**NATURAL RESOURCES COMMISSION**

Information Bulletin #30

Mountain Bikes on DNR Properties

**1. Introduction**

This document establishes policies and guidelines to govern recreational mountain bike use on a DNR property (as defined at 312 IAC 8-1-4(3)). The purpose of this information bulletin is to assure consistent, fiscally and ecologically sound decision making is followed in managing recreational mountain bike use on DNR properties.

Mountain biking is a valid recreational use of certain DNR properties. As a result of the Statewide Comprehensive Outdoor Recreation Planning process, research into the outdoor recreation participation habits indicates mountain biking is one of the fastest growing outdoor recreation activities.

Mountain biking will be allowed on designated trails that are constructed or converted and maintained to recognized standards. These trails will be non-technical in nature and may be designated by the Department of Natural Resources (the DNR) in locations and lengths that do not unacceptably alter the environment, natural resources, or the existing or historic recreational opportunities of the area. This bulletin does not authorize the use of mountain bikes except at localities approved by the DNR and as conditioned here and on-site by the DNR.

**2. Mountain Biking History and Background**

Mountain biking is a relatively new sport and activity. In the last 20 years, mountain bikes have gone from being unheard of to the number one type of bike sold in the United States. Bicycles were originally a means of transportation, and they are still used that way today. The first mountain bikes were nothing more than road bikes with fat tires. Today's mountain bikes are technological marvels, with 24 or more gears, aluminum alloy frames, and even suspension systems. The off-road cyclist is looking for more riding areas to test both the rider and bicycle and to experience the outdoors while covering much more ground than the average hiker.

Currently mountain bikers are limited to federal, local, or private trails because a Natural Resources Commission policy does not address this type of use on state property. The Huntington Reservoir Mountain Bike Pilot Project has demonstrated the management of a mountain bike trail is feasible on some state properties. This information bulletin is intended ensure future bike trails adhere to sound management practices and that trails will be made available to more riders throughout the state.

**3. Policy statements**

**A. "Mountain bike" defined**

The term "mountain bike" refers to *non-motorized* bicycles designed or used for off-road travel.

**B. Trail construction and maintenance**

Mountain bike trails shall be maintained using current International Mountain Bicycling Association standards. Trail density and carrying capacity will be determined and reviewed by the DNR as needed.

**C. Mountain bike access to DNR properties**

Access to DNR properties by mountain bikes is limited to designated public entrances. Public entrances are defined as day-use parking areas, designated trailheads and (for ride-on users only - no vehicle or trailer access allowed) those sites where designated mountain bike trails intersect a public roadway.

When trails exist in gated DNR property, users must enter though the gate and pay applicable fees.

Access from adjacent private property is authorized only if each of the following conditions is met:

1. The property is not gated
2. The access is made a designated public trailhead for all mountain bike users with the landowner accepting liability, in writing, for public access through the property; or, the landowner grants the DNR a recreation access easement,
3. The development of an access does not conflict with another section or subsection of this information bulletin, and the access is consistent with the property plan for mountain bicycle trail management.

**D. Multiple use and single use trails**

Mountain bike trails on DNR properties shall be designated as mountain bike only, multiple use bicycles included, or otherwise identified special use trails. The use designation shall be based on resource, recreation, or maintenance considerations. Mountain bikes will be allowed only on trails or areas designated for this use (312 IAC 8-2-1).

**E. Special event rides**

The DNR may issue a license for a special event trail ride under the following conditions:

1. The event is limited in size so as not to exceed the specified carrying capacity of the facilities.
2. The sponsor of the event obtains a special event license from the DNR. The special event license shall contain appropriate conditions and deposit fees as determined by the property manager.
3. The property manager must pre-approve the use of all trails and facilities to be used for special events.
4. All special events shall comply with 312 IAC 8.

**F. DNR properties that provide mountain bike trails**

The decision to authorize a mountain bike trail on a DNR property is made by the division responsible for the management of the property. The decision shall be based on the division's mission statement, environmental considerations, and this information bulletin.

As a prerequisite to authorizing a mountain bike trail, a DNR property shall support a minimum of five (5) miles of continuous

or connected mountain bike trail. In addition, the DNR will not add new or expand existing mountain bike facilities until each of the following conditions is met:

1. The facilities meet the DNR mountain bicycle trail standards.
2. Adequate funding is available to assure proper operation and maintenance of the facilities.
3. The need for additional facilities is verified.

**G. Safety**

The following standards apply to promote public safety:

1. Trails shall have a speed limit of 15 miles per hour on all multiple-use trails.
2. On multiple-use trails, mountain bike riders must yield to all other users.
3. The designation of a public vehicle road as a bike trail is limited to where no other trail routing is feasible. Trails currently using public vehicle roads should be re-routed to avoid this conflict. Every effort will be made to minimize the use by mountain bikes on the driving surface of a public vehicle road.

**H. Volunteers and donations**

The DNR shall actively pursue cooperative programs with individuals or groups wishing to volunteer services or donate funds or materials to improve facilities on DNR properties. Donations and volunteer efforts will be used only within a structured program approved by the division and consistent with this information bulletin and the goals of the property, the Division and the DNR. These structured programs will be jointly developed by property staff and volunteers whenever possible and will focus on bringing existing facilities up to standards before considering expansion or creating new trails or facilities. For each program, the property manager will define in writing what, if any, special privileges or conditions will be accorded to volunteers within that program.

**I. Concessionaires**

Any person, group, or firm that engages in business on a DNR property, or uses the property as the base for, or as part of, any for-profit business, must have a written contract or vendor's permit for operation from the DNR.

**J. Education**

To the extent practicable, the DNR shall provide users with information on the impacts of recreational use, methods of minimizing negative impacts, trail ethics and general natural resource information.

**K. Closures**

The property manager may temporarily close a bike trail, or a portion of a bike trail, where reasonably required to protect public safety.

An authorized representative (as defined at 312 IAC 8-1-4(1)) may temporarily close a bike trail, or a portion of a bike trail, or may restrict users on a bike trail, for any of the following purposes:

1. Protection of public safety.
2. Protection of the environment.
3. Prevention of damage to the trail.
4. Trail maintenance or rotation.

The DNR director may close or restrict the use of a bike trail for any reason determined in the director's exercise of sound discretion.

Before implementing a closure, the DNR shall seek to minimize the negative impact on the recreational opportunities of all users. A closure should be conspicuously signed.

**4. Approval, Effective Date, and Amendment**

This information bulletin was approved by the Natural Resources Commission during a regular monthly meeting held on February 21, 2001. The Commission also asked the DNR to report at a later date concerning the use of helmets on mountain bike trails. The bulletin is effective April 1, 2001 and may be subsequently amended by the Commission.

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**DEPARTMENT OF STATE REVENUE**

28930185.LOF

**LETTER OF FINDINGS NUMBER: 93-0185 CSET**
**Controlled Substance Excise Tax**
**For Tax Periods: 1992**

**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 methamphetamine. The Indiana Department of Revenue issued a Record of Jeopardy

Finding, Jeopardy Assessment Notice and Demand on December 14, 1992, in a base tax amount of $232.00. Taxpayer filed a protest to the assessment. A hearing on the protest was held by telephone on January 8, 2001. 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 methamphetamine 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, Indiana State Police Laboratory report and Taxpayer's guilty plea indicate that Taxpayer was in possession of the controlled substance. Taxpayer did not offer any evidence to contradict the facts of the file. Taxpayer did not sustain her burden of proving that the assessment was incorrect.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

28930775.LOF

**LETTER OF FINDINGS NUMBER: 93-0775 CSET**
**Controlled Substance Excise Tax**
**For Tax Periods: 1993**

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

**ISSUE**

**1. Controlled Substance Excise Tax – Imposition**

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

Taxpayer protests the assessment of Controlled Substance Excise Tax.

**STATEMENT OF FACTS**

Taxpayer was arrested for possession of marijuana. The Indiana Department of Revenue issued a Record of Jeopardy Finding, Jeopardy Assessment Notice and Demand on September 3, 1993 in a base tax amount of $119.60. Taxpayer paid the tax and filed a protest to the assessment. Taxpayer was invited to provide additional information regarding the substance of this protest. Taxpayer, however, failed to respond. 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 bears the burden of proving that the assessment of tax is incorrect. IC 6-8.1-5-1(b). The arresting officer's report indicates that Taxpayer was in possession of marijuana. The Indiana State Police Laboratory Report indicates that the marijuana weighed 2.99 grams. Since Taxpayer did not offer any evidence to contradict the contents of the file, Taxpayer did not sustain his burden of proving that the assessment was incorrect.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

02950384.LOF

**LETTER OF FINDINGS NUMBER: 95-0384**
**Indiana State Gross Income Tax**
**For Years 1987, 1988, and 1989**

**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 its 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. Gross Income Tax Base for 1987-89 – Exclusion of Sales Under the Interstate Commerce Clause Exemption**

**Authority:** IC 6-2.1-2-2; IC 6-2.1-3-3; IC 6-8.1-5-1(b); D.H. Holmes Co. v. McNamara, 486 U.S. 24 (1988); Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232 (1987); Reynolds Metals Co. v. Indiana Dept. of State Revenue, 433 N.E.2d 1 (Ind. Ct. App. 1982); Mueller Brass Co. v. Indiana Dept. of Revenue, 265 N.E.2d 704 (Ind. 1971); 45 IAC 1-1-120(1)(b); IAC 1-1-120(2); IAC 1-1-120(2)(a); IAC 1-1-120(2)(c); IAC 1-1-120(2)(d)

Taxpayer protests the imposition of the state's Gross Income Tax on the proceeds of sales made between certain of taxpayer's

out-of-state subsidiaries.

**II. Gross Income Tax Base for 1987-89 – Taxability of the Sales of Goods Temporarily Stored Within Indiana**

**Authority**: IC 6-2.1-2-2(a)(1); IC 6-8.1-5-1(b); 45 IAC 1-1-118; 45 IAC 1-1-119; 45 IAC 1-1-119(2)(b)

Taxpayer protests the imposition of the Gross Income Tax on sales of its products, temporarily stored at taxpayer's Indiana location, for use by the taxpayer at its out-of-state locations.

