customers would not be able to satisfactorily disperse the colorant.

Taxpayer's Automatic Colorant Dispensers are equipment used in the direct production of tangible personal property and, therefore, qualify for the gross retail tax exemption provided under IC 6-2.5-5-3(b). The functions performed by this equipment are an essential and integral part of a manufacturing process that produces tangible personal property as required by Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 525 (Ind. Tax 1983), and 45 IAC 2.2-5-8(g).

The dedicated Computer Equipment also qualifies for the exemption provided under IC 6-2.5-3(b). The computer links together and controls The Color Matching system and Automatic Colorant Dispenser thereby making it possible to produce a finished marketable product. As such, the Computer Equipment, in translating the coded instructions, selecting the

necessary colorants, determining the amount of colorant, and controlling the dispensing of the colorants, acts as an integral part of taxpayer's manufacturing process.

Taxpayer's Color Matching systems do not qualify for the exemption afforded under IC 6-2.5-5-3(b) because the Color Matching systems operate outside of and are independent to the manufacturing process that produces the taxpayer's finished product. The Color Matching systems do not produce an immediate change on the finished product. Instead, the Color Matching systems are used to analyze the customer's paint sample and to produce data that is entered into or sent to the computerized control unit where the actual production of the finished product begins.

To the extent that taxpayer's Shakers are used to mix customized paint products, the Shakers are exempt from the gross retail tax under IC 6-2.5-5-3(b). However, to the extent the Shakers are used to mix the taxpayer's non-customized paints, the Shakers are not entitled to the exemption. In addition, to the extent that the Shakers are used to re-mix paints previously sold but which may have over time become separated, the Shakers are also not entitled to the exemption.

FINDING

Taxpayer's protest is sustained in part and denied in part.

I. State Gross Retail Tax – Quality Control Equipment Used at Powder Coatings Plant.

DISCUSSION

Taxpayer protests the assessment of state gross retail tax on gram scales, floor scales, water chiller, and quality control laboratory equipment. The quality control laboratory equipment includes a spray gun, convection oven, air compressor, vacuum pump, and "Q-panels" (onto which paint samples are sprayed). Taxpayer argues this equipment should be exempt from the state gross retail tax under IC 6-2.5-5-3 because the equipment was acquired for the direct use in the direct production of its powder coatings product.

The courts and the Department interpret IC 6-2.5-5-3 to mean that equipment is directly used in direct production if the equipment is both integral and essential to taxpayer's production process. 45 IAC 2.2-5-8(c). Further, if the equipment is both integral and essential to the manufacturing process it has an immediate effect on the article being produced. Id. 45 IAC 2.2-5-8(d) specifically excludes equipment used in pre-production and post-production activity.

Taxpayer maintains that its purchase of floor scales is exempt because it was a purchase of manufacturing equipment coming within the IC 6-2.5-5-3(b) double direct exemption. The audit disagreed determining that the purchase of the floor scales was not exempt because the scales were pre-production assets functioning outside of the taxpayer's production process. The tax court in Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. Tax 1983) defined the production process broadly stating that the exemption "statute circumscribes all of the operations or processes by which the finished product is derived." Id. at 524. This broad definition encompasses the taxpayer's floor scales because the floor scales are a part of the integrated process of producing powder coatings where, in its initial stages, the scales are used to weigh, measure, and combine the powder coatings' constituent ingredients. The example of exempt equipment cited at 45 IAC 2.2-5-8(c)(2)(G) is analogous to taxpayer's floor scales. 45 IAC 2.2-5-8(c)(2)(G) states that the purchase of an automated scale process employed to measure quantities of raw aluminum used in the next production step is exempt. The fact that taxpayer's own floor scales are not similarly automated is irrelevant because it is the relationship of the equipment at issue to the integrated production process which determines its exempt status not the particular manner in which that equipment functions.

Taxpayer's purchase of a water chiller is exempt from tax. The water chiller has both a direct effect on and is directly used in the direct production of taxpayer's powder coatings. Furthermore, the water chiller is exclusively dedicated for that purpose and is not used for any ancillary, non-production purposes. During taxpayer's powder coatings production process, raw materials are mixed, heated, and transformed into a liquid state in a piece of equipment called an extruder. After leaving the extruder, the liquid material is chilled to return it to a solid form. Finally, that cooled and solidified mixture is crushed and ground into the finished powder coatings. Taxpayer's water chiller operates at the intermediate production stage to cool and circulate the water used to transform the liquid material back into solid form.

Taxpayer's quality control equipment is used in two situations. The equipment is used to analyze and test samples of paint produced during the actual manufacturing process, and it is used to analyze and match a particular customer's individual paint specifications.

Under 45 IAC 2.2-5-8(i)(2), machinery, tools, and equipment used to test and inspect the product as part of the production process are exempt. The Department interprets this regulation to exempt equipment used to test the in-process manufacturing of products which will later be sold. Therefore, to the extent that taxpayer's equipment is used to test samples, removed from the in-process production line, for qualities such as thickness, gloss, and adhesion, that equipment is exempt.

However, to the extent that taxpayer's quality control equipment is used to analyze and match customer's paint specifications, the equipment is not exempt. The equipment, used as such, constitutes pre-production assets which are outside the exemption provided under IC 6-2.5-5-3. The equipment is not directly used in the direct production of taxpayer's powder coatings. It is neither integral nor essential to taxpayer's production process.

FINDING

Taxpayer's protest is denied in part and sustained in part. Taxpayer's purchase of floor scales is exempt from tax. Taxpayer's purchase of a water chiller is exempt from tax. Taxpayer's quality control equipment is exempt from tax to the extent that the equipment is used to test samples removed during the in-process production of powder coatings. However, taxpayer's quality control equipment is taxable, as a pre-production asset, to the extent the equipment is used to analyze and match customers' individual paint specifications.

IV. State Gross Retail Tax – Dust Collection Installation at Powder Coatings Plant.

DISCUSSION

Taxpayer protests the assessment of gross retail tax on the dust collection system installed at its powder coatings plant. Taxpayer argues that the dust collection system should be exempt, under IC 6-2.5-5-3, IC 6-2.5-5-30, and 45 IAC 2.2-5-70, because the system was installed to comply with environmental standards.

The dust collection system is attached to the sifter at the end of each of the six powder coatings production lines. Residual dust is collected and transported to a container outside the building where its is later collected for landfill disposal.

IC 6-2.5-5-3 provides that sales of tangible personal property are exempt from the state retail tax if: (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining or agriculture.

Taxpayer must meet the two requirements found in IC 6-2.5-5-30 before the dust collection system can be considered exempt personal property. It is clear that taxpayer meets the second of those two requirements. Taxpayer is a corporate "person," under IC 6-2.5-1-3, engaged in the business of manufacturing paint and paint related products.

However, the auditor disagreed with taxpayer's contention that the dust collection system was purchased for the purpose of complying with environmental quality statutes stating that, "[n]o documentation [had] been provided to support the installation of the dust collection to comply with environmental quality regulations."

Documentation supplied by taxpayer supports taxpayer's contention that the dust collection system was installed in order to comply with applicable environmental regulations. Document labeled "Appendix A: Emission Calculations" prepared by the Indiana Department of Environmental Management (IDEM), contains statistics related to the amount of particulate matter produced at taxpayer's powder coatings plant. The document specifies the amount of potential particulate matter produced at taxpayer's plant before control device (dust collector) installation, specifies the amount of particulate matter following installation of the dust collector, compares those two amounts to the amount of "allowable" particulate matter, and concludes, "this process is in compliance with 326 IAC 6-3."

A letter from IDEM, dated December 11, 1996, notified taxpayer that, pursuant to 326 IAC 6-3, the dust collection system "*shall* be in operation at all times when the powder coating manufacturing process is in operation and *shall* not exceed the allowable particulate matter (PM) emission rate of 4.10 pounds per hour." (Emphasis added). That same document mandates that any malfunction of taxpayer's emission control equipment shall be reported to the Office of Air Management within four hours after the malfunction occurs.

Taxpayer is in compliance with both requirements of IC 6-2.5-5-30. Taxpayer's dust collection system was installed "for the purpose of complying with... state, local, or federal environmental quality statutes, regulations, or standards."

FINDING

Taxpayer's protest is sustained.

V. State Gross Retail Tax – Safety Equipment and Supplies Used at Powder Coatings Plant

DISCUSSION

Taxpayer protests the auditor's determination that its purchases of safety glasses, safety gloves, overalls, and earplugs are subject to gross retail tax. Taxpayer maintains that, under 45 IAC 2.2-5-8(c)(2)(F), this equipment is properly exempt.

Under IC 6-2.5-5-3(b) 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 or other tangible personal property. Equipment purchased for direct use in direct production must have an immediate effect on the article being produced. 45 IAC 2.2-5-8(c). Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process that produces tangible personal property 45 IAC 2.2-5-8(c); Indiana Dept. of Revenue v. United States Steel Corp., 425 N.E.2d 659, 664 (Ind. Ct. App. 1981). The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product is not determinative. 45 IAC 2.2-5-8(c)(2). Under 45 IAC 2.2-5-8(c)(2)(F), "Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production," is exempt from tax.

Taxpayer argues that because production of its powder coatings requires very high purity levels, these items must be worn by the workers to prevent contamination of the powder coatings. Contamination would result in added expenses in

producing the powder coatings and taxpayer's customers would not receive properly manufactured goods. Taxpayer states that earplugs are essential for its workers to produce the powder coatings because, without the earplugs, workers could not perform their duties as the noise from the machinery would drastically affect their hearing.

Purchases of earplugs worn by taxpayer's employees to prevent hearing damage in high noise manufacturing areas are exempt from tax. Purchases of overalls, to the extent that the overalls are worn exclusively within the manufacturing area, are exempt. Purchases of safety gloves and safety glasses, acquired for the purpose of protecting taxpayer's employees from injury at its manufacturing line, are exempt from tax.

FINDING

Taxpayer's protest is sustained.