**STATEMENT OF FACTS**

Taxpayer provides services, products, and systems for the movement and management of information. Taxpayer also provides installation, maintenance, and repair services for its products and communication systems. Taxpayer provides interstate and intrastate interLATA (Local Access and Transport Area) long distance telecommunications services throughout the United States among those geographical areas which been termed Local Access and Transport Areas. In addition, taxpayer provides interstate telecommunications services from areas outside the continental United States.

Nine different constituent companies fall within the ambit of the audit report. The audit maintained that two of those nine constituent subsidiaries not only had an extensive business presence in Indiana, but also offered comprehensive support programs for equipment installation, engineering, maintenance, and leasing. A complete listing of Indiana business locations, as of September 1992, included 127 separate business sites. Taxpayer declined to specify which constituent company utilized any particular location but did acknowledge that the affiliated companies shared a number of the 127 locations.

**I. Gross Income Tax Base for 1987-89 – Exclusion of Sales Under the Interstate Commerce Clause Exemption**

**DISCUSSION**

It was the auditor's position that all product sales were connected with taxpayer's Indiana locations and/or were attributable to the "bundle of corporate activity" which generated the sales. Two of taxpayer's subsidiary corporations (hereinafter "technology subsidiary" and "information subsidiary") not only had a major business presence in Indiana, but also offered extensive support programs for installation, engineering, maintenance, and equipment leasing related to the taxpayer's out-of-state activities. Technology subsidiary provided engineering, design and installation support for the products sold by information subsidiary. Technology subsidiary also manufactured products and oversaw the printing of technical manuals. Information subsidiary manufactured, marketed, leased and maintained various telecommunications and computer products. It also operated retail outlets for the taxpayer's consumer products. (Taxpayer's information subsidiary and technology subsidiary have since merged into the parent company, but the subsidiary companies remain identifiable as separate business units.) As a result, the auditor deemed that all product sales were subject to the Gross Income Tax.

Taxpayer argued that the auditor improperly included within its assessment product sales which should have been excluded from the Indiana Gross Income Tax base under the Interstate Commerce exemption. Taxpayer explained that the "vast majority" of sales by technology subsidiary, included in audit's Gross Income Tax determination, resulted from orders placed by a third subsidiary. Those orders were received and approved at taxpayer's offices in Illinois with payment received by a taxpayer subsidiary located in Georgia. According to the taxpayer, 95 percent of those orders ultimately resulted in shipment from various taxpayer locations outside of Indiana to taxpayer locations outside of Indiana. Therefore, as to those out-of-state shipments, technology subsidiary performed no support, installation, engineering, maintenance, or leasing services within Indiana. Taxpayer concluded that technology subsidiary's activity, with respect to the specific out-of-state to out-of-state transactions, did not give rise to the requisite level of nexus necessary to impose the Indiana Gross Income Tax.

Taxpayer is required to carry its burden of proof by demonstrating that the proposed tax has been incorrectly assessed. IC 6-8.1-5-1(b) states in relevant part that "[t]he 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." In addition, because the taxpayer asserts that the sales in question are not subject to the Gross Income Tax by virtue of the protection afforded under the Interstate Commerce Clause (U.S. Const. art. I, § 8), taxpayer, as "[t]he party claiming an interstate commerce exemption, or that the danger that he is subject to the risk of multiple taxation, bears the burden of establishing such facts, and any doubt should be resolved in favor of the tax." Reynolds Metals Co. v. Indiana Dept. of State Revenue, 433 N.E.2d 1, 8 (Ind. Ct. App. 1982).

The Indiana Gross Income Tax (IC 6-2.1-0.6 to 6-2.1-8-7) "is imposed upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident of Indiana." IC 6-2.1-2-2 To assure that only funds properly subject to a state tax are subject to the Gross Income Tax, IC 6-2.1-3-3 provides that "[g]ross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign county 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." IC 6-2.1-3-3 was passed in recognition of the fact that the Commerce Clause requires that Indiana not unduly burden commerce between the states. Therefore, Indiana may not impose a tax that discriminates against interstate commerce in favor of intrastate commerce. "While a state may impose a tax burden that is reasonable in light of the incidence of commercial contact by the taxpayer with [the state], a tax system which may produce a multiple taxation burden is proscribed." Mueller Brass Co. v. Gross Income Tax Division, Indiana Dept. of Revenue, 265 N.E.2d 704, 717 (Ind. 1971).

The taxpayer argues that the sales in question fell within the protection afforded by the Interstate Commerce Clause. More specifically, taxpayer cites to 45 IAC 1-1-120(1)(b) which exempts from the Gross Income Tax those "[s]ales made by a nonresident who has a business or business activities within the State, but the situs or activities are not significantly associated with the sales, and the goods are shipped directly to the buyer upon receipt of a prior order." In contrast, audit cited 45 IAC 1-1-120(2) which states, as an example of sales subject to the Gross Income Tax, those "[s]ales made by a nonresident, when the seller has established a business situs within the State, and the sales originated from, were channeled through, or were otherwise connected with the Indiana situs." 45 IAC 1-1-120(2)(a). Audit also cited 45 IAC 1-1-120(2)(c) which subjects to the Gross Income Tax those "[s]ales made by nonresidents where the goods are shipped directly to the buyer from an out-of-state business location, but where the seller is conducting substantial business activities within the State which were connected with the state." Audit also found relevant 45 IAC 1-1-120(2)(d) which imposes the tax on those "[s]ales made by nonresidents where the goods are shipped by the seller directly from an out-of-state location to the buyer, but where the seller had an employee or employees working within the State who were responsible for maintaining valuable and long-lasting contractual relations between seller and buyer, from which relations the sales arose."

The Supreme Court rejected the notion that every transaction in interstate commerce itself could not be taxed by the states but recognized that, with certain restrictions, interstate commerce may be subjected to state taxes. D.H. Holmes Co. v. McNamara, 486 U.S. 24, 30-31 (1988).

The Supreme Court has stated that "the crucial factor governing nexus is whether the activities performed in [the] state are significantly associated with the taxpayer's ability to establish and maintain a market in [the] state for the sales." Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232, 250 (1987). Although it is undisputed that taxpayer's technology subsidiary maintains a business presence within Indiana, the transactions in dispute are those which occur between an out-of-state location and a second out-of-state location. Absent evidence that the technology subsidiary's Indiana activities are in any way related to those exclusively out-of-state transactions, no nexus can be found.

Assuming the factual assertions regarding taxpayer's purported out-of-state to out-of-state transactions are correct and verifiable, the proposed tax assessment on those particular transactions is inappropriate. Therefore to the extent that taxpayer's transactions occurred between one out-of-state location and another out-of-state location, taxpayer's protest is sustained. A supplemental audit is requested in order to determine specifically which of taxpayer's transactions are subject to this determination and to adjust the taxpayer's assessment accordingly.

**FINDING**

Taxpayer's protest is sustained subject to the findings of a supplemental audit.

**II. Gross Income Tax Base for 1987-89 – Taxability of the Sales of Goods Temporarily Stored Within Indiana**

**DISCUSSION**

Taxpayer protests the auditor's determination that certain product sales, made from goods temporarily located at taxpayer's Indiana facility, to taxpayer's out-of-state subsidiaries, are subject to the imposition of the Gross Income Tax.

As a general rule, under the provisions of the Interstate Commerce Clause, the income from the sales of goods to out-of-state purchasers is exempt from the imposition of state tax. 45 IAC 1-1-118, 119. A general exception to that rule occurs when the sales are completed in Indiana. 45 IAC 1-1-119. As an example, 45 IAC 1-1-119(2)(b) provides that "[s]ales to nonresidents where the goods are accepted by the buyer or he takes actual delivery within the State" are subject to the Indiana Gross Income Tax.

Taxpayer protests the imposition of tax on sales of its goods, temporarily stored within Indiana, from taxpayer's Indiana technology subsidiary to certain of its out-of-state operating subsidiaries. Unfortunately, the taxpayer provides no factual or legal basis upon which to predicate this particular portion of its protest. Absent a more substantive basis upon which to make a decision, the Department is left with (1) IC 6-2.1-2-2(a)(1) which imposes the Gross Income Tax upon "the entire taxable gross income of a taxpayer who is a resident or domiciliary of Indiana;" (2) the provisions of 45 IAC 1-1-119 which permit the imposition of the Gross Income Tax on sales to out-of-state buyers when "the sales are completed in Indiana;" and (3) IC 6-8.1-5-1(b) which states the "[t]he notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid." That same regulatory section continues by imposing on taxpayer "[t]he burden of proving that the proposed assessment is wrong...." Id.

**FINDING**

The taxpayer's protest is respectfully denied.

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**DEPARTMENT OF STATE REVENUE**

02970447.LOF

**LETTER OF FINDINGS NUMBER: 97-0447 IT**
**Gross Income Tax – Industrial Processing**
**For Tax Periods: 1993 through 1995**

**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 – Industrial Processing**

**Authority:** IC 6-2.1-2-1, IC 6-2.1-2-2, IC 6-2.1-2-4, IC 6-2.1-2-5; Jefferson Smurfit v. Indiana Department of State Revenue, 681 N.E.2d 806 (Ind.Tax 1997)

Taxpayer protests proposed assessments of Indiana gross income tax, at the high rate, on a portion of its Indiana gross receipts.

**STATEMENT OF FACTS**

Taxpayer sells telephone equipment. Taxpayer also provides maintenance contracts to a variety of customers. During the audit period (1993-1995), Taxpayer earned receipts subject to Indiana's gross income tax. Taxpayer characterized these receipts as having been derived from "wholesale sales." As such, taxpayer computed its Indiana gross income tax at the statutory rate of.30%. Audit disagreed. Audit, contended these receipts were derived from taxpayer's provision of services; as such, the receipts should have been taxed, for gross income tax purposes, at the statutory rate of 1.2%. Audit's findings resulted in an increase in taxpayer's Indiana gross income tax. Taxpayer now protests Audit's re-characterization of its receipts and the additional proposed assessments of Indiana gross income tax.

**I. Gross Income Tax – Industrial Processing**

**DISCUSSION**

The transactions at issue involve work performed by taxpayer on customer owned tangible personal property (telephone equipment). For purposes of analysis, taxpayer's activities (work) may be classified in one of two ways. In some instances, taxpayer performs material management activities. Taxpayer receives customer (telephone companies) equipment in bulk, "breaks" the equipment down into individual units, date stamps and inserts warranty cards, packages the equipment and inserts, and then delivers the packaged equipment to customer job sites.

Taxpayer also performs assembly activities. To wit, taxpayer receives partially assembled equipment from its customers. Taxpayer completes assembly according to customer specifications. According to taxpayer, assembly requires taxpayer "to contribute" its own wiring and fasteners to the final product. After assembly, taxpayer packages and then delivers the equipment to customer job sites.

Taxpayer believes the aforementioned activities represent "industrial processing" (a type of wholesale sale") as defined in IC 6-2.1-2-1(c)(1)(D), explained in 45 IAC 1-1-86, and analyzed by the Indiana Tax Court in Jefferson Smurfit v. Indiana Department of State Revenue, 681 N.E.2d 806 (Ind.Tax 1997).

Taxpayer, in support of its position, directs the Department's attention to IC 6-2.1-2-1(c)(1)(D)(ii), which has broadened (as amended by P.L.76-1985, SEC.8) the statutory definition of wholesale sales to include:

(D) Receipts from industrial processing or servicing, including:

(i) tire retreading; and

(ii) the enameling and plating of tangible personal property which is owned and is to be sold by the person for whom the servicing or processing is done, either as a complete article or incorporated as a material, or as an integral or component part of tangible personal property produced for sale by such person in the business of manufacturing, assembling, constructing, refining, or processing (emphasis added).

Taxpayer argues its assembly and material management activities "fit" well within the definition of industrial processing (see Jefferson Smurfit v. Indiana Department of State Revenue, 681 N.E.2d 806 (Ind.Tax 1997)). Taxpayer reasons since industrial processing is considered to be a subset of wholesale sales for purposes of computing Indiana's gross income tax (IC 6-2.1-2-1), all receipts derived from its "industrial processing" activities (i.e., material management and assembly) must, by statute, be taxed at the low rate. (IC 6-2.1-2-4).

Indiana imposes a gross income tax on the "entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana." IC 6-2.1-2-2. The tax is imposed at two rates—the high rate (1.2%), and the low rate (.03%). Receipts from wholesale sales and from selling at retail are taxed at the low rate. IC 6-2.1-2-4. Receipts from service activities, as well as from other business activities, are taxed at the high rate. IC 6-2.1-2-5. The issue now before the Department is whether taxpayer's contested activities represent industrial processing (receipts taxed at the low rate), or represent service activities (receipts taxed at the high rate).

After reviewing the statutory language and relevant case law, the Department must disagree with taxpayer's conclusions. Specifically, the Department finds that taxpayer's assembly and materials management activities are best characterized as conventional service activities and not those of an industrial processor.

Explicit in the statutory definition of industrial processing is the requirement that taxpayer's customers must be engaged in the business of "manufacturing, assembling, constructing, refining, or processing" (see IC 6-2.1-2-1(c)(1)(D)(ii))—notwithstanding the elimination of the resale requirement by the Tax Court in Jefferson Smurfit.

Additionally, the Department notes that regardless of moniker used—whether taxpayer is engaged in rebuilding, repairing, refurbishing, or even remanufacturing—taxpayer's customers must be engaged in activities listed in the statutory definition. Implicit in the concept of industrial processing is the notion that owners of the processed property (i.e., taxpayer's customers) must be

engaged in manufacturing, processing, or similar types of production activities. In this instance, however, taxpayer's customers—telephone companies—are not engaged in production activities. Rather, taxpayer's customers are service providers.

The concept of "wholesale sales" anticipates the production of tangible personal property by one claiming the "wholesale sales" exemption. The language of IC 6-2.1-2(c)(1)(D)(ii)—i.e., "by such person in the business of manufacturing, assembling, constructing, refining, or processing"—is consistent with this notion. The Department, therefore, will not exclude the "manufacturing, assembling, refining, or processing" requirement from its definition, and understanding, of "industrial processing." Consequently, since taxpayer's customers are not engaged in production activities, taxpayer does not qualify for low-rate treatment as an industrial processor. In other words, Audit was correct in its determinations. Accordingly, the receipts derived from taxpayer's provision of assembly and material management services must be taxed at the high rate for purposes of Indiana's gross income tax.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

02970521.LOF

**LETTER OF FINDINGS NUMBER: 97-0521**
**Indiana Corporation Income Tax**
**For Years 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 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. Reallocation of Taxpayer's Sales to Indiana – Throw-back Sales**

**Authority:** 15 U.S.C.S. § 381; IC 6-3-2-2(e); IC 6-3-2-2(n)(1); IC 6-3-2-2(n)(2); Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992). Indiana Dept. of State Revenue v. Continental Steel Corp., 399 N.E.2d 754 (Ind. Ct. App. 1980); 45 IAC 3.1-1-53(5); 45 IAC 3.1-1-64

Taxpayer has protested the auditor's determination that certain of its sales, resulting in shipments from the taxpayer's plants inside Indiana but delivered to customers within other states, should be included in the throw-back calculation, relevant in determining taxpayer's corporate income tax liability, because the taxpayer's activities within those foreign states did not exceed solicitation. The taxpayer argues that because it is taxable within those other states, sales to those out-of-state customers should not be included within the throw-back calculation for purposes of determining Indiana Corporation Income tax.

**STATEMENT OF FACTS**

Taxpayer is a manufacturer of custom-designed plastic products. Ninety-six percent of taxpayer's business is generated through the design and manufacture of custom designed packing and shipping trays ("Transport Packaging Systems"). The remainder of taxpayer's business derives from the manufacture of small storage trays used in classrooms. The taxpayer is headquartered in Ohio. The taxpayer operates plants, owns various properties, controls inventory, and pays taxes in Indiana and Ohio. However, the taxpayer ships products from Indiana to states other than Indiana and Ohio.

**ISSUE**

**I. Reallocation of Taxpayer's Sales to Indiana: Throw-back Sales**

Taxpayer protests the imposition of the Indiana adjusted gross income tax on the proceeds of sales made to certain of its out-of-state customers. The auditor determined that, for purposes of determining the taxpayer's tax liability, the sales to out-of-state customers should be allocated back to Indiana because the sales were made to customers located within states where the taxpayer was not subject to tax. Under 45 IAC 3.1-1-53(5), "[I]f the taxpayer is not taxable in the state of the purchaser, the sale is attributed to [Indiana] if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state." Such sales are designated as "throw-back" sales. Id. The auditor found that taxpayer's transactions qualified as "throw-back" sales because the taxpayer did not file out-of-state income or property tax returns, had no property or inventory in the foreign states, and was unable to provide definitive proof that the taxpayer was subject to out-of-state tax. The taxpayer conducts business in 39 states outside of Indiana but files income tax returns in only four of those states.

IC 6-3-2-2(e) provides that "[s]ales of tangible personal property are in this state if... (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and... (B) the taxpayer is not taxable in the state of the purchaser." IC 6-3-2-2(n) provides that "[f]or purposes of allocation and apportionment of income... a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." Therefore, in order to properly allocate income to a foreign state, taxpayer

must show that one of the taxes listed in IC 6-3-2-2(n)(1) has been levied against him or that the state has the jurisdiction to impose a net income tax regardless of whether the state actually does so.

15 U.S.C.S. § 381 (Public Law 86-272) controls those occasions in which a state may properly impose a tax on the net income, derived from sources within that state, by foreign (out-of-state) taxpayers. 15 U.S.C.S. § 381 establishes the minimum standard for the imposition of a state income tax based on the solicitation of interstate sales. Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447, 2453 (1992). 15 U.S.C.S. § 381 prohibits a state from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within that state unless those business activities exceed the mere solicitation of sales. 15 U.S.C.S. § 381(a), (c). Conversely, the effect of the throw-back rule is to revert sales receipts back to the state from where the goods were shipped in those situations where 15 U.S.C.S. § 381 deprives the purchaser's own state of the power to impose a net income tax. 45 IAC 3.1-1-64. In effect, 15 U.S.C.S. § 381 permits Indiana to tax out-of-state business activities, without violating the commerce clause and without the possibility of subjecting taxpayer to double taxation, because Indiana's right to tax those out-of-state activities is derivative of the foreign state's own taxing authority. In every transaction, at least one state has the authority to tax income derived from the sale of tangible personal property; if the state wherein the sale occurred is forbidden to do so by 15 U.S.C.S. § 381, then the income is "thrown-back" to the originating state.

The definition of activity which does and does not exceed "mere solicitation" has been set out in Indiana Dept. of State Revenue v. Continental Steel Corp., 399 N.E.2d 754 (Ind. Ct. App. 1980). The court held that, "solicitation should be limited to those generally accepted or customary acts in the industry which lead to the placing of orders, not those which follow as a natural result of the transaction, such as collections, servicing complaints, technical assistance and training..." Id. at 759. Further, "solicitation must be limited to those acts which lead to the placing of orders and does not include those acts which follow as a result of the transaction." Id. The court set out examples of activity which exceeded "mere solicitation" including "giving spot credit, accepting orders, collecting delinquent accounts and picking up returned goods within the taxing state, collecting deposits and advances on orders within the taxing state, pooling and exchanging technical personnel in a complex mutual endeavor, maintaining personal property [] and associated local business activity for purposes not related to soliciting orders within the taxing state." Id.

In Continental, the court held that the taxpayer's activities within the foreign state exceeded solicitation because taxpayer's activities "[did] not lead to the placing of orders but follow[ed] as a natural result of the transaction." Id. Those activities included the taxpayer's "salesmen making adjustments on complaints, [and] salesmen giving customers technical assistance..." Id.

The "mere solicitation" standard was refined by the Supreme Court in Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co. 112 S.Ct. 2447, 2453 (1992). The Court concluded that "although solicitation covered more than what was strictly essential to making requests for purchases, the fact that an activity is performed by salespersons does not automatically convert that activity into solicitation." Id. at 2456-57. The Court held that whether the taxpayer's in-state activity was sufficiently de minimis to avoid the loss of taxpayer immunity, conferred by 15 U.S.C.S. § 381, depended on whether the activity establishes a "non-trivial additional connection with the taxing State." Id. at 2458. In Wrigley, the Court determined that the taxpayer's sales representatives' activities, consisting of replacing stale gum at retail locations, was an activity outside 15 U.S.C.S. § 381 immunity. Id. at 2458-59. The court held that although the representatives' activity could be said to facilitate the sales, it did not facilitate the *requesting* of sales and was not ancillary to the solicitation of sales. Id. at 2459 (Emphasis added). Therefore, because taxpayer's practice of having its representatives rotate stocks of stale gum was an activity outside the solicitation of sales, taxpayer brought itself outside the scope of 15 U.S.C.S. § 381 immunity and subjected itself to the local net income tax. Id. at 2460.