VI. State Gross Retail Tax – Wrapping Materials, Drums, and Shipping Pallets Used at Warehouse.

DISCUSSION

Taxpayer protests the auditor's determination that taxpayer's purchases of shrink-wrap, pallets, tape, packaging adhesive, used in its warehouse facility are subject to the state gross retail tax. Taxpayer further asserts the auditor incorrectly assessed the tax on drums that were shipped from its warehouse facility and later returned to the warehouse for refilling. Taxpayer cites 45 IAC 2.2-5-16(c)(1) to support its position.

45 IAC 2.2-5-16(a) states that the state gross retail tax shall not apply to sales of (1) nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and (2) returnable containers containing contents sold in a sale constituting selling at retail and (3) returnable containers sold empty for refilling. IC 6-2.5-5-9 is the applicable statutory exemption.

Taxpayer's purchases are exempt from state gross retail tax to the extent that the non-returnable wrapping materials (i.e. shrink-wrap, tape, packaging adhesive) are used in sales of tangible personal property to taxpayer's retail customers. Taxpayer's purchase of those materials is not exempt from the state gross retail tax to the extent that those materials are used by taxpayer to make inter-division transfers such as transfers to its own retail stores.

Taxpayer protests the assessment of the state gross retail tax on its purchase of shipping pallets. The taxpayer maintains that, to the extent it uses the shipping pallets to make product deliveries to its customers, the initial purchase of the shipping pallets should be exempt from sales and use tax.

The applicable statutory exemption is IC 6-2.5-5-9(d) which provides that the "[s]ales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds." Therefore, the applicability of the exemption is dependent upon the contents of the container. To the extent that taxpayer is purchasing nonreturnable shipping pallets for the purpose of delivering to its customers a product for sale, the purchase of the pallets is exempt.

The taxpayer protests the assessment of the gross retail tax on its purchase of returnable drums. These returnable containers were used by the taxpayer to ship paint and paint related products and then returned to its warehouse facility for refilling. The applicable interpretative regulation is found at 45 IAC 2.2-5-16(d)(3) which clearly states in relevant part that "[t]he sale of returnable containers to the original or first user thereof is taxable." Therefore, taxpayer, as the first purchaser of its returnable containers, is responsible for paying the state gross retail tax on its initial purchase of returnable containers.

FINDING

Taxpayer's protest is denied in part and sustained in part. Taxpayer's purchases of shrink-wrap, tape, and packaging adhesive are exempt to the extent provided under 45 IAC 2.2-5-16(a), (c)(1). Taxpayer's purchase of non-returnable pallets is exempt to the extent provided under IC 6-2.5-5-9(d). Taxpayer's purchases of returnable drums are not exempt.

VII. Abatement of Penalty:

DISCUSSION

Taxpayer requests that the 10% negligence penalty, imposed under the authority of IC 6-8.1-10-2(a), be abated.

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

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

Taxpayer argues that the 10% negligence penalty should be abated for the following reasons; 1) taxpayer demonstrated reasonable cause for the penalty to be abated, 2) taxpayer has made it a practice to file its Indiana sales and use tax returns

on a timely basis, 3) taxpayer remitted substantially all (95.75%) of sales and use taxes in a timely manner, 4) taxpayer exercised reasonable care and prudence in reporting and remitting sales and use taxes.

Taxpayer has raised reasonable arguments in support of the choices it made in calculating its gross retail and use taxes. On at least one issue, the taxability of manufacturing equipment used at its retail outlets, taxpayer relied on a determination made in its favor during a previous audit, conducted in 1991, covering the years 1987-1990. Further, outside the issues raised concerning taxpayer's powder coatings plant, there is no evidence taxpayer acted in other than good faith.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

02-20000078P.LOF

LETTER OF FINDINGS NUMBER: 00-0078P
STATE CORPORATE INCOME TAX: PENALTY
For 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. Income Tax - Penalty

Authority: 45 IAC 15-11-2; IC 6-8.1-10

Taxpayer protests the negligence penalty assessment for under reporting and payment of estimated tax.

STATEMENT OF FACTS

Taxpayer is a subsidiary corporation and limited partner in a group of entities engaged in the manufacture and multinational marketing of consumer products. Taxpayer's parent company sold assets and as part of the sale a sizable gain was realized on various patents and trademarks related to the consumer products business. The party/parties responsible for making estimated payments for taxpayer were unaware of taxpayer's ownership of the aforementioned patents and trademarks and did not include their value in the determination of taxpayer's estimated payments and these payments were subsequently underpaid by taxpayer with a penalty resulting and said penalty the subject of this protest.

I. Income Tax - Penalty

DISCUSSION

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10. The Indiana Administrative Code further provides in 45 IAC 15-11-2:

(b) "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.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;
(2) judicial precedents set by Indiana courts;
(3) judicial precedents established in jurisdictions outside Indiana;
(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer argues that the penalty was inappropriate based on taxpayer's exemplary prior performance and the unique

nature of the one-time event generating the taxable amount. Standing alone neither of the taxpayer's arguments are dispositive but they are factors which are indicative of the taxpayer's reasonable care, caution, or diligence.

FINDING

Taxpayer protest sustained.

DEPARTMENT OF STATE REVENUE

0420000148.LOF

LETTER OF FINDINGS NUMBER: 00-0148
Sales Tax
For Tax Periods 1996-1998

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. Sales Tax — Service Plans

Authority: Covington Pike Toyota, Inc. v. Cardwell, 829 S.W.2d 132 (Tenn. 1992); IC 6-2.5-4-1; 45 IAC 2.2-4-2; 45 IAC 15-3-2; Information Bulletin # 2; Information Bulletin #15

Taxpayer protests imposition of sales tax on service plans sold to its customers.

II. Sales Tax—Capital Cost Reduction on Leased Vehicles

Authority: Meridian Mortgage Company, Inc. v. State, 395 N.E.2d 433 (Ind. App. 1979); City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind.Tax 1998); IC 6-2.5-1-5; IC 6-2.5-1-6; IC 6-2.5-5-38.2; IC 6-8.1-3-3; Attorney General Official Opinion No. 90-21

Taxpayer protests imposition of sales tax on Capital Cost Reductions on Leased Vehicles.

STATEMENT OF FACTS

Taxpayer operates three automobile dealerships in Indiana. The Department of Revenue ("Department") conducted an audit for the years 1996 through 1998. As a result of this audit, the Department issued Sales Tax assessments against taxpayer. Taxpayer protests two of the items assessed.

I. Sales Tax—Service Plans

DISCUSSION

Taxpayer protests the imposition of Sales Tax on certain service plans it sells to its customers. The Department imposed Sales Tax on the basis that these service plans call for the definite transfer of personal property. The Department did not impose Sales Tax on service plans that did not call for the definite transfer of personal property. Taxpayer does not believe that the taxed service plans represent the sale of tangible personal property, but rather the transfer of intangible personal property.

Taxpayer refers to IC 6-2.5-4-1(b), which states:

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

(1) acquires tangible personal property for the purpose of resale; and

(2) transfers that property to another person for consideration.

Taxpayer believes that the service plans are contract rights transferred to the customer, and that these contract rights represent a form of intangible property not tangible personal property as required by the above-referenced regulation. Taxpayer states that it is therefore not engaged in selling at retail and so should not collect sales tax on the service plans.

The Department believes that taxpayer is engaged in selling at retail, as evidenced by the service plans that provide for the definite transfer of tangible personal property. The Department refers to IC 6-2.5-4-1(c), which states:

For purposes of determining what constitutes selling at retail, it does not matter whether:

(1) the property is transferred in the same form as when it was acquired;

(2) the property is transferred alone or in conjunction with other property or services; or

(3) the property is transferred conditionally or otherwise.

Taxpayer states in its protest letter, "It is also important to recognize that, when selling a Service Plan, the Taxpayer has not obligated itself to supply tangible personal property or anything else to the customer." The taxpayer is selling the service plans. The fact that the service plans are agreements between the manufacturer and the customer are not determinative. Whether or not the service plans provide for the definite transfer of tangible personal property is the determinative issue.

Taxpayer offers several scenarios in which the customer would not have service performed at taxpayer's dealerships,

and therefore not receive tangible personal property from taxpayer. Among these scenarios are: The customer may have the service done at another dealership for this make of car; if a car is wrecked, coverage under the service plan is terminated; the customer may intentionally or unintentionally skip scheduled maintenance. Taxpayer believes that, for these and other reasons, there is no certainty that taxpayer will ever provide any services or furnish any parts to a particular customer when a service plan is sold.

Taxpayer asserts that the service plans at issue embody a promise from the auto manufacturer to cover the costs of scheduled maintenance and repairs. Taxpayer offers the analogy of gift certificates to explain why it believes the service plans are not taxable. Taxpayer believes that sales tax should apply only to the sale of tangible personal property as it is supplied with routine maintenance.

Taxpayer explains that the service plans are exempt from Sales Tax according to Information Bulletin #2, which covers the subject of "Warranties and Maintenance Contracts". Information Bulletin #2 states in part:

> Optional extended warranties and maintenance agreements are offered as a separate added amount to the purchase price of property being sold and a fixed sum is charged for the furnishing of tangible personal property throughout the term of the warranty or the agreement. Optional warranties and maintenance agreements are not subject to sales or use tax. Optional warranties and maintenance agreements are not subject to tax because the purchase of the warranty or maintenance agreement is the purchase of an intangible right to have property supplied and there is no certainty that property will be supplied. However, if the agreement includes a charge for property to be periodically supplied, the agreement would be subject to tax.
>
> Taxpayer also refers to Examples 4 and 5 in Information Bulletin #2, which state:
>
> 4. A computer software company sells a taxable software package to a customer for $2,000. The customer also purchases a maintenance agreement from the company. The customer did not have to buy the maintenance agreement. The agreement entitles the customer to up to twenty hours of programmer help to deal with any problems the customer might have in using the software package. The maintenance agreement is an optional maintenance and is not subject to sales tax.
>
> 5. Same facts as in Example 4, but the maintenance agreement also entitles the customer to four program updates per year. The program updates are available to all of the company's customers who purchased the software package. The maintenance is subject to sales tax because it is a certainty that tangible personal property, the updates, will be given to the customer under the terms of the maintenance agreement.

Taxpayer believes that the auditors refused to apply Information Bulletin #2 to the service plans at issue. The audit report states that it is definite that tangible personal property will be transferred to the customer, while taxpayer contends that it is not definite that tangible personal property will be transferred.

The service plan contains a section titled, "WHAT THIS AGREEMENT COVERS". Subsection B of that section states:

> WE will pay the COST to perform scheduled maintenance services for those items listed in YOUR [Manufacturer] Owner's Handbook. Oil changes can be performed every three (3) months or 3,000 miles, or every six (6) months or 6,000 miles, whichever best describes the driving conditions of YOUR VEHICLE. This coverage applies only if the services are performed at a [Manufacturer] Retailer or [Manufacturer] Authorized Repair Facility and at the time/mileage intervals stated in the [Manufacturer] Maintenance Schedule. (Manufacturer's name omitted.)

The service plan provides for the definite transfer of tangible personal property in the form of motor oil and filters associated with oil changes. Even if the customer does not drive the car enough to meet the mileage trigger of 3,000 miles, the customer is entitled to a minimum of two oil changes every year under the six-month trigger. Additionally, the service plan also has a section titled, "CLAIM PROCEDURES", which states in part:

> If a FAILURE occurs, YOU must:
>
> 1) Use reasonable means to protect the covered VEHICLE from additional damage.
>
> 2) Contact the [Manufacturer] Retail from whom YOU purchased this AGREEMENT, or any other [Manufacturer] Retailer or [Manufacturer] Authorized Repair Facility; and
>
> 3) Obtain prior authorization from US before any work is done on the covered VEHICLE. If necessary, YOU must provide any information WE may reasonably require, including proof of required maintenance, and allow US to inspect the VEHICLE before WE authorize any repair. (Manufacturer's name omitted.)

The customer's coverage under the service plan is dependent on the customer complying with the maintenance schedule. Therefore, in order for the service plan to remain in effect, regular maintenance must be performed. The service plans compel the customer to perform regular maintenance or face having the plans invalidated.

In Example 5 of Information Bulletin #2, the maintenance agreement entitles the customer to four program updates per year. The program updates are available to all of the company's customers who purchased the software package. The maintenance is subject to sales tax because it is a certainty that the tangible personal property, the updates, will be given to the customer under the terms of the maintenance agreement. The service plan at issue in this case entitles the customer

to a minimum of two oil changes per year under the six-month trigger.

Taxpayer has put forth the possibility that the customer may not have the maintenance performed at the dealership that sells the plan. This is not the determining factor. The plan is an agreement between the manufacturer and the customer. The sale takes place in Indiana. The sales tax should be collected in Indiana. Taxpayer puts forth the possibility that the customer will never have the maintenance performed at all. It is sufficient that the service plan entitles the customer to the maintenance for the plan to be taxable.

Taxpayer offers the analogy of gift certificates to explain why it believes the service plans should not be taxed. Taxpayer states that the Department has ruled that the purchaser of gift certificates acquires the intangible right to purchase tangible personal property in the future, and that sales tax would only apply if and when the customer actually uses the gift certificate to purchase tangible personal property. Taxpayer believes that, in a similar fashion, the service plans provide the customer with the opportunity to acquire parts and labor in the future, if and when the customer has the car serviced.

There is a difference, however, between gift certificates and the service plans at issue. The gift certificates may or may not be used to purchase tangible personal property. Also, sales tax will be collected when the gift certificates are utilized for the purchase of tangible personal property. The service plans definitely entitle the customer to a minimum of two oil changes per year. As previously established, it does not matter if the customer has the oil changes performed. The fact that the customer is entitled to the tangible personal property associated with the oil changes is sufficient to make the service plans taxable.

Taxpayer refers to Information Bulletin #15, which covers the subject of "Application of Indiana Retail Sales Tax to Sales of Gasoline, Gasohol and Special Fuels Sold Through Stationary Metered Pumps". Section IX of Information Bulletin #15, covering "Service Station Nontaxable Income", states:

> A. Labor charges separately stated on repair orders are not subject to sales tax. (Sales tax must be collected on any parts used unless the purchaser issues an exemption certificate certifying exempt use.
>
> B. Charges for washes, lubrications, polishing and waxing are not subject to sales tax. (The service station must pay sales tax on the purchase of any supplies consumed.)

Taxpayer explains that the auditors are imposing sales tax on one hundred percent (100%) of the purchase price of the service plans, thus imposing sales tax on all the parts and labor. Taxpayer states that if the customer had simply purchased scheduled maintenance services as needed, the tax would have been applied only on the parts supplied, then poses the question, "Why the tax burden should be higher when the scheduled maintenance is provided pursuant to an optional Service Plan?". The reason, as explained in Section IX of Information Bulletin #15, is that the service plans do not separately state labor charges.

Taxpayer states that the Department's position is inconsistent with the decisions of courts in other states. The Department is not subject to the courts of other states, as provided in 45 IAC 15-3-2(b), which states:

> An interpretation of the statutory provisions governing the listed taxes, made by a court of competent jurisdiction, which conflicts with rules promulgated by the department, will render that rule, or portion of a rule, null and void, and will become the official interpretation of the department, effective upon the date of issuance of the court's decision. If such decision is appealed by the department, the interpretation will become effective when such decision becomes final.

The courts of any state other than Indiana are not courts of competent jurisdiction over the Indiana Department of State Revenue. Therefore the Department is not subject to decisions issued by courts in other states.

In addition to the fact that the case cited by taxpayer is not binding on the Department, which it is not, it is not relevant. Taxpayer cites Covington Pike Toyota, Inc. v. Cardwell, 829 S.W.2d 132, 135 (Tenn. 1992), where that court states:

> The words "performing" and "installing," taken in their natural and ordinary sense, mean the carrying out of physical acts. Performing repair services does not include the act of entering into a contractual commitment to provide in the future and on a contingent basis repair services. Under the statute, "[t]he taxable event is the rendering of repair services in Tennessee," LeTourneau Sales & Serv., Inc. v. Olsen, 691 S.W.2d 531, 536 (Tenn. 1985), not the future and uncertain prospect of having repair services performed in Tennessee. The taxable activity described in § 67-6-102(22)(F)(iv) is a physical activity performed with respect to tangible personal property, and does not include the undertaking of a contractual commitment whereby such services may, or may not, be provided in the future.

The warranties at issue in Covington Pike Toyota were for repair services. There was no certainty that the cars would need repairs in that case. The Department has already agreed that the service plans sold by taxpayer in the instant case which provide solely for repair and not for maintenance are not subject to sales tax. The service plans at issue in this protest are for repair and maintenance services. There is a certainty that the customers who purchase the service plans in this instance will be entitled to a minimum of two oil changes per year under the six-month trigger.

Taxpayer states that the tangible personal property supplied to customers under the service plans account for less than ten percent (10%) of the total sale price, and are therefore not subject to sales tax under 45 IAC 2.2-4-2(a). That regulation states:

> Professional services, personal services, and services in respect to property not owned by the person rendering such

services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

There are four steps that must be satisfied in order for sales tax to not apply under this regulation. Taxpayer has submitted no documentation establishing that: 1) it is engaged in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property; 2) the tangible personal property purchased is used or consumed as a necessary incident to the service; 3) the price charged for tangible personal property is ten percent or less compared with service charges; or 4) that it pays gross retail tax or use tax upon the tangible personal property at the time of acquisition. Therefore, none of the four steps have been satisfied, let alone all four as required in order for this regulation to apply.

In conclusion, the service plans entitle the customer to a minimum of two oil changes per year and therefore provide for the definite transfer of tangible personal property. As explained in Example 5 of Information Bulletin #2, an optional maintenance agreement is taxable when it entitles a customer to tangible personal property.

FINDING

Taxpayer's protest is denied.

II. Sales Tax — Capital Cost Reduction on Leased Vehicles

DISCUSSION

Taxpayer protests imposition of Sales Tax on the Capital Cost Reduction on Leased Vehicles ("Reductions"). The Department imposed Sales Tax on the reductions for the period from July 1, 1995 to June 30, 1997. Taxpayer believes that the reductions are not taxable for several reasons.

Taxpayer does not agree that the exchange of a customer-owned vehicle for a leased vehicle falls outside the definition of a "like kind exchange" in IC 6-2.5-1-5 and IC 6-2.5-1-6. IC 6-2.5-1-5 states in relevant part:

(a) "Gross retail income" means the total gross receipts, of any kind or character, received in a retail transaction, except 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;

IC 6-2.5-1-6 states:

(a) "Like kind exchange" means the reciprocal exchange of personal property between two (2) persons, when:

(1) the property exchanged is of the same kind or character regardless of grade or quality; and

(2) the persons exchanging the property both own the property prior to the exchange.

(b) A "like kind exchange" may be part of a transaction involving additional consideration other than the exchanged property.

(c) Notwithstanding subsection (a), a "like kind exchange" does not occur when:

(1) the transaction involves more than two (2) persons; or

(2) one (1) party to the transaction, through agreement or negotiation with the second party, acquires personal property for the primary purpose of exchanging that property for like kind property held by the second party.

Taxpayer believes that the owned car exchanged for the leased car is an exchange of like kind tangible personal property.

As explained in Meridian Mortgage Company, Inc. v. State, 395 N.E.2d 433, 439 (Ind. App. 1979), "The three primary indicia of ownership of personal property are Title; possession; and Control, which includes the right to sell, dispose of, or transfer." A renter does not have these rights, therefore, the Department considers the bundle of rights associated with ownership as different from the bundle of rights associated with rental. Since the rights associated with an owned car and those associated with a rented car are not the same, the Department did not consider the trade of an owned car for a rented car a like kind exchange.