The nature of taxpayer's business is the production of large, plastic shipping trays custom designed to conform to the shipping requirements of the customer's particular products. The majority of taxpayer's customers are in the business of producing and shipping either television picture tubes or automobile parts. Each shipping tray is custom designed to conform to the size, weight, and form of the individual components and is further adapted to the particular means by which the components will be shipped. Each tray is designed to securely hold multiple components. Each tray is designed to stack atop an identical tray and, by this means, provide additional protection for the components sandwiched between the different levels of trays. The trays are specifically designed to fit within or on shipping pallets and/or various shipping containers.

Taxpayer retains salespersons to solicit orders for shipping trays. Once a sales representative has made an initial presentation and the customer has expressed an interest in taxpayer's product, a purchase order is prepared and signed. Although a "concept drawing" may have been prepared before the purchase order was signed, the more detailed collaborative design, engineering, and testing work occurs after the purchase is signed. Once that purchase order has been obtained, the salesperson or taxpayer's engineers – depending on the complexity of the desired tray – consults with the customer to design the specific tray required. Once taxpayer and customer have considered and agreed on the characteristics of the shipping tray, a wooden die is fabricated, sample plastic trays are produced, and the samples are shipped to customer for testing and approval. Simultaneously, taxpayer tests the samples at its own location. Once tested and approved, a final metal die is prepared. This metal die, at customer's choice, will remain the property of either taxpayer or the customer. If customer obtains ownership of the die, the customer is potentially free to retrieve the die, select another vendor, and, using the original die, have the replacement vendor produce additional trays. In approximately 82.8 percent of cases, customer acquires and retains ownership of the tooling although the die normally remains at the taxpayer's manufacturing

facility. (Taxpayer Letter, November 10, 2000).

Whether taxpayer's collaborative design activities occur before or after a completed sale is question of fact and open to some degree of interpretation. In general, taxpayer regards the solicitation for the initial sale as "complete" before the design and engineering work is commenced. Taxpayer is of the opinion that it will not enter into extensive preparatory work until it has some degree of assurance that the sale is complete. However, there are instances where, after the design and engineering work is complete, the resulting product is found to be unsatisfactory and the customer will decline to purchase the taxpayer's products. What is undisputed is that 60 percent of taxpayer's business constitutes repeat business with existing customers. This degree of repeat business gives some evidence of a continuing and ongoing collaborative relationship between the taxpayer and its individual customers.

After an initial "run" of the trays is complete, the taxpayer remains in contact with the customer for various reasons. The salespersons or taxpayer's chief financial officer may contact the customer to resolve payment issues. The salesperson may contact customer to determine if additional trays are required. At the end of the useful life of the tray, either through wear or because the product specifications have changed, the taxpayer maintains an arrangement whereby it will repurchase the trays and recycle the component plastics in preparation for fabricating new packaging materials.

Taxpayer has provided documentation related to the amount of time, unrelated to an initial sale, its personnel spend at customer locations. Taxpayer's sales personnel spend an average of 3.5 days per week at customer locations. Members of the engineering department spend an average of ten days per month at customer locations. (Taxpayer Letter, November 10, 2000).

Standing alone, none of the taxpayer's isolated activities is sufficient to demonstrate that taxpayer's out-of-state activities exceed the "mere solicitation" standard established in 15 U.S.C.S. § 381 as defined in Continental, 399 N.E.2d 754. However, given the totality of the circumstances and the evidence as set forth by the taxpayer, the taxpayer's out-of-state activities go beyond "those generally accepted or customary acts in the industry which lead to the placing of orders" but evinces a relationship with its foreign-state customers that demonstrates an ongoing, complex, collaborative endeavor. Id. at 759. Compared to the business activity in Wrigley, wherein Wrigley, by rotating stocks of stale chewing gum, was found to have exceeded solicitation of sales, taxpayer's own foreign state activities are clearly even more extensive. Because taxpayer produces a custom designed product, the utility of which is dependent upon closely adhering to the customer's specifications and requirements, the simple solicitation of orders is insufficient to complete a customer transaction. The transaction takes place over an extended period of time and involves extensive consultations between customer and taxpayer in order to produce a product satisfactory to the customer. These consultations involve not only taxpayer's salespersons but also the taxpayer's engineers, design staff, and comparable numbers of the customer's own personnel. Such activity creates a sufficient nexus with the out-of-state jurisdiction such that only those foreign states have jurisdiction to tax the taxpayer. Id. The fact that taxpayer does or does not file an income tax return in those states, does or does not pay the pertinent tax in those jurisdictions, is irrelevant and is of no concern to the state of Indiana. Id. at 758; IC 6-3-2-2(n)(2).

**FINDING**

Taxpayer's protest is sustained subject to the findings of a supplemental audit.

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**DEPARTMENT OF STATE REVENUE**

02970533.LOF

**LETTER OF FINDINGS NUMBER: 97-0533**
**Corporate Income Tax**
**For Tax Periods 1992-1994**

**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.

**ISSUES**

**I. Income Tax – Foreign Source Dividends**

**Authority:** Ind. Code § 6-3-2-12

Taxpayer protests the calculus used to compute its foreign source dividend deduction.

**STATEMENT OF FACTS**

Taxpayer (holding company and subsidiaries) is engaged in multinational operations. Historically, taxpayer has reported its Indiana income (both gross and adjusted gross) on a unitary basis. The Department visited taxpayer and conducted an audit for tax periods ending in 1992 and 1993. This audit resulted in additional proposed assessments of Indiana adjusted gross income tax. Taxpayer now protests these assessments.

**I. Income Tax – Foreign Source Dividends**

**DISCUSSION**

In calculating its Indiana tax liabilities, taxpayer, pursuant to IC 6-3-2-12, deducted foreign source dividend income from its

Indiana adjusted gross income. Audit, however, disagreed with taxpayer's calculus. Re-calculation by Audit resulted in an increase in taxpayer's Indiana adjusted gross income and tax. Proposed assessments of Indiana adjusted gross income tax followed.

Taxpayer, in response, directs the Department's attention to the language of IC 6-3-2-12(b), which 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 aforementioned subsections (c), (d), and (e) allow corporate taxpayers to receive a one hundred percent (100%) deduction for foreign source dividends received from corporations in which a taxpayer has an eighty percent (80%) or larger ownership interest; an eighty-five percent (85%) deduction for dividends received from corporations in which a taxpayer has a fifty to seventy-nine percent (50%-79%) ownership interest; and a fifty percent (50%) deduction for dividends received from corporations in which a taxpayer has less than a fifty percent (50%) ownership interest. IC 6-3-2-12(c)-(e).

This statutory language is cogent and clear. IC 6-3-2-12 authorizes pro rata deductions (based on the percentage ownership of the payor by the payee) of certain foreign source dividend income. In this instance, taxpayer has followed the statutory prescriptions in calculating its foreign source dividend deductions.

**FINDING**

Taxpayer's protest is sustained.

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**DEPARTMENT OF STATE REVENUE**

28970603.LOF

**LETTER OF FINDINGS NUMBER: 97-0603 CSET**
**Controlled Substance Excise Tax**
**For Tax Periods: 1997**

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

**ISSUE**

**Controlled Substance Excise Tax – Imposition**

**Authority:** IC 6-7-3-5, IC 6-8.1-5-1 (b), Hurst v. Department of Revenue, 720 N.E. 2d 370 (Ind. Tax.1999)

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 October 23, 1997 in a base tax amount of $5,768.70. Taxpayer filed a protest to the assessment. A hearing was held by telephone. Further facts will be provided as necessary.

**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).

Officers in an Indiana State Police helicopter sighted marijuana growing near a barn on a routine flyover. Ground units were directed to the farm and officers knocked at the door. Taxpayer answered the door. Also at the home was another person who owned the property. The other person gave the officers permission to search the house, outbuildings and the farm. The officers found five marijuana plants growing about 20 feet from the east side of the barn.

Possession of the marijuana can be either actual or constructive. Hurst v. Department of Revenue, 720 N.E. 2d 370 (Ind. Tax. 1999). Although both direct and circumstantial evidence may prove constructive possession, proof of presence in the vicinity of drugs, presence on property where drugs are located, or mere association with the possessor is not sufficient. Id., 374-375. To prove constructive possession there must be a showing that Taxpayer had not only the requisite intent but also the capability to maintain dominion and control over the substance. Id., 374.

In this case, Taxpayer did not own the property. There was marijuana residue found under the bed in which he was sleeping. Other people, however, also slept in that room. He also admitted that he sometimes mowed the lawn. This evidence, however, is not enough to determine that he had constructive possession of the marijuana growing on the farm as defined by the Court.

**FINDING**

Taxpayer's protest is sustained.

**DEPARTMENT OF STATE REVENUE**

02980419.LOF

**LETTER OF FINDINGS NUMBER: 98-0419**
**Gross Income Tax**
**For Tax Periods 1994-1995**

**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. Gross Income Tax – Interstate Transportation**

**Authority:** IC 6-8.1-3-3; 45 IAC 1-1-121; 45 IAC 1-1-145

Taxpayer protests imposition of Gross Income Tax on sorting and handling services.

**STATEMENT OF FACTS**

Taxpayer maintains handling and sorting contracts with interstate carriers. Taxpayer handles packages as they move through an airport located in Indiana. The packages are unloaded from airplanes and trucks, sorted and then reloaded onto other airplanes and trucks. The Department of Revenue ("Department") conducted an audit of the taxpayer covering the years of 1994 and 1995. A result of this audit was an adjustment to taxpayer's Indiana gross income. Additional proposed assessments of Gross Income Tax were made on taxpayer's income from these handling and sorting contracts. Taxpayer, however, believes this income is exempt from Gross Income Tax as the income represents receipts earned from interstate commerce.