Taxpayer points out that by not taxing trade-ins on or after July 1, 1997, the Department is acknowledging IC 6-2.5-5-38.2, which states:

The value of an owned vehicle is exempt from the Indiana gross retail tax in a vehicle lease transaction if the owned vehicle is exchanged for a like kind exchange.

The Department notes that absent language stating otherwise, statutes are given prospective treatment. In this instance, the wording of Public Law 253 Section 38 - the law in which IC 6-2.5-5-38.2 was enacted – explicitly states that this new section was to take effect on July 1, 1997. Therefore, the Department can not apply this statute retroactively.

Taxpayer argues that the Department did not take the necessary steps to change its interpretation of the applicable

statutes. Taxpayer states that by recognizing the exclusion from sales tax before July 1, 1995, but taxing such transactions after that date, the Department has clearly changed its interpretation of the applicable statutes. Taxpayer refers to IC 6-8.1-3-3(b), which states:

No change in the department's interpretation of a listed tax may take effect before the date the change is:

(1) adopted in a rule under this section; or

(2) published in the Indiana Register under IC 4-22-7-7(a)(5), if IC 4-22-2 does not require the interpretation to be adopted as a rule;

if the change would increase a taxpayer's liability for a listed tax.

The Department issued an advisory letter, dated April 25, 1995, to the Indiana Automobile Dealer's Association, which explained the Department's position regarding the Reductions. The letter explained the Department's reliance on 45 IAC 2.2-1-1(j), which states that there is a taxable event when any property is used as a medium of exchange in lieu of cash. In taxpayer's case, the customer trades property, the used car, in lieu of cash for the lease on the new vehicle. The letter also explained that the automobile dealers should collect sales tax on the reductions starting July 1, 1995.

Taxpayer's position is that the advisory letter does not satisfy IC 6-8.1-3-3(b), because taxpayer views it as a change in the Department's interpretation of a listed tax. The advisory letter was not a change in the Department's interpretation of 45 IAC 2.2-1-1(j). The Department issued the letter to make automobile dealers aware of the regulation and to allow them time to begin collection of the sales tax. The Department never recognized the exclusion from sales tax for trade-ins, as taxpayer asserts. The Department always interpreted the use of property as a medium of exchange in lieu of cash as a taxable event. Therefore, there was no change in interpretation, and so IC 6-8.1-3-3(b) does not apply.

Taxpayer next raises Attorney General Official Opinion No. 90-21. That opinion concerns the Department's desire to impose gross income tax on cable television franchise fees. The Attorney General determined that legislative change was required before the Department could subject cable television franchise fees received from a private cable television operator by a political subdivision to Indiana Gross Income Tax. The Attorney General's opinion was based on the fact that Indiana Department of Revenue rules listed examples of activities that would subject a political subdivision to Gross Income Tax, and cable television franchise fees was not listed.

The Attorney General concluded that if the Department would start taxing those fees, it would constitute a change in the Department's interpretation of a listed tax. For the reasons previously discussed, the Department in the instant case did not change its interpretation of a listed tax. Therefore, Attorney General Official Opinion No. 90-21 does not apply here.

Next, taxpayer raises City Securities Corp. v. Indiana Department of State Revenue, 704 N.E.2d 1122 (Ind. Tax 1998). Taxpayer states that the Court in that case held that the Department was prohibited from changing an interpretation without adopting a regulation. Again, for the reasons previously discussed, the Department has not changed its interpretation of a listed tax. Therefore, the opinion in City Securities does not apply here.

In conclusion, the Department properly taxed the capital cost reductions on leased vehicles for the time included in this audit. The Department can not retroactively apply IC 6-2.5-5-38.2. The Department did not change its interpretation of a listed tax and therefore did not need to promulgate a new regulation.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0320000244.LOF

LETTER OF FINDINGS: 00-0244
STATE WITHHOLDING TAX
For the 1996 Tax Year

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Withholding Tax Levies Against Taxpayer as Responsible Corporate Officer:

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

Taxpayer protests the assessment of tax levies based upon the presumption that taxpayer, as corporate secretary-treasurer, functioned as a responsible officer for a now bankrupt corporation. The taxpayer maintains that during the relevant tax year of 1996, because he was not responsible for corporate decisions regarding payment of bills, payroll, or other financial matters, the taxpayer should not now be held liable for unpaid trust taxes.

STATEMENT OF FACTS

Taxpayer served as the secretary-treasurer of a now bankrupt corporation from approximately 1981 until October 1996. During that time, the taxpayer was responsible for maintenance, freight, and computer services. According to the taxpayer, between the years 1984 to 1988, the taxpayer shared duties for certain bookkeeping matters including payroll responsibilities. The taxpayer was relieved of those particular responsibilities during 1988 and 1989. Those responsibilities, together with all other corporate financial matters, were turned over to the corporation's comptroller in December 1992. Although unclear from the taxpayer's written submission, it would appear that during the intervening three years, corporate financial matters were in the hands of the corporate president. After 1992, the taxpayer was denied access to most corporate financial information. The taxpayer retained check-signing authority for one of the corporation's operational accounts until 1993 at which time that particular account was closed by the comptroller.

At no time during the taxpayer's employment, did taxpayer have authority to sign contracts, obtain financing, or make purchasing decisions. At no time during the taxpayer's employment, did taxpayer have authority to determine which creditors would be paid or which creditors would be given priority.

Taxpayer was a minority shareholder and served as the corporate secretary-treasurer until tendering his resignation in August of 1996 with the resignation taking effect on the day in which the corporation was acquired by a second business interest. That takeover was completed on August 27, 1996. Although his resignation as secretary-treasurer took effect on that day, taxpayer remained as an employee of the corporation retaining essentially the same responsibilities held before resigning as a corporate officer. At the time of the takeover, taxpayer agreed to tender his minority share of stocks in exchange for shares of stock in the acquiring corporation.

DISCUSSION

I. Withholding Tax Levies Against Taxpayer as Responsible Corporate Officer:

The taxpayer protests the imposition of the tax levies on the ground that he was not under a duty nor did he have the responsibility for assuring that the corporation's 1996 withholding taxes were paid.

Withholding taxes may be assessed against a responsible corporate officer under the provisions of IC 6-3-4-8(g) which states that "[i]n 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."

Under the provisions of IC 6-3-4-8(g), any individual can be held personally liable for unpaid withholding taxes if (1) he was an officer, employee or a member of the employer, and (2) he had a duty to remit taxes to the Department. Indiana Dept. of State Revenue v. Safayan, 654 N.E.2d 270, 273 (Ind. 1995). In determining whether a taxpayer had the authority to see that withholding taxes were paid, the court will look at three relevant factors. The court will look to the person's position within the power structure of the corporation. Where that person is a high ranking officer within the corporate power structure, that officer is presumed to have had sufficient control over the company's finances to give rise to a duty to remit trust taxes. That presumption may be rebutted by a showing the officer did not in fact have such authority.

Second the court will look to the authority of the officer as established by the articles of incorporation, bylaws, or the officer's employment contract.

Third, the court will consider whether the person actually exercised control over the finances of the business including whether the person controlled the corporate bank account, signed corporate check and tax returns, or determined when and in what order to pay corporate creditors.

Under IC 6-8.1-5-1(b), 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." Therefore, as a shareholder and corporate officer until the date of his resignation in 1996, the taxpayer has the burden of demonstrating that he is not liable for payment of the unpaid trust taxes.

The taxpayer has met his burden of demonstrating that, while serving as corporate officer, he lacked the delegated, actual, or practical authority to see that corporate taxes were paid and, as a result, that taxpayer should not be held personally liable for unpaid trust taxes.

The evidence offered by the taxpayer persuasively characterizes the taxpayer as an employee, having specifically prescribed responsibilities, rather than as a corporate officer exercising expansive or discretionary responsibilities. The evidence demonstrates that, while taxpayer possessed certain payroll authority during the years from 1984 to 1998, what payroll authority taxpayer had was removed by 1989. The last apparent remnant of taxpayer's independent authority over corporate finances was removed in 1993 when the taxpayer's authority over an operational checking account was ended and the account closed.

The taxpayer has rebutted the presumption, predicated on his status as corporate officer, that he had authority over corporate finances such that taxpayer should be held liable for unremitted trust taxes. *See* Safayan, 654 N.E.2d at 273. Additionally, there is some evidence that taxpayer was specifically denied access to corporate financial records and to information regarding the status of the corporation's financial status.

Although the taxpayer has presented no evidence concerning the duties and responsibilities placed on the taxpayer

by the corporation's bylaws and articles of incorporation, the evidence suggests that – whatever those specifically delegated responsibilities – the taxpayers actual authority over financial matters was carefully circumscribed. Whether actual, official, delegated, or implied there is no evidence to suggest that taxpayer was in a position – subsequent to 1993 – to assure that the corporation's trust taxes were paid in 1996.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220000246.LOF

LETTER OF FINDINGS NUMBER: 00-0246P
STATE CORPORATE INCOME TAX: PENALTY
For 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. Income Tax - Penalty

Authority: 45 IAC 15-11-2; IC 6-8.1-10

Taxpayer protests the negligence penalty assessment for under reporting and under payment of estimated tax.

STATEMENT OF FACTS

Taxpayer was a limited partner in a partnership doing business in Indiana while taxpayer's commercial domicile was out of state. Taxpayer filed and paid Adjusted Gross Income tax for Indiana, but underreported its liability and was assessed a penalty.

I. Income Tax - Penalty

DISCUSSION

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10. The Indiana Administrative Code further provides in 45 IAC 15-11-2:

(b) "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.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;
(2) judicial precedents set by Indiana courts;
(3) judicial precedents established in jurisdictions outside Indiana;
(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer argues that the penalty was inappropriate based on taxpayer's exemplary prior performance and the unique nature of the one-time event generating the taxable amount. Standing alone neither of the taxpayer's arguments are dispositive but they are factors which are indicative of the taxpayer's reasonable care, caution, or diligence.

FINDING

Taxpayer protest sustained.

DEPARTMENT OF STATE REVENUE

0420000259.LOF

LETTER OF FINDINGS NUMBER: 00-0259 ST
STATE GROSS RETAIL TAX
For Years 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. State Gross Retail Tax – Imposition

Authority: 45 IAC 2.2-5-16

Taxpayer protesting assessment of tax on taxpayer's purchase of returnable containers.

STATEMENT OF FACTS

Taxpayer sells bottled water in returnable containers. Taxpayer purchases the filled containers from a supplier, paying for both the contents and the container, then sells the water, in the returnable container, to consumers. When consumers return the containers, taxpayer refunds the deposit amount to the customer and returns the empty containers to the supplier for refill. For subsequent refills, the taxpayer only pays the supplier for the water within the containers, having already purchased the container. Taxpayer was not paying use tax on the initial purchase of the containers; rather taxpayer was charging the customers sales tax on both the contents of the containers and the deposit amount. Department has assessed tax on taxpayer's purchase of the returnable containers.

I. State Gross Retail Tax – Imposition

DISCUSSION

45 IAC 2.2-5-16 addresses returnable containers; it states in relevant part:

(a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and *returnable containers containing contents sold in a sale constituting selling at retail* and returnable containers sold empty for refilling.

.....

(c) General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property are *exempt from state gross retail tax:*

.....

(2) *Deposits for returnable containers received as an incident to a transaction of a retail merchant constituting selling at retail.*

.....

(d) Application of general rule.

.....

(3) Returnable containers sold empty. To qualify for this exemption, the returnable containers must be resold with the purpose of refilling. *The sale of returnable containers to the original or first user thereof is taxable. (emphasis added)*

.....

Essentially taxpayer was shifting the incidence of the tax from taxpayer's purchase of the container to the transaction with taxpayer's customers. As 45 IAC 2.2 –5-16 requires, the tax is not applied to deposits on transactions of a retail merchant, but rather to the sale of the returnable containers to the original user, which is taxpayer. 45 IAC 2.2-5-16 does not permit the taxpayer to transfer responsibility for this tax from taxpayer to taxpayer's customers.

FINDINGS

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120000279.LOF

LETTER OF FINDINGS NUMBER: 00-0279 AGI
ADJUSTED GROSS INCOME TAX
FOR TAX PERIODS: 1997-1999

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

Adjusted Gross Income Tax: Imposition

Authority: IC 6-3-2-1(a), IC 6-3-2-2(a), Webster's II New Riverside University Dictionary, 1988, page 858.

Taxpayer protests the imposition of the adjusted gross income tax.

STATEMENT OF FACTS

The taxpayers protested an assessment of adjusted gross income tax for the years 1997-1999 on partnership income. A hearing was held with Taxpayer's representative. More facts will be provided as necessary.

Adjusted Gross Income Tax: Imposition

DISCUSSION

The taxpayers are a married couple. The wife is a limited partner in an Indiana limited partnership. The taxpayers are residents of New Jersey. The Indiana Department of Revenue assessed adjusted gross income tax on the wife's earnings from the Indiana limited partnership. The taxpayers protested this assessment. The taxpayers contend that they do not owe Indiana adjusted gross income tax on the wife's earnings from the Indiana limited partnership because she is a resident of New Jersey and does not personally do business in Indiana.

The Indiana Department of Revenue imposed adjusted gross income tax on the taxpayers pursuant to the following provisions of IC 6-3-2-1(a):

Each taxable year, a tax at the rate of three and four-tenths percent (3.4%) of adjusted gross income is imposed... on that part of the adjusted gross income derived from sources within Indiana of every nonresident person.

"Income derived from sources within Indiana" is defined by the following provisions of IC 6-3-2-2(a)

With regard to corporations and nonresident persons, 'adjusted gross income derived from sources within Indiana', for the purposes of this article, shall mean and include:... (2) income from doing business in this state:

A partnership is "a contract entered into by two or more persons in which each agrees to furnish a part of the capital and labor for a business enterprise and by which each shares in some fixed proportion in profits and losses. " Webster's II New Riverside University Dictionary, 1988, page 858.The Indiana limited partnership was organized for the purpose of making profits. This is a business purpose. The wife received her interest in the partnership in exchange for her contribution of corporate stock. The partnership continues to hold these same shares of stock. The partnership has also made investments in various corporations and partnerships and loans to corporations owned by the family. The partnership is managed by the wife's mother who lives in Indiana. The limited partnership is organized under the laws of Indiana. The partnership clearly has an Indiana business situs. The wife received a distributive share of partnership income from the Indiana limited partnership. This was clearly income from an Indiana source as defined in the statute. The taxpayers are not Indiana residents. Therefore they fall into the nonresident status. The distributive share of profits of an Indiana limited partnership qualifies as taxable income from a source within Indiana. The taxpayers owe Indiana adjusted gross income tax on any income non Indiana residents received from an Indiana limited partnership.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

1320000343.LOF

LETTER OF FINDINGS NUMBER:
Fuel Tax 00-0343
For Years 1992, 1993, 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. Fuel Tax – Estoppel

Authority: IC § 6-6-1.1-103; IC § 6- 6-1.1-201; *Crooke v. Lugar*, 354 N.E. 2d 755 (Ind. Appeal 1976)

Taxpayer argues state's issuance of an improper license prohibits the assessment of tax against the taxpayer.

STATEMENT OF FACTS

Taxpayer operated a marina located on a lake within Indiana for the tax years in question. As part of the operations of the marina, taxpayer applied for a permit to sell marine fuel and was improperly issued a Marine Fuel Dealer's Permit for fuel sales by a marina located on a body of water not within Indiana, which exempted the taxpayer from the payment of fuel tax on the purchase of fuel. An investigation by the state established the liability for the years in question and an assessment, which is the subject of this protest, was made.

I. Fuel Tax – Estoppel

DISCUSSION

Taxpayer's argument is based on estoppel against the state. Indiana law requires the taxpayer to show five elements for estoppel:

1) A representation or concealment of material facts; 2) The representation must have been made with knowledge of the facts; 3) The party to whom it was made must have been ignorant of the matter; 4) It must have been made with the intention that the other party should act upon it; 5) The other party must have been induced to act upon it.

Crooke v. Lugar, 354 N.E. 2d 755 at 765 (Ind. Appeal 1976)

The material facts at issue are two Indiana statutes -IC § 6- 6-1.1-201, that established a fuel tax on the fuel purchases, and IC § 6-6-1.1-103(k), that granted an exemption for marina sales by marinas located on bodies of water outside of Indiana- for the tax years in question. These statutes were published and promulgated prior to and throughout the time at issue; consequently, the first three elements of the estoppel test are not met. Additionally; taxpayer made no showing of any attempt by the department to intentionally misled taxpayer, nor is there any showing that the department benefited by erroneously issuing an exemption from state taxes, thus the fourth element of estoppel is not met as well.

FINDINGS

Taxpayer protest denied.

DEPARTMENT OF STATE REVENUE

0420000356.LOF

LETTER OF FINDINGS NUMBER: 00-0356
SALES AND USE TAX
FOR TAX PERIODS: 1997-1998

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.

1. Sales and Use Tax: Delivery Charges

Authority: IC 6-2.5-2-1, IC 6-2.5-4-1, IC 6-2.5-4-1 (e).

Taxpayer protests the imposition of tax delivery charges.

2. Tax Administration: Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2(b).

Taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation which produces and sells concrete. Additional Sales Tax, interest and penalty were assessed after a routine audit. Taxpayer protested the assessment and submitted written materials in lieu of a hearing. Further facts will be provided as necessary.

1. Sales and Use Tax:. Delivery Charges

DISCUSSION

Taxpayer produces ready mix concrete. The raw materials are poured into the concrete mixer which processes the concrete en route to the customer's location. Taxpayer charges for the concrete by the amount of materials used in the mixing of the concrete and adds a separately stated delivery charge. Taxpayer did not collect sales tax on the delivery charges. The Indiana Department of Revenue audit assessed sales tax on the delivery charges and Taxpayer protested that assessment.

IC 6-2.5-2-1 imposes a sales tax "on retail transactions made in Indiana." Retail transactions are the transfer of tangible personal property for consideration by a retail merchant. IC 6-2.5-4-1.

Taxpayer contends that this assessment is incorrect because the delivery charges are not tangible personal property. Rather, Taxpayer contends, that the delivery charges qualify for exemption as nontaxable services.

The taxability of services related to a sale of tangible personal property is considered at IC 6-2.5-4-1 (e) as follows:

The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:

(1) the price of the property transferred, without the rendition of any service; and

(2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.

The production of the concrete begins when the raw materials are poured into a cement truck where the processing occurs. The processing continues through the transportation period and is not completed until the concrete is poured for the customer. The Indiana Department of Revenue allows for a manufacturing exemption on the cement trucks since they are part of the manufacturing process. Taxpayer contends that the title to the concrete passes to the customer when the materials are poured into the cement mixer. If title transferred before the manufacturing or processing of the concrete as Taxpayer alleges, there would be no manufacturing exemption for the cement trucks. Title to the concrete does not pass until the concrete is actually fully processed and delivered to the customer. The delivery service takes place prior to the transfer of the property. As such, the sales tax must be imposed on the delivery charge.

FINDING

Taxpayer's protest is denied.

2. Tax Administration: Penalty

DISCUSSION

Taxpayer also protests the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

"Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence.

Upon previous examination by the Indiana Department of Revenue, no additional assessment was made. Therefore, Taxpayer's failure to collect and remit sales tax on the delivery charges does not constitute negligence in this instance.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420000380P.LOF

LETTER OF FINDINGS NUMBER: 00-0380P
Use Tax
Calendar Years 1997, 1998, and 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.

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on an audit completed on June 26, 2000.

Taxpayer is a manufacturer and retailer of organic gardening supplies. Taxpayer failed to self-assess use tax on clearly taxable purchases.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to self assess use tax for clearly taxable purchases.