**I. Gross Income Tax – Interstate Transportation**

**DISCUSSION**

Taxpayer protests the imposition of Gross Income Tax on income derived from work performed as a part of interstate transportation. The Auditor assessed Gross Income Tax on the basis that the income from these contracts was derived from the performance of services performed wholly within Indiana. Taxpayer counters by referencing 45 IAC 1-1-145, which states:

> Receipts from Truck Transportation. Receipts from transportation charges or other charges directly related to transporting goods by truck are exempt from gross income tax if such transportation is an initial, intermediate or final step in interstate transportation.

Taxpayer believes that since it is handling and sorting packages for interstate transportation companies, its performance of the contracts qualifies as an intermediate step in interstate commerce.

The Department refers to 45 IAC 1.1-1-121, which states in part:

> Income from the Performance of a Contract or Service. Gross income derived from the performance of a contract or service within Indiana is subject to gross income tax. Below is a list of some of the situations which have arisen in dealing with service income, with an indication of the taxability of each:
>
> > (a) Income from a contract for the performance of services within the State is subject to gross income tax. However, if the contract calls for the performance of services both within and without the State by a nonresident with no in-state business situs and the nonresident's performance within the State is minimal or incidental in comparison to his performance out-of-state, no service income will be taxed. In determining what will be considered "minimal" or "incidental," the Department has formulated these guidelines: If five percent (5%) or less of the total hours or total fee under the contract in any tax year is attributable to services performed in Indiana, the entire proceeds of the contract received in that year are exempt from gross income tax. If the five percent (5%) figure is exceeded, the entire proceeds of the contract are taxable. The purpose of the five percent (5%) rule is to avoid taxing the proceeds of contracts involving minimal activities in the State. The Department reserves the right to review any contract to determine if it calls for more than minimal in-state activities, non-withstanding the "five percent (5%) rule" guidelines.

Taxpayer fulfils its contracts with the interstate carriers by unloading, handling and sorting packages as they come into the airport and reloading those packages before they leave the airport. Taxpayer does not truck the packages themselves. The packages never leave the airport while in taxpayer's control.

At hearing, taxpayer explained that the Department had issued assessments for the same issue covering tax year 1993 and that the assessment had been successfully disputed in 1995. Taxpayer stated that since the assessment on the same issue had been resolved in its favor, and since there had been no change in Indiana tax laws regarding this issue, it would expect the same results in this protest.

Review of the Department's records shows that the disputed assessment was the result of a review of taxpayer's return. No audit

was performed. No Letter of Findings was issued. The assessment was simply canceled. While this error results in a benefit for taxpayer for tax year 1993, it does not bar the Department from issuing assessments in following years for the same issue. IC 6-8.1-3-3(b) explains:

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.

In this case, the Department is not changing its interpretation of a listed tax. There never was an interpretation for the 1993 assessment. The assessment was merely canceled without explanation.

Taxpayer is not engaged in interstate transportation activities, but rather provides local delivery services. Therefore, 45 IAC 1-1-121 applies to taxpayer's situation. Taxpayer's income resulted from contracts for the performance of services wholly within Indiana. 45 IAC 1-1-145 applies to taxpayer's customers—the interstate carriers. The cancellation of the previous assessment does not constitute an interpretation; therefore the Department may issue assessments in this case.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

04980447.LOF

**LETTER OF FINDINGS NUMBER: 98-0447**
**Sales and Use Tax**
**For Tax Periods: 1994-1996**

**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.

**1. Sales and Use Tax – Contract to Furnish and Install**

**Authority:** IC 6-8.1-5-1, IC 6-2.5-2-1(b), 45 IAC 2.2-4-22(d)

Taxpayer protests the imposition of tax on the transfer of precast concrete.

**2. Sales and Use Tax – Change Orders**

**Authority:** IC 6-2.5-2-1(b), 45 IAC 2.2-4-22(d)

Taxpayer protests the imposition of tax on certain change orders.

**3. Tax Administration – Penalty**

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

Taxpayer protests the imposition of the penalty.

**STATEMENT OF FACTS**

Taxpayer is an out of state corporation which serves as a general contractor on construction jobs. Additional sales and use tax, interest and penalty was assessed after a routine audit. Taxpayer protested the assessment and a hearing was held. Further facts will be provided as necessary.

**1. Sales and Use Tax – Contract to Furnish and Install**

**DISCUSSION**

In September and October, 1994, Taxpayer paid a subcontractor for precast concrete. The subcontractor was also paid to install the precast concrete on Taxpayer's job. After fabrication of the precast concrete, the subcontractor invoiced Taxpayer for the material portion of the job and stored the precast concrete for Taxpayer. Tax was assessed against these invoices as sales of tangible personal property. Taxpayer contends that this transaction should not be considered a sale of tangible personal property, since all material in this instance was transferred pursuant to an agreement to furnish and install the precast concrete.

The presumption is that all Indiana Department of Revenue tax assessments are accurate. Taxpayers bear the burden of proving that an assessment is incorrect. IC 6-8.1-5-1.

IC 6-2.5-3-2 (c) imposes the use tax in construction cases as follows:

The use tax is imposed on the addition of tangible personal property to a structure or facility, if, after its addition, the property becomes part of the real estate on which the structure or facility is located. However, the use tax does not apply to additions of tangible personal property described in this subsection, if:

(1) the state gross retail or use tax has been previously imposed on the sale or use of that property; or

(2) the ultimate purchaser or recipient of that property would have been exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

This law concerning the gross retail tax liability of contractors is explained at 45 IAC 2.2-4-26 as follows:

(a) A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used.

(b) A person selling tangible personal property to be used as an improvement to real estate may enter into a completely separate contract to furnish the labor to install or construct such improvement, in which case the sales tax shall be collected and remitted by such seller on the materials sold for this purpose. Such sales of materials must be identifiable as a separate transaction from the contract for labor. The fact that the seller subsequently furnished information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material.

The issue to be determined is whether the precast concrete were transferred pursuant to a contract to furnish and install and qualify for exemption pursuant to paragraph "a" of the regulation or if the precast concrete were sold separately and subject to gross retail tax pursuant to paragraph "b" of the regulation.

The evidence indicates that the subcontractor produced the precast concrete, issued bills for the preparation of the precast concrete, received payment for the precast concrete and transferred title of the precast concrete to Taxpayer on September 20, 1994 and October 24, 1994. Taxpayer also provided a statement from the subcontractor stating that the subcontractor can produce the pieces of concrete faster than the erector can install the precast concrete. Therefore the subcontractor bills for the materials with "a conditional bill of sale which gives the customer title to the panels once payment had been received." Taxpayer paid for the tangible personal property immediately after it was produced and paid for the services after completion of the services. Taxpayer also provided a "Progress Statement" which shows that the material was separately listed from the service of engineering, erection services and delivery.

Taxpayer, however, argues that the tangible personal property was transferred as part of a contract to furnish and install tangible personal property, the precast concrete. Taxpayer bases its argument that the transfer was made pursuant to a contractual agreement to make an improvement to realty on a contract submitted to the Indiana Department of Revenue prior to the hearing. The contract states on page 6 that the subcontractor will "Furnish all labor, material, tools, equipment and supervision necessary to provide all precast concrete work in accordance with (architect's) plans." The contract called for the sale of the prefabricated concrete and services of installation for one price. The transfer of the property was made pursuant to the contract to furnish and install which indicates that it was sold for one price with a partial payment of the total price made at the time of the transfer of title to the precast concrete to Taxpayer.

**FINDING**

Taxpayer's protest is sustained.

**2. Sales and Use Tax – Change Orders**

**DISCUSSION**

Taxpayer's second point of protest concerns the assessment of gross retail tax on certain electrical change orders. The electrical subcontractor paid Indiana sales tax on the materials it used in executing the change orders for Taxpayer. These change orders were invoiced on a time and material basis. Indiana imposes a state gross retail tax on "retail transactions made in Indiana." The payment and collection of the gross retail tax is explained at IC 6-2.5-2-1 (b) as follows:

The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The law concerning installation of tangible personal property is explained for at 45 IAC 2.2-4-22 (d) as follows:

Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax

and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

(1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction material and the cost for the labor and other charges (only the gross proceeds from the sale of the construction materials are subject to tax).

Pursuant to the law and regulation, Taxpayer clearly owed sales tax on the tangible personal property used in the construction. The tax should have been collected and remitted by the electrical contractor. The fact that the contractor mistakenly paid Indiana sales tax on the electrical supplies when it purchased the materials for the change orders does not change the fact that the contractor should have collected Indiana sales tax from Taxpayer pursuant to the time and materials contract.

**FINDING**

Taxpayer's protest is denied.

**3. Tax Administration – Penalty**

**DISCUSSION**

Taxpayer's final point of protest concerns 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.

The rules concerning the payment of tax on a time and materials contract are clear and easily accessible in Indiana Department of Revenue publications. Taxpayer's failure to read and follow these instructions constitutes negligence.

**FINDING**

Taxpayer's final point of protest is denied.

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**DEPARTMENT OF STATE REVENUE**

03980752.LOF

**LETTER OF FINDINGS NUMBER: 98-0752**
**Withholding Tax**
**For Tax Periods: 1995-1997**

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

**1. Withholding Tax – Employee v. Independent Contractor**

**Authority:** IC 6-3-4-8 (a,b,g), IC 6-8.1-5-1 (b), Longmire v. Indiana Department of State Revenue, 638 N.E.2d 894, 897, Indiana Tax Court, 1994

The taxpayer protests the classification of service providers as employees.

**2. Withholding Tax – Safe Haven**

**Authority:** 26 U.S.C.A. 530

The taxpayer requests safe haven treatment.

**3. Tax Administration – Penalty**

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

The taxpayer protests the imposition of the penalty.

**STATEMENT OF FACTS**

The taxpayer is a general contractor whose business activity consists of commercial and residential contracts. The taxpayer performs both lump sum and time and material jobs. After a routine audit, the taxpayer was assessed additional withholding tax, penalty and interest. Taxpayer protested the assessment. Further facts will be provided as necessary.