Taxpayer requests a waiver of penalties because there was not a Controller employed from the period February 1998 through May 1999 and it has gradually increased its use tax compliance.

Taxpayer failed to self assess use tax on clearly taxable purchases in all years of the audit. A review of taxpayer's prior audit completed on October 17, 1995 indicates there were similar adjustments. For the three-year audit period, the taxpayer failed to self assess use tax on more than thirty percent (30%) of the use tax due. In addition, taxpayer compliance showed a significant decline in each year of the audit.

The taxpayer was negligent in failing to self-assess and remit use tax on clearly taxable purchases and has not shown reasonable cause for failing to do so.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000395P.LOF

LETTER OF FINDINGS NUMBER: 00-0395P
Use Tax
Calendar Years 1993, 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.

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on an audit completed on May 30, 2000.

Taxpayer has several business locations in Indiana. Taxpayer failed to self-assess use tax on clearly taxable purchases.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to self assess use tax for clearly taxable purchases.

Taxpayer requests a waiver of penalties and states that the additional tax due is the result of differences in interpretation of the Indiana Tax Statutes and not the result of any willful disregard of the Indiana Sales and Use Tax laws. Taxpayer also cites its past and current good faith efforts to use care and prudence in order to comply with Indiana's tax laws.

Taxpayer failed to self assess use tax on clearly taxable purchases in all years of the audit. A review of taxpayer's prior audit completed on September 12, 1994 indicates there were similar adjustments. For the four-year audit period, the taxpayer failed to self assess use tax on more than fifty percent (50%) of the use tax due.

The taxpayer was negligent in failing to self-assess and remit use tax on clearly taxable purchases and has not shown reasonable cause for failing to do so.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

4420000399.LOF

LETTER OF FINDINGS NUMBER: 00-0399PUF
Fuel Tax
For Year 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.

ISSUES

I. Fuel Tax – Civil Penalty

Authority: IC § 6-6-2.5-64; IC § 6-8.1-5-1

Taxpayer protests state's assessment of penalty for use of red dye fuel.

STATEMENT OF FACTS

Taxpayer's truck was stopped and the officer observed red dye in the fuel. The department's report of the investigation notes that the driver of the vehicle admitted to putting dyed fuel in the tanks approximately three weeks prior to the stop and subsequent lab test confirmed the presence of dye in the fuel. Taxpayer protested the assessed fine and the department notified taxpayer by first class mail on November 1st of 2000 of a hearing set for 10:00 am on December 5th of 2000. Taxpayer did not appear for the hearing, consequently this Letter of Findings was prepared based on taxpayer's written protest and documentation provided by both taxpayer and the Special Fuel tax division of the Department.

I. Fuel Tax – Civil Penalty

DISCUSSION

IC § 6-6-2.5-64 imposes civil fines of varying amounts (based on the number of prior violations) for the use of non taxed fuel-identified by red dye- in vehicles operated on Indiana's roads. Taxpayer argues that his records demonstrate that all of the fuel purchased by him and the operator of the vehicle were of taxed (non-dyed) fuel.

IC § 6-8.1-5-1(b) states in relevant part:

> ... 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.

Taxpayer has provided records showing purchases of non-dyed fuel prior to the stop, but provided no explanation as to the presence of the dyed fuel in the vehicle's tank or the driver's statement admitting to the prior purchase of the dyed

fuel. Consequently; taxpayer's argument fails to overcome the statutory burden of proof in IC § 6-8.1-5-1(b).

FINDINGS

Taxpayer protest denied.

DEPARTMENT OF STATE REVENUE

0320000404P.LOF

LETTER OF FINDINGS NUMBER: 00-0404P
Withholding Tax - Penalty
For the Period Ended November 30, 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.

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was assessed a late payment penalty. Taxpayer was one day late.

Taxpayer protests the penalty and requests a waiver.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer states it uses an outside payroll service whose responsibility is to assure that all payments are made timely. Due to the service's attempt to update its computer to be Y2K ready, it had a major crash and as soon as it was operational payment was sent. Taxpayer further states its payments are always timely and this late payment was an exception.

A review of taxpayer's payment history indicates it had a late payment for the period ended February 28, 1997. Taxpayers are encouraged to mail returns prior to the due date, as the Post Office may not postmark the mail until the following day. Consistent with statute, adherence to the postmark date is evidence of a timely return.

The department finds that a negligence penalty is proper.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000412P.LOF

LETTER OF FINDINGS NUMBER: 00-0412P
Sales/Use Tax
Calendar Years Ended 1997, 1998, and 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.

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

II. Tax Administration – Interest

Authority: IC 6-8-1-10-1

Taxpayer protests the interest assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty that was not assessed.

Taxpayer also protests the interest.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty; however, the issue is moot, as penalty was not assessed.

FINDING

Taxpayer's protest is sustained. The issue is moot.

II. Tax Administration – Interest

DISCUSSION

Taxpayer protests the interest assessed.

The department has no authority to waive interest.

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is denied for Issue II and the issue is moot for Issue I.

DEPARTMENT OF STATE REVENUE

0420000413P.LOF

LETTER OF FINDINGS NUMBER: 00-0413P
Sales/Use Tax
Calendar Years Ended 1997, 1998, and 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.

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

II. Tax Administration – Interest

Authority: IC 6-8-1-10-1

Taxpayer protests the interest assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty that was not assessed.

Taxpayer also protests the interest.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty; however, the issue is moot, as penalty was not assessed.

FINDING

Taxpayer's protest is sustained. The issue is moot.

II. Tax Administration – Interest

DISCUSSION

Taxpayer protests the interest assessed.

The department has no authority to waive interest.

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is denied for Issue II and the issue is moot for Issue I.

DEPARTMENT OF STATE REVENUE

04200000425P.LOF

LETTER OF FINDINGS NUMBER: 00-0425P
Sales and Use Tax
Calendar Years 1997, 1998 and 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.

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is a roofing contractor. At audit, it was determined that the taxpayer limited its payment of use tax to materials. It did not self assess tax on tools, equipment, administrative items, and other clearly taxable items. Taxpayer was previously audited in 1993 with the same or similar issues.

Taxpayer failed to remit use tax on clearly taxable purchases although it had a use tax accrual system in place.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to remit use tax on clearly taxable items that were issues in a prior audit. Taxpayer also charged sales tax to its customers for time and materials contracts and only remitted use tax on its materials cost resulting in underpayment of sales tax.

Taxpayer states it was assessed tax on equipment rental, supplies, and fuel consumed on State School projects and, it, the School Corporations, and its CPA firm believed that everything used or consumed during the construction or renovation of a State School project was tax exempt, and as such, it never collected the tax. A penalty waiver is requested.

45 IAC 2.2-4-26(e) clearly taxes utilities, machinery, tools, forms supplies, equipment or any other items used by or consumed by the contractor and which do not become a part of the improvement to real estate. In addition, taxpayer was audited previously with primarily the same issues. Taxpayer made no attempt to self assess use tax on taxable purchases that were issued in a prior audit. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220000426P.LOF

LETTER OF FINDINGS NUMBER: 00-0426P
Income Tax
Calendar Year Ended 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.

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was assessed a penalty for the late payment of income taxes. Taxpayer filed its original return after the original due date with a payment of $5,286.00 in tax due. The late payment generated a ten percent (10%) penalty and updated interest.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed because it erroneously forgot to include a copy of its federal extension with the Indiana return.

The penalty was assessed because less than ninety percent (90%) of the expected tax due was not paid by the original

due date.

IC 6-8.1-6-1 clearly states that at least ninety percent (90%) of the tax that is reasonably expected to be due must be paid on or before the due date or penalties may be imposed for failure to pay the tax. More than twelve percent (12%) of the tax due was paid after the due date, which incurs a late payment penalty.

Taxpayer has not provided reasonable cause to allow a waiver of the penalty. Ninety percent of the tax due was not paid by the due date of the return.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000431P.LOF

LETTER OF FINDINGS NUMBER: 00-0431P
Sales and Use Tax
Calendar Years 1997, 1998, and 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.

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is a commercial motel that also rents meeting rooms. At audit, it was determined that the taxpayer failed to remit sales tax for the rental of meeting rooms and to self-assess use tax on taxable items such as office supplies, forklifts, janitorial supplies, subscriptions, and other clearly taxable items. Taxpayer was previously audited in 1993 and failed to set up an accrual system for use tax.

Taxpayer failed to remit use tax on clearly taxable purchases and had no use tax accrual system in place. Taxpayer failed to remit sales tax for the rental of meeting rooms.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to remit use tax on clearly taxable items that were issues in a prior audit and had no accrual system in place.

Taxpayer's only statement in a letter dated October 13, 2000 is that it "respectfully protests the penalty amount of $286.99". No reasons were given although the taxpayer was allowed twenty days from November 16, 2000 to present additional arguments.

Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02200000432P.LOF

LETTER OF FINDINGS NUMBER: 00-0432P
Gross Income Tax
Calendar Years 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(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer, incorporated in Kentucky was audited for calendar years 1995 through 1998. Upon audit it was discovered that the taxpayer failed to report all of its gross income for calendar years 1997 and 1998.

Taxpayer requests that the department waive the negligence penalty.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer was assessed a negligence penalty because it failed to report all of its gross income for calendar years 1997 and 1998. Taxpayer maintains a sales office in Indiana.

Taxpayer, in a letters dated November 1, 2000 and November 27, 2000 states that the penalty for gross income tax is not equitable and that the major portion of the penalty stems from it erroneously omitting the gross income tax altogether in 1998.

Taxpayer maintained a sales office in Indiana during the audit period and reported gross income in previous years; i.e. for calendar years 1995 and 1996 but failed to report a portion in 1997 and more than ninety-five percent (95%) in 1998. Taxpayer utilizes a Certified Public Accountant and "erroneously overlooking" the gross income tax is not reasonable cause.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120000450P.LOF

LETTER OF FINDINGS NUMBER: 00-0450P
Individual Income Tax
Calendar Year 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.