**1. Withholding Tax – Employee v. Independent Contractor**

**DISCUSSION**

A business which is required under federal law to withhold, collect and remit withholding tax to the Internal Revenue Service on wages paid to its employees must also deduct, withhold and remit Indiana withholding tax to the Indiana Department of Revenue on wages paid to its employees. IC 6-3-4-8 (a). Failure to withhold tax on wages paid to the business' employees causes the employer to be liable for the withholding tax. IC 6-3-4-8 (g). Businesses are not required to withhold, collect and remit withholding on fees paid to independent contractors. If an employer does not collect and remit withholding tax for employees, the employee withholding tax is assessed against the business. IC 6-8.1-5-1 (b). Assessments by the Indiana Department of Revenue are presumed to be correct and the taxpayer bears the burden of proof that the assessment is incorrect. IC 6-8.1-5-1 (b).

Determining whether an individual worker is an employee or independent contractor necessitates examination of the relationship between the worker and the business. Behavioral and financial controls are the crucial factors in determining whether an employee relationship exists. An employment relationship exists when "the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished." Longmire v. Indiana Department of State Revenue, 638 N.E.2d 894, 897, Indiana Tax Court, 1994.

The auditor determined that most of the individual workers on the taxpayer's projects were employees and assessed withholding tax against the taxpayer on their wages. The auditor's determination of employee status was based on several factors. The taxpayer had registered to collect and remit withholding tax. Further the taxpayer did not prepare 1099 Miscellaneous Income Statements for the individual workers each year. Rather, the taxpayer produced the 1099 Miscellaneous Income Statements at the time of the audit. Many of the statements were not completely filled out. A search of the Indiana Department of Revenue records indicated that the majority of the individual workers did not file individual Indiana income tax returns. The taxpayer was unable to produce contracts, invoices or billings which would indicate an independent contractor status.

The taxpayer contends that all of the individual workers were independent contractors. The taxpayer produced statements from several individual workers concerning their relationships with the taxpayer. Although the statements were not identical, each of these statements indicated that the individual worker or subcontractor was an independent contractor rather than employee. The statements included several items such as the individual workers considered themselves independent contractors, provided their own insurance, reported and paid income taxes on the fees received, chose their own hours, provided their own tools and bill and receive payment by the job rather than the hour. These statements were made after the fact and were not notarized or made under penalties of perjury. These self serving statements do not meet the statutory standard or a preponderance of the evidence. The taxpayer has not met its burden of proof that the individual workers were independent contractors rather than employees. The taxpayer's protest to these assessments is denied.

**FINDING**

The taxpayer's protest is denied.

**2. Withholding Tax – Safe Haven**

**DISCUSSION**

The taxpayer contends that it qualifies for safe haven treatment for the individual workers who have been found to be employees and subject to the withholding tax. Safe haven treatment is offered pursuant to 26 U.S.C.A. 530. If a taxpayer qualifies for safe haven treatment, employees can be treated as independent contractors and withholding tax is not assessed against the employer. Safe haven treatment is available if employers meet three requirements. First the employer must have relied on the advice of a tax professional that the individual workers and subcontractors were independent contractors. In this case, the taxpayer submitted a statement from its former accountant that satisfied this requirement. Secondly, the taxpayer must have issued 1099 Miscellaneous Income Statements. The taxpayer did not sustain his burden of proving that it issued these statements at the proper time since they were not originally available for the auditor. Further, many of the statements the taxpayer produced were incomplete. The taxpayer did not meet this requirement. Finally the taxpayer must treat all individual workers and subcontractors in the same manner. The taxpayer did not sustain its burden of proof that it treated all in the same manner. The auditor found that three of the workers were actually independent contractors. The remainder, as discussed in the previous issue, were employees. Since the taxpayer did not meet all three of the requirements, it does not qualify for safe haven status.

**FINDING**

Taxpayer's protest is denied.

**3. Tax Administration – Penalty**

**DISCUSSION**

The taxpayer's final point of protest concerns 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.

The taxpayer did not maintain good records and did not exhibit diligence in the issuance of the 1099 Miscellaneous Income Statements. This constitutes negligence. Taxpayer's final point of protest is denied.

**FINDING**

Taxpayer's protest is denied.

**DEPARTMENT OF STATE REVENUE**

04990093.LOF

**LETTER OF FINDINGS NUMBER: 99-0093 RST**
**Sales and Use Tax**
**For Years 1995, 1996, and 1997**

**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 Corn Receiving and Storage Facilities**

**Authority:** Ind. Code § 6-2.5-3-2; Ind. Code § 6-2.5-5-30; Ind. Admin. Code tit. 45, r. 2.2-5-10

The taxpayer protests the imposition of use tax on its purchase of corn receiving and storage facilities.

**II. Use Tax – Imposition of Use Tax on Lake Water In-Take System**

**Authority:** Ind. Admin. Code tit. 45, r. 2.2-5-8; Ind. Admin. Code tit. 45, r. 2.2-5-10

The taxpayer protests the imposition of use tax on its purchase of pumping system equipment to bring lake water into its facility.

**III. Use Tax – Imposition of Use Tax on Palletizing Equipment**

**Authority:** Ind. Admin. Code tit. 45, r. 2.2-5-8; Ind. Admin. Code tit. 45, r. 2.2-5-10

The taxpayer protests the imposition of use tax on its purchase of palletizing equipment.

**IV. Use Tax – Imposition of Use Tax on Propylene Oxide Tanks**

**Authority:** Ind. Admin. Code tit. 45, r. 2.2-5-10

The taxpayer protests the imposition of use tax on its purchase of propylene oxide tanks.

**STATEMENT OF FACTS**

The taxpayer is a Maine corporation doing business in Indiana. The taxpayer processes corn and produces various products including cornstarch, corn syrup, corn oil, and high protein animal feed. The taxpayer receives the corn by truck and by railcar. The corn is dumped through a grating onto conveyors. The grating removes some of the large foreign matter from the corn. At the end of the conveyors, the corn kernels are sprayed with mineral oil. After the spraying operation, the corn is carried by bucket elevators into large silos. From the silos, the corn is conveyed to milling areas where it is ground, refined, cleansed, and the kernels are separated into their various components. The taxpayer's products are passed through various filters, screens, and magnets to remove contaminants. The completed goods are bagged or loaded directly into railcars or trucks for shipment. Packaged products are palletized prior to shipment.

On November 10, 1998, a sales and use tax audit was completed. The taxpayer was assessed use tax on several items it had purchased. The taxpayer filed a timely protest and an administrative hearing was held on July 27, 2000. Additional information will be provided as necessary.

**I. Imposition of Use Tax on Corn Receiving and Storage Facilities**

**DISCUSSION**

The taxpayer was assessed use tax on equipment such as storage silos and grain conveyors. The taxpayer's position is that it began to process the corn it received when it sprayed the corn with mineral oil. The taxpayer claims that the mineral oil acts to trap dust onto the corn kernels thus increasing both the weight and nutritional value of the corn. The taxpayer also claims the mineral oil acts to reduce foaming during the production process. The taxpayer concludes the production process begins when it applies the mineral oil and therefore, equipment used after that point is exempt as equipment directly used in processing or refining. The taxpayer receives an environmental exemption for purchases of mineral oil and spraying equipment used for dust suppression purposes, pursuant to Ind. Code § 6-2.5-5-30. The issue before the Department now, however, is to determine the beginning of taxpayer's production process in order to properly characterize, for exemption purposes, certain "production" equipment.

"An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." Ind. Code § 6-2.5-3-2(a).

> (c) Purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in processing or refining are exempt from tax; provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the tangible personal property being processed or refined. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which processes or refines tangible personal property.
>
> (d) Pre-processing and post-processing activities. 'Direct use' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the processing or refining has altered the item to its completed form, including packaging, if required.
>
> Ind. Admin. Code tit. 45, r. 2.2-5-10.

The auditor found that the production process began at the machine, known as the Texas Shaker, that acted to remove extraneous material from the corn, just before the corn was conveyed to steeping tanks where the kernels of corn are broken down. This point is after the mineral oil was sprayed on the corn.

The purpose of spraying the received corn with mineral oil is to suppress dust which can cause an explosion if ignited. The oil does not alter the corn nor does it become part of the final product. Therefore, the oil does not represent a raw material component of the taxpayer's products. Application of the oil is a pre-production activity for the purpose of suppressing dust. If, as the taxpayer

claims, the mineral oil enhances the nutritional content of the corn to some degree by making dust stick to the kernels, it is an incidental and minimal effect.

The production process begins, as the auditor indicated, at the Texas Shaker machine, after the corn is sprayed with mineral oil. Therefore, the storage silos, conveyors, and any other equipment utilized by the taxpayer prior to the start of the production process are taxable.

**FINDING**

The taxpayer's protest is denied.

**II. Imposition of Use Tax on Lake Water In-Take System**

**DISCUSSION**

The taxpayer pumps large quantities of water, approximately 22,000,000 gallons per day, from Lake Michigan to be used in its plant. The water is pumped through underground pipes a distance of one half mile from the lake to the plant. The water is chlorinated and passes through several screens to remove water life and debris. The water is then pumped into a large well where it is temporarily stored for use in the plant's operations. The primary function of the water is to be cycled through heat exchangers to cool the taxpayer's manufacturing machinery. Some of the treated water is sent to boilers to provide steam to other machinery. Finally, some of the water is directly used in the production process by being mixed with the product itself. Excess water, and water not actually consumed in the production process, is treated and cycled into a smaller lake.

The auditor assessed use tax on the pumping system equipment based on how the Lake Michigan water was used in the production process. The auditor determined that 12% of the water used actually came into contact with the taxpayer's product during the processing operations. This water was treated as a raw material for use tax purposes and the remaining 88% was treated as a consumable. Therefore, the auditor exempted 12% of purchases associated with the pumping system equipment per Ind. Admin. Code tit. 45, r. 2.2-5-10, and assessed use tax on the remaining 88% of the purchases. The taxpayer protests the assessment, claiming that all of the pumping system equipment should be exempt under Ind. Admin. Code tit. 45, r. 2.2-5-8.

> The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.
>
> Ind. Admin. Code tit. 45, r. 2.2-5-8(c).
>
> This Administrative Code section contains several examples of exempt equipment:
>
> (2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.
>
> (C) Boilers, including related equipment such as pumps, piping systems, etc., which draw water, or produce and transmit steam to operate exempt machinery and equipment used in direct production.
>
> ....
>
> (3) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment is built in a manner to service various pieces of exempt equipment, as an alternative to building the equipment into each of the pieces of exempt machinery, is not determinative.
>
> (A) Pumping and filtering equipment and related tanks and tubing used to supply lubricating and coolant fluids to exempt drilling and cutting machinery.
>
> (B) Cooling towers and related pumps and piping used to cool, circulate, and supply water employed to control the temperature of exempt furnaces and exempt machines used in the foundry and machining areas.
>
> Ind. Admin. Code tit. 45, r. 2.2-5-8(c)(2), (3)(A, B).

As shown in the above examples, the taxpayer's pumping system equipment qualifies as property that is an essential and integral part of an integrated process producing tangible personal property. To the extent that the pumping system equipment is used to supply water to exempt equipment, it is exempt. To the extent the pumping system equipment supplies water to non-exempt equipment, it is not exempt. Ind. Admin. Code tit. 45, r. 2.2-5-8(c)(3)(C). Use of the pumping system equipment to deliver water to heat exchangers to cool exempt equipment, to deliver water to boilers to produce steam for direct use in the production process, and to deliver water into the production process for inclusion in the product itself are exempt uses.

As determined in Part I of this Letter of Findings, the production process begins at the Texas Shaker machine. None of the machinery and equipment used prior to the start of the production process is exempt and any use of the pumping system equipment to deliver water to that machinery and equipment is taxable. Likewise, any use of the pumping system equipment to deliver water to other non-exempt machinery or equipment in the taxpayer's plant is taxable.

**FINDING**

The taxpayer's protest is sustained pursuant to the aforementioned language.

**III. Imposition of Use Tax on Palletizing Equipment**

**DISCUSSION**

The taxpayer protests the imposition of use tax on its purchases of palletizing equipment. The audit report found that the taxpayer's bags of corn products were palletized for shipping convenience. The auditor concluded that the palletizing operation was post-production and, therefore, taxable. In response, the taxpayer cites the example found in Ind. Admin. Code tit. 45, r. 2.2-5-10(c)(2)(D): "The exempt production process begins after the bottles are introduced onto the bottle conveyors for the filling step of production and ends with the final packaging of the product onto the case palletizers." The taxpayer maintains that palletizing of its bags of corn products is part of the integrated production process and, therefore, the palletizing equipment is exempt from use tax.

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

(d) 'Direct use in the production process' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Ind. Admin. Code tit. 45, r. 2.2-5-8.

Taxpayer has provided additional information to show that its palletizing operation is an adjunct to its manufacturing operations—and not to its shipping operations. As taxpayer explained, "…[the] palletizing operation is a continuous, uninterrupted, integrated production process that is only complete once the bagged items are wrapped and secured on a pallet. At that point the loaded pallets are taken from the production line to the shipping warehouse."

**FINDING**

The taxpayer's protest is sustained.

**IV. Imposition of Use Tax on Propylene Oxide Tanks**

**DISCUSSION**

The taxpayer protests the imposition of use tax on the purchase of propylene oxide storage tanks and associated connecting pipes. Propylene oxide is introduced into the production process and acts to enhance the characteristics of the corn starch produced by the taxpayer. The auditor found that the storage tanks were too far removed from the production process to qualify as exempt production equipment. The taxpayer focuses on a section of the Administrative Code to support its argument that the storage tanks and connecting pipes are exempt. "Component parts of an exempt unit of machinery and equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of the manufacturing unit." Ind. Admin. Code tit. 45, r. 2.2-5-10(g).

The propylene oxide tanks and pipes are not component parts of exempt machinery and equipment. The propylene oxide is a raw material used by the taxpayer to process corn starch. The purpose of the storage tanks is to contain the propylene oxide until it is needed for introduction into the production process. The relevant regulation is Ind. Admin. Code tit. 45, r. 2.2-5-10(e): "Tangible personal property used in or for the purpose of storing raw material... is subject to tax...." The raw material, propylene oxide, does not act upon the taxpayer's product until it is actually introduced into the production process. Storage tanks and connecting pipes for delivery of the raw material are pre-production equipment and subject to tax.

**FINDING**

The taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000131.LOF

**LETTER OF FINDINGS NUMBER: 00-0131**
**Use Tax**
**Calendar Year 1997**

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

**ISSUE**

**I. Use Tax – Agricultural Equipment Exemption**

**Authority:** 45 IAC 2.2-5-6; 45 IAC 2.2-3-4; IC 6-2.5-5-2

The taxpayer protests the assessment of use tax on its tractor.

The taxpayer protests the Department's assessment of use tax on a Ford 4000 Tractor with Loader.

The taxpayer contends that the tractor is used in farming and, therefore, qualifies for an exemption.

45 IAC 2.2-5-3 (b) states:

In general purchases of tangible personal property by farmers is taxable. The exemptions provided by this regulation [45 IAC

2.2] apply only to seeds, fertilizers, fungicides, insecticides, and other tangible personal property to be directly used by the farmer in the direct production of food and agricultural commodities. This exemption is limited to "farmers."

45 IAC 2.2-5-3(d)(8) states that transportation of animals, poultry, feed fertilizer, etc. to the farm for use on farming; is taxable.

45 IAC 2.2-5-4(c) does not allow exemption for graders, ditchers, front end loaders, or similar equipment (except equipment to haul animal waste).

45 IAC 2.2-5-4(e) further states:

The fact that an item is purchased for use on the farm does not necessarily make it exempt from sale [sic.] tax. The farmer in the direct production of agricultural products must directly use it. The property in question must have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process that produces agricultural products. The fact that a piece of equipment is convenient, necessary, or essential to farming is insufficient in itself to determine if it is used directly in direct production as required to be exempt.

45 IAC 2.2-5-3(d)(4) exempts implements used in the tilling of land and harvesting of crops therefrom, including tractors and attachments.

45 IAC 2.2-5-3(d)(9) exempts equipment designed to haul waste.

Taxpayer states the tractor is only used in farming, and, although he no longer owns cattle, he was hauling feed to them. The current tractor was a replacement for another tractor destroyed in a fire. Taxpayer states he utilizes a smaller utility tractor to pull grain wagons to the bin and for brush mowing.

Taxpayer refused to provide percentage of use of the tractor stating that the tractor was exempt, that all use is exempt, and that he will not pay percentage of use.

45 IAC 2.2-5-3(d)(7) states:

Tangible personal property purchased by a farmer for use in general farm maintenance of taxable items is taxable.

45 IAC 2.2-5-4(c) taxes all tools including forks, shovels, hoes, welders, power tools, and hand tools; graders, ditchers, front end loaders, or similar equipment (except equipment designed to haul animal waste).

The taxpayer's protest is denied. The taxpayer has refused to provide the department with information to allow the department to reduce or cancel the assessment.

**FINDINGS**

The taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0220000225.LOF

**LETTER OF FINDINGS: 00-0225**
**Indiana Corporation Income Tax**
**For the 1998 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. Penalties and Interest Incurred As a Result of Taxpayer's Erroneous Treatment of LIFO Recapture**

**Authority:** I.R.C. § 1363(d); IC 6-8.1-10-1; IC 6-8.1-10-1(a); IC 6-8.1-10-2.1(a)(2); IC 6-8.1-10-2.1(a)(3); IC 6-8.1-2.1(b)(2), (4); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c)

Taxpayer protests the imposition of penalties and interest incurred when taxpayer erroneously determined the manner in which a LIFO recapture would be treated for purposes of the state corporate income tax.

**STATEMENT OF FACTS**

The taxpayer is an automobile dealership which, in 1998, elected to be treated as an S corporation effective on January 1, 1999. As a result of that decision, the taxpayer incurred liability for the recapture of LIFO benefits as specified under I.R.C. § 1363(d). The taxpayer purportedly consulted with a Department member in order to determine the manner in which Indiana allows the LIFO recapture to be treated. The taxpayer alleges that it was advised that Indiana "piggy backs" with the federal provision, I.R.C. § 1363(d)(2), which allows for the LIFO recapture to be paid over four tax years. Accordingly, the taxpayer filed a 1998 state tax return in which it reflected the four-year payment scheme specified under the Internal Revenue Code. Subsequently, taxpayer received a Proposed Assessment which, in effect, disallowed the four-year spread and demanded immediate payment. The Department took the position that the federal provision was a tax payment plan unavailable for purposes of the Indiana tax but that all income tax due from the LIFO recapture was due and should have been reported at the time of the taxpayer's final C corporation state return. The taxpayer has withdrawn that portion of its original protest challenging the assessment of taxes.

**DISCUSSION**

**I. Penalties and Interest Incurred As a Result of Taxpayer's Erroneous Treatment of LIFO Recapture**

Taxpayer protests the imposition of penalties and interest – incurred when the taxpayer erroneously reported its LIFO recapture – on the ground that its treatment of the LIFO recapture was predicated upon advice received from the Department. Taxpayer requests the abatement of both penalties and interest the treatment of which will be addressed separately.

**A. Abatement of the Ten-Percent Negligence Penalty**

Under IC 6-8.1-10-2.1(a)(2), a taxpayer is subject to a penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return of payment." IC 6-8-10-2.1(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 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 the "'[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 reasonable 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.

The "particular facts and circumstances" presented by the taxpayer lead to a conclusion that taxpayer's treatment of the LIFO recapture, as represented on the taxpayer's 1998 Indiana return, was due to "reasonable cause and not due to negligence." Taxpayer's treatment of the LIFO recapture – misguided as it was – was based upon apparently erroneous advice received from a member of the Department. Taxpayer has supplied evidence of its request for information from the Department and the advice received as a result of that request. Therefore, because the taxpayer made a decision based upon a reasonable extrapolation of the relevant Internal Revenue Code – a decision reinforced by advice received upon consulting with the Department – taxpayer has demonstrated reasonable care, caution, and diligence sufficient to justify abating the ten-percent negligence penalty assessed under authority of IC 6-8.1-10-2.1(a)(2).

**B. Abatement of Accrued Interest**

Taxpayer protests the imposition of interest on assessed taxes and requests that the interest which has accumulated on those assessed taxes be abated. Under IC 6-8.1-10-1(a), if a person incurs a deficiency upon a determination by the Department, "the person subject to interest on the amount of underpayment."

Despite the reasonable care and caution demonstrated by the taxpayer, the Department has no discretion regarding the imposition of interest. Under IC 6-8.1-10-1, interest is not abated for any reason.