ISSUE(S)

I. Tax Administration – Late payment penalty

Authority: IC 6-8.1-10-2; 45 IAC 15-11-2

Taxpayers protests the penalty assessed.

STATEMENT OF FACTS

Taxpayers, in a letter dated October 25, 2000 protested the penalty because they owned an S corporation whose income flows through to its personal income tax return. At April 15, 2000, the corporate year-end was not yet complete. As a result, taxpayers estimated the amount of flow through profit to be reported on its personal income tax returns. On April 15, 2000, taxpayer filed federal Form 4868 with the IRS and Form IT-9 with the State with a remittance of $3,639. Because of a clerical error, the Form IT-9 was inadvertently incorrectly prepared in the amount of $3,629 instead of the correct amount of $32,2000. In early August taxpayers filed their completed return and remitted the additional tax, which should have been paid in April.

I. Tax Administration – Penalty

DISCUSSION

At issue is whether the taxpayers had reasonable cause in not submitting payment timely.

Taxpayers failed to pay forty-nine percent (49%) of its tax by the due date of the return and state that the failure to remit the full amount of tax due by the due date was due to a clerical error. Taxpayers request the department waive its penalty.

IC 6-8.1-10-2 (a) states:

If a person fails to file a return for any of the listed taxes or fails to pay the full amount of tax shown on his return on or before the due date for the return or payment, incurs, upon examination by the department, a deficiency which is due to negligence, or fails to timely remit any tax held in trust for the state, the person is subject to a penalty.

IC 6-8.1-6-1(c) states:

If the Internal Revenue Service allows a person an extension on his federal Income tax return, the corresponding due

dates for the person's Indiana income Tax returns are automatically extended for the same period as the federal extension, plus thirty (30) days. However, the person must pay at least ninety percent (90%) of the Indiana income tax that is reasonably expected to be due on the original due date by that due date, or he may be subject to the penalties imposed for failure to pay the tax.

Taxpayer should have remitted at least ninety percent (90%) of the tax due by April 15, 1999. Taxpayer has not provided reasonable cause for failure the remit tax by the due date.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

28940642.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 94-0642 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

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 July 29, 1994 in a base tax amount of $65,920.00. Taxpayer filed a protest to the assessment. Taxpayer did not appear for his original hearing set for February 8, 2000. A Letter of Findings denying Taxpayer's protest was issued on February 25, 2000. Taxpayer, by counsel, requested a supplemental hearing. A supplemental hearing was held by telephone with Taxpayer's representative on May 4, 2000. Taxpayer's representative was granted until August 23, 2000 to submit additional evidence. No additional evidence was submitted.

CONTROLLED SUBSTANCE EXCISE TAX-IMPOSITION

DISCUSSION

IC 6-7-3-5 imposes the Controlled Substance Excise Tax on the possession and delivery of marijuana and cocaine 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 1648 grams of marijuana. Taxpayer did not sustain his burden of proving that the assessment was incorrect.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02940668.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 94-0668 IT
Gross Income Tax — Best Information Available
Adjusted Gross Income Tax — Foreign Source Dividends
Tax Administration — Negligence Penalty
For Tax Periods: 1986 Through 1989

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. Gross Income Tax — Best Information Available

Authority: IC 6-8.1-5-1(a) and (b)

Taxpayer protests the Department's approval of the sampling technique used by Audit in calculating taxpayer's taxable Indiana gross income.

II. Adjusted Gross Income Tax — Foreign Source Dividends

Authority: 45 IAC 3.1-1-29; 45 IAC 3.1-1-60; 45 IAC 3.1-1-61

Taxpayer protests the Department's determination that certain income was subject to Indiana apportionment.

III. Tax Administration — Negligence Penalty

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

Taxpayer protests the Department's imposition of a ten-percent (10%) negligence penalty.

STATEMENT OF FACTS

The following narrative appeared in the initial letter of findings:

Taxpayer is in the computer and information management business. Taxpayer designs, manufactures, and sells computer systems and software. Additionally, taxpayer leases equipment and provides related services, maintenance contracts, facilities planning, as well as a variety of custom products.

Taxpayer filed Form IT-20 for tax periods 1986 through 1989. On schedules (Schedule F-1) attached to Form IT-20, taxpayer reported amounts of dividend income as "nonbusiness income"—income not subject to apportionment for Indiana adjusted gross income tax purposes. Audit characterized the dividend income as "business income." Audit's reclassification resulted in an increase in taxpayer's Indiana adjusted gross income.

Audit also discovered that taxpayer had failed to segregate its Indiana gross receipts on its Indiana gross income tax returns. Additionally, Audit found that taxpayer's records could not support the amounts that were reported by taxpayer on its Indiana returns. Consequently, the audit was based on the best available information.

Taxpayer protested the proposed assessments of additional Indiana gross and adjusted gross income tax. At a subsequent administrative hearing, Taxpayer's protest was denied. Taxpayer then timely requested, and the Department granted, a rehearing.

I. Gross Income Tax — Best Information Available

DISCUSSION

Audit used a sampling technique to compute taxpayer's taxable gross receipts. Taxpayer argued the sampling technique used overstated its Indiana sales, and consequently, its taxable Indiana gross income. Again, from the initial letter of findings:

As an acceptable alternative, taxpayer suggests the use of its sales receipt figures. Taxpayer believes that if Audit had used the sales receipt figures taken from taxpayer's previously audited sales tax returns, a more accurate determination of gross income would have resulted.

Taxpayer contends that its gross income for the years in question should equal its Indiana sales receipts as reported on audited sales tax returns. Taxpayer reasons that since the sales tax receipts were the basis for its quarterly estimated gross income tax, these sales tax receipts should also be an accurate estimation of its annual gross receipts.

The Department, at the initial hearing, upheld Audit's reliance on the best information available in calculating Taxpayer's gross income and tax. The Department based its decision on two (2) statutory authorities. IC 6-8.1-5-1(a) authorizes the following:

If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department.

And according to IC 6-8.1-5-1(b):

The rate 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.

Taxpayer now revisits its original argument. Taxpayer questions Audit's adoption of a sampling technique to compute Taxpayer's Indiana gross income. Taxpayer contends its Indiana gross receipts should equal its Indiana gross retail income. And since its Indiana gross retail income was established in a relatively contemporaneous Indiana sales/use tax audit, this figure should be accepted by the Department as Taxpayer's gross receipts for Indiana gross income tax purposes.

The Department notes that "gross receipts" and "gross retail income" are not synonymous concepts and, therefore, may not (and usually do not) represent equivalent amounts. Gross receipts for gross income tax purposes "means all the gross receipts a taxpayer *receives…from trades, businesses, or commerce"* with certain exceptions. IC 6-2.1-1-2. On the other hand, "[g]ross retail income" means the total gross receipts, of any kind or character, *received in a retail transaction*, except 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; or

(2) the receipts received in a retail transaction which constitute interest, finance charges, or insurance premiums on either a promissory note or an installment sales contract.

IC 6-2.5-1-5(a).

Taxpayer has failed to show that its "gross retail income" is equal to its "gross receipts" as defined by IC 6-2.1-1-2. Additionally, Taxpayer was unable to verify the "gross retail income" figure provided to the Department.

FINDINGS

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax — Foreign Source Dividends

DISCUSSION

Taxpayer protested the characterization of a portion of its foreign source dividends as "business income" — income subject to apportionment for Indiana adjusted gross income tax purposes. Taxpayer asserted such income was non-business in nature.

Taxpayer advanced two (2) arguments in its initial protest:

Taxpayer's regular trade or business was the design, manufacture and marketing of electronic based information systems. Taxpayer contends its principle business is not the holding of the investment in its subsidiaries. This activity is incidental to the regular business conducted by the taxpayer. Reference is made to the United States Supreme Court decision in Allied-Signal, Inc. v. Director of Taxation, decided June 15, 1992. Pursuant to this decision, Taxpayer contends the receipt of these Subpart F dividends has no connection with the activities carried on in the State of Indiana. Because of this, the non-business income classification of these dividends should be restored.

Furthermore, Taxpayer contends Indiana's treatment of Subpart F income is facially discriminatory against foreign commerce in violation of the Foreign Commerce Clause of the United States Constitution. Reference is made to the United States Supreme Court decision in Kraft General Foods, Inc. v. Iowa Department of Revenue, decided June 18, 1992.

The Department, in denying Taxpayer's protest, stated:

While *Allied Signal* does provide guidance, absent additional facts, the Department is unable to determine whether taxpayer's situation is analogous to that of the taxpayer in *Allied-Signal*….[T]axpayer has failed to develop legal arguments, discuss Indiana authorities, or provide additional supporting information.

Taxpayer's constitutional argument failed as well. At rehearing, Taxpayer re-introduced both arguments.

Substantively, the issue is not whether these foreign source dividends should be characterized as business or non-business income, but rather, whether Indiana is entitled to an apportioned share of such income. In Indiana, corporations may deduct from its adjusted gross income certain foreign source dividends. Specifically, IC 6-3-2-12(b) states:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of:

(1) the amount of the foreign source dividend included in the corporation's adjusted gross income for the taxable year; multiplied by

(2) the percentage prescribed in subsection (c), (d), or (e), as the case may be.

The amount to be deducted (dividend times percentage) depends upon the percentage of stock owned by Taxpayer in the foreign corporation from which the dividend is derived. The allowable percentages range from fifty percent (50%) to one hundred percent (100%). IC 6-3-2-12(c) through (e).

Taxpayer's income represents foreign source dividends. Taxpayer, therefore, must include these dividends in its Indiana adjusted gross income. However, pursuant to IC 6-3-2-12, Taxpayer may deduct a percentage of these dividends consistent with the statutory schedule. Audit will review the available information to determine the appropriate percentages and deductible amounts. Taxpayer's liabilities will then be adjusted accordingly.

FINDINGS

Taxpayer's protest is denied.

III. Tax Administration — Negligence Penalty

DISCUSSION

Taxpayer protests the Department's imposition of the ten-percent (10%) penalty. A negligence penalty may be imposed under IC 6-8.1-10-2.1 and 45 IAC 15-11-2.

45 IAC 15-11-2 provides:

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 out or failing to carry out a duty giving rise to the penalty imposed under this section.

In its initial letter of findings, the Department noted:

Taxpayer attributes any underreporting to "exceptional circumstances." Taxpayer also maintains that the turnover of personnel in the tax department, both before and during the audit, contributed to the reporting discrepancies.

While taxpayer has offered an explanation for these tax discrepancies, taxpayer has not shown reasonable cause under 45 IAC 15-11-2.

Since the circumstances attributed to Taxpayer's underreporting of its Indiana tax liabilities have not changed, the Department's characterization of those circumstances remains the same.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02970476.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0476
Adjusted Gross Income Tax
For Tax Years 1991 through 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

I. Corporate Income Tax—Apportionment Factor Calculations

Authority: 45 IAC 3.1-1-39; 45 IAC 3.1-1-40; 45 IAC 3.1-1-63

Taxpayer protests the numbers used by the Department in determining rental expenses in the property factor of the apportionment formula.

STATEMENT OF FACTS

Taxpayer operates a delivery service. Taxpayer hires independent contractors to pick up packages at customer locations and deliver to locations in Indiana and other states. Independent long-distance haulers provide the transportation link. Those haulers pick up the packages at the terminals and deliver to another terminal. Independent intercity drivers make subsequent deliveries. Taxpayer protests the numbers used by the Department in determining rental expenses in the property factor of the apportionment formula for its Indiana Adjusted Gross Income Tax returns.

I. Corporate Income Tax—Apportionment Factor Calculations

DISCUSSION

Taxpayer protests assessments made by the Department of Revenue on taxpayer's 1991, 1992 and 1993 corporate income taxes. The disagreement involves the Department's estimation of the portion of rental payments to independent truck drivers which was apportioned to truck rental as opposed to driver salary. The Department allocated eighty percent (80%) of the rental payments to truck rental and twenty percent (20%) to driver salary. Taxpayer believes that the portion of rental payments allocated to truck rental are significantly lower than eighty percent.

The original Letter of Findings explained that taxpayer did not separate rental payments into labor costs and equipment costs. In order to establish the property factor for the apportionment formula for the tax years in question, the Department assigned eighty percent (80%) of the rental costs towards equipment rental payments. At the original hearing, taxpayer claimed that this percentage was not accurate, but failed to present any documentation supporting that assertion. At rehearing, taxpayer provided sufficient documentation to establish that the portion of rental payments allocated towards rented equipment was lower than originally set. The information supplied by taxpayer at rehearing will be provided to the Audit division of the Department of Revenue for review.

Taxpayer also asserts that the Department is unfairly treating transportation companies differently than it treats other companies doing business in multiple states. Taxpayer believes that the Department does not treat other businesses involved in multiple states the same way it treats transportation companies. The Department follows 45 IAC 3.1-1-63. That regulation has a subsection titled "Transportation Companies", which states in pertinent part:

> IC 6-3-2-2(b) requires that interstate carriers and all other multistate taxpayers use the three-factor formula in apportioning their business income. This method will assure consistency in the application of the Adjusted Gross Income Tax Act to multistate carriers. Business income for transportation companies is apportioned to Indiana by use of the following formula:

$$\frac{\text{Tangible property + payroll + revenue from transportation}}{3}$$

45 IAC 3.1-1-63(A) explains the tangible property factor:

Tangible Property. Fixed properties such as buildings and land used in business, shop and terminal equipment and trucks or cars used locally or any tangible property connected with the transportation business, will be assigned to the state in which such properties are located. The value of all moveable equipment used in interstate transportation will be assigned to this State on the basis of total miles traveled in this State, as compared to total miles everywhere. Fixed and moveable property will then be combined to arrive at the total property factor, Indiana property over property everywhere.

Property owned by the transportation company is valued at original cost. Property rented is valued at eight (8) times the annual rental rate less any annual subrental.

The standard apportionment formula, as described in 45 IAC 3.1-1-39, is:

$$\frac{\text{Business income x property factor + payroll factor + sales factor}}{3}$$

In describing the property factor mentioned in 45 IAC 3.1-1-39, 45 IAC 3.1-1-40 explains in part:

Property Factor. The property factor is a fraction, the numerator of which is the average value of the taxpayer's Indiana property, and the denominator of which is the total value of the taxpayer's property everywhere. As used in this regulation *[45 IAC 3.1-1-40]*, the word "property" includes all real and tangible personal property of the taxpayer, whether owned or rented, which is or could be used to produce business income during the tax period. This includes land, buildings, machinery, inventory, equipment and any real or tangible personal property used to produce business income, but not coin, currency or intangibles.

Put simply, the Department determines the apportionment percentage for non-transportation companies by adding the tangible personal property factor to the payroll factor and the sales factor, and then dividing by three for 1991 and 1992, and 3.33 for 1993. The Department determines the apportionment percentage for transportation companies by adding the tangible personal property factor to the payroll factor and the sales factor, and then dividing by three for 1991 and 1992, and 3.33 for 1993. The Department is not convinced that its treatment of transportation companies is unfair.

Next, taxpayer states that the truck owners are free to pick up other trailers on their return trip, and that the trucks are therefore not under taxpayer's control one hundred percent of the time. The Department's assessment is not based on the percentage of time the taxpayer controls the trucks. Rather, the assessment is based on the amount taxpayer pays to rent the trucks. The duration of that rental period is not relevant. The fact that others may rent the equipment when taxpayer is not renting it is not relevant.

Taxpayer states that Indiana does not attempt to tax "purchased transportation", but only "owned or rented" assets. Taxpayer refers to MTC model regulation IV.18(g) (1986) which the Department used as a base for its assignment of 80% of rental costs towards equipment rental. Taxpayer confuses the application of 45 IAC 3.1-1-63, which provided for the inclusion of rented property in the property factor of the apportionment formula, with the application of MTC model IV.18(g) (1986), which provided the model for the method to determine the percentage of rental costs to be included in the property factor.

The Department did not base its assessment on MTC model IV.18(g). 45 IAC 3.1-1-63 authorizes the inclusion of rented property in the apportionment formula. The referral to MTC model IV.18(g) was not for authorization. Rather, the referral was to help determine a method to separate equipment rental costs from labor costs in the absence of such a separation by the taxpayer.

Taxpayer states three government agencies have all concluded the arrangement between taxpayer and the owner-operators is that of true independent contractors. Taxpayer also states that these agencies use common law tests rather than statutory tests and that, absent statutory authority to the contrary, Indiana should view the relationship under the common law test. Taxpayer believes that the owner-operators are providing a service to taxpayer and therefore none of the tangible personal property used by the owner-operators should be viewed as "owned or rented" property in taxpayer's property factor.

Taxpayer offers no citation explaining why tangible personal property used by owner-operators, even if those owner-operators are independent contractors, should not be included in taxpayer's property factor for Adjusted Gross Income Tax. As explained in 45 IAC 3.1-1-63(A), rented property is included in the tangible property factor. Taxpayer's assertion that the equipment should not be included in the tangible personal property factor is insufficient.

In conclusion, taxpayer has provided sufficient documentation to show that the portion of the rental payments it made to owner-operators is lower than the original estimate. The rented equipment was properly included in the tangible personal property factor for the apportionment formula. The file will be returned to the Audit Division for recalculation of the tangible property factor of the apportionment formula.

FINDING

Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest is sustained to the extent that it has established the percentage of the payments allocated towards renting equipment is lower than originally set. Taxpayer's protest is denied to the extent that the rented equipment was properly included in the apportionment factor.

DEPARTMENT OF STATE REVENUE
REVENUE RULING #2001-01 IT
January 5, 2001

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 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

Gross Income Tax – Limited Liability Company Electing to be Treated as a Partnership for Federal Income Taxation

Authority: Tax Policy Directive #2, 45 IAC 1.1-3-12, IC 6-2.1-3-25, IC 6-3-1-19

The taxpayer requests the Department to rule on the application of Indiana gross income tax to the gross income of a limited liability company electing to be treated as a partnership for federal income taxation.

STATEMENT OF FACTS

The taxpayer is an Illinois "C" corporation that is qualified to do business in Indiana. The taxpayer's primary business is out-bound telemarketing. Currently the taxpayer operates call centers in four Indiana communities and is contemplating opening additional call centers in Indiana.

The taxpayer is now proposing to form a wholly-owned subsidiary. Upon the subsidiary's formation, the taxpayer and the taxpayer's subsidiary propose to form a limited liability company (LLC). The taxpayer and its subsidiary would be the sole members of the LLC.

The LLC will elect to be treated as a partnership for federal income taxation. The LLC will not be a publicly traded partnership that is treated as a corporation for federal income taxation.

DISCUSSION

"Tax Policy Directive #2" provides that limited liability companies will be classified for Indiana income tax purposes in the same manner that they are classified for federal income tax purposes. Further, Rule 45 IAC 1.1-3-12, interpreting IC 6-2.1-3-25 and IC 6-3-1-19, states that the term "partnership" for gross income taxation includes a limited liability company if it is treated as a partnership for federal income tax purposes.

Here, the LLC will be treated as a partnership for federal income tax purposes, hence, will be treated as a partnership for gross income taxation. Pursuant to IC 6-2.1-3-25, gross income received by a partnership is exempt from Indiana gross income taxation unless the gross income is received by a publicly traded partnership that is treated as a corporation for federal income tax purposes under Section 7704 of the Internal Revenue Code. The LLC will not be a publicly traded partnership, therefore, the LLC's gross income will not be subject to Indiana gross income taxation.

RULING

The Department rules that the gross income received by the LLC (which will elect to be treated as a partnership for federal income taxation) will not be subject to Indiana gross income taxation.

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 respect 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, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.