**FINDING**

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

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**DEPARTMENT OF STATE REVENUE**

0220000306.LOF

**LETTER OF FINDINGS NUMBER: 00-0306**
**Corporate Income Tax**
**For Tax Periods: 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**

**1. Adjusted Gross Income Tax – Addback of Property Taxes**

**Authority:** IC 6-3-1-3.5(b)

Taxpayer protests the add-back of property taxes.

**STATEMENT OF FACTS**

Taxpayer is a manufacturer of automobiles. After an audit for the tax period 1998, Taxpayer was assessed additional adjusted gross income and supplemental net income taxes. Taxpayer timely protested the assessments and a hearing was held. Further facts will be presented as necessary.

**I. Adjusted Gross Income Tax – Addback of Property Taxes**

**DISCUSSION**

Taxpayer's protest concerns the add back of property taxes. Taxpayer calculated its Indiana tax return based upon its calculation of its adjusted gross income pursuant to IC 6-3-1-3.5 (b) as follows:

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

(1) Subtract income that is exempt from taxation under IC 6-3 by the Constitution and statutes of the United States.

(2) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 170 of the Internal Revenue Code.

(3) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.

(4) Subtract an amount equal to the amount included in the corporation's taxable income under Section 78 of the Internal Revenue Code.

In calculating its adjusted gross income, Taxpayer did not add back the amount of property taxes which were classified for federal purposes as costs of goods sold. Taxpayer argues that the property taxes which are a component of costs of goods sold and should not be added back since they are not deductions allowed pursuant to Section 63 of the Internal Revenue Code as follows.

(a) In General. – Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus the deductions allowed by this chapter (other than the standard deduction).

The capitalized property taxes, as part of the cost of goods sold, are deducted from Taxpayer's total receipts in determining Taxpayer's gross income. Therefore they are included in the gross income. When deductions are taken from the gross income to determine the "taxable income" as defined by this statute, the inclusion of the deductions in the gross income effectively includes those deductions in the term "taxable income" as defined by this statute.

Taxpayer contends that it does not have to add back property taxes because they are defined as nondeductible from "taxable income" as defined by the statute pursuant to the following provisions of Section 263 A as follows:

(a) Nondeductibility of Certain Direct and Indirect Costs.

(1) In general. –In the case of any property to which this section applies, any costs described in paragraph (2)—

(A) in the case of property which is inventory in the hands of the taxpayer, shall be included in inventory costs, and

(B) in the case of any other property, shall be capitalized.

(2) Allocable costs. – The costs described in this paragraph with respect to any property are-

(A) the direct costs of such property, and

(B) such property's proper share of those indirect costs (including taxes) part or all of which are allocable to such property.

Any cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.

Taxpayer is correct in that this provision does not allow a deduction of the property taxes after the determination of "taxable income" as defined by this statute. That does not negate the fact, however, that the property taxes were deducted in the determination of the gross income portion of the formula for determination of the "taxable income" as defined by the statute. Therefore the property taxes were effectively deducted and must be added back.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

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**CONSOLIDATED LETTER OF FINDINGS**
**00-0375, 00-0376, 00-0377**
**State Withholding, Sales, and Riverboat Admissions Tax**
**For 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. Riverboat Building Credit – Claim for Credit**

**Authority:** IC § 6-3.1-17-5; IC § 6-3.1-17-7; IC § 6-3.1-17-8; IC § 6-8.1-10-1

Taxpayer is protesting the billing of interest accrued after a two year delay in the application of a credit.

**STATEMENT OF FACTS**

Taxpayer built a casino/riverboat eligible for tax credits and submitted a request for application of said credits to taxpayer's tax liability. After a two year delay, taxpayer submitted sufficient information for the Department to apply the credit. Department applied the credit to taxpayer's liability at the time of the receipt of adequate information from taxpayer, which was after two years

of interest had accumulated on the liability. Taxpayer is protesting this calculation of liability.

**I. Riverboat Building Credit – Claim for Credit**

**DISCUSSION**

IC § 6-3.1-17-5 establishes the credit in question; stating in relevant part:

A taxpayer is entitled to a credit against the taxpayer's state tax liability for a taxable year if the taxpayer makes a qualified investment in that taxable year.

The qualified investment that would be eligible for the credit is defined in IC § 6-3.1-17-7 as:

(a) To be entitled to a credit under this chapter, a taxpayer must request the department of commerce to determine whether costs incurred to build or refurbish a riverboat are qualified investments.

(b) The request under subsection (a) must be made before the costs are incurred.

(c) The department of commerce shall find that costs are a qualified investment to the extent that the costs result:

(1) from the work performed in Indiana to build or refurbish a riverboat; and

(2) in taxable income to any other Indiana taxpayer;

As determined under the standards adopted by the department of commerce.

Taxpayer did fulfill the requirements of IC § 6-3.1-17-7. IC § 6-3.1-17-8 then establishes the requirements to claim the aforementioned credit:

To receive the credit provided by this chapter, a taxpayer must claim the credit on the taxpayer's state tax return or returns in the manner prescribed by the department. The taxpayer shall submit to the department the certification of credit by the department of commerce, proof of payment of the certified qualified investment, and all information that the department determines is necessary for the calculation of the credit provided by this chapter and for the determination of whether an investment cost is a qualified investment cost.

Finally, IC § 6-8.1-10-1 requires:

(a) If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on his return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

…

(e) Except as provided by IC § 6-8.1-5-2(e)(2) the department may not waive the interest imposed under this section.

To receive the credit provided by this chapter the taxpayer was required to complete four steps. First, the taxpayer needed to build and pay for a riverboat/casino. Second, the taxpayer needed to receive certification of taxpayer expense from the Department of Commerce. Third, taxpayer had to provide proof of the expenses and credit due amounts to the Department of Revenue; and finally, taxpayer was to reflect the credit on the taxpayer's state tax return or returns in the manner prescribed by the Department. The taxpayer did not submit adequate documentation to prove expenses and credit due amounts to the Department until two years after the accrual of the tax liability for the year in question. While taxpayer argues that the various tax forms filed by taxpayer did not have a convenient arrangement for reflecting the credit, taxpayer does not address taxpayer's two year delay in providing the necessary documentation to the Department.

When taxpayer submitted the information required by statute to the Department, the taxpayer "receive[d] the credit provided by this chapter" IC § 6-3.1-17-8. This credit was applied to a existing tax liability. Taxpayer was not eligible for the waiver provided in IC § 6-8.1-10-1(e) and thus at the time the return and payment were due, taxpayer had failed "…to pay the full amount of tax shown on his return by the due date for the return or the payment…." Consequently, the taxpayer was "… subject to interest on the nonpayment" IC § 6-8.1-10-1.

The time value of money is a well understood concept. The bond market, certificates of deposit, and loans all operate on the varying value of a sum certain over time. A sum certain based on that year's tax liability was incurred by taxpayer. The value in question -as would be expected in a financial transaction requiring an extended time- was modified by the accumulation of interest on the principle due. Taxpayer's delay in receiving the credit was a direct consequence of taxpayer's delay in providing supporting documentation to the Department as required by IC § 6-3.1-17-8. The accrual of interest on the liability over the two year delay was required by IC § 6-8.1-10-1. Taxpayer presents no statutory basis for the waiver of this interest.

**FINDING**

Taxpayer protest denied.

**DEPARTMENT OF STATE REVENUE**

0420000383P.LOF

**LETTER OF FINDINGS NUMBER: 00-0383P**
**Sales and Use Tax**
**Calendar Years 1997, 1998, 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 an Indiana corporation headquartered out of state. Taxpayer has an Indiana location that manufactures and markets its products.

Upon audit, it was discovered that the taxpayer failed to remit use tax on clearly taxable items such as office supplies, building maintenance items, capital assets, and other miscellaneous items. Taxpayer filed yearly ST 103's with "zero" tax due. Taxpayer was assessed a negligence penalty because if failed to have a use tax accrual system in place.

**I. Tax Administration – Penalty**

**DISCUSSION**

At issue is whether the taxpayer was negligent in failing to remit use tax due.

Taxpayer failed to remit use tax on clearly taxable items and had no use tax accrual system in place.

Taxpayer states that it was the first time the company had been audited by Indiana and it had a turnover of corporate staff since 1995. In addition, the headquarters are out of state. Additional arguments include that the bulk of the use tax is on trays that are exempt in Ohio. It has also started to correct its records for the year 2000. Due to the lack of awareness of Indiana use tax rules, not intentional disregard of such rules, it requests an abatement of penalties.

Taxpayer has not provided reasonable cause for failing to comply with Indiana Sales and Use Tax statutes. Failure to make itself aware of Indiana tax laws when doing business in the state is considered negligence.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0120000384.LOF

**LETTER OF FINDINGS NUMBER: 00-0384 AGI**
**Adjusted Gross Income Tax**
**For Tax Periods: 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**

**Adjusted Gross Income Tax – Imposition**

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

Taxpayer protests the imposition of the adjusted gross income tax.

**STATEMENT OF FACTS**

The Indiana Department of Revenue issued the taxpayers a refund of taxes for 1998. The Indiana Department of Revenue determined that the refund was issued in error. The Indiana Department of Revenue then issued an assessment for adjusted gross income tax, interest and penalty for 1998. Further facts will be provided as necessary.

**Adjusted Gross Income Tax – Imposition**

**DISCUSSION**

An adjusted gross income tax is imposed upon all Indiana residents. IC 6-3-2-1. The taxpayers are a married couple who argue that they have no Indiana Adjusted Gross Income for 1998 and therefore do not owe any tax. The taxpayers note that the Indiana Code borrows some of its definitions from the Internal Revenue Code. For instance, "gross income" is defined at IC 6-3-1-8 as having the meaning as defined by section 61(a) of the Internal Revenue Code." Section 61 (a) which states in part:

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items...

The taxpayers contend that since the word "wages" is not listed in Section 61, wages are not taxable income. Therefore they filed a entering "zero" on the line titled "Wages, Tips, other Compensation." They then entered a federal adjusted gross income of "zero" on their Indiana return. Following this erroneous logic, Taxpayer protested the assessment of additional tax, penalty and interest for 1998.

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

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

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

**FINDING**

The taxpayers' protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0220000417P.LOF

**LETTER OF FINDINGS NUMBER: 00-0417P**
**Adjusted Gross Income Tax**
**Calendar Years 1996, 1997, and 1998**

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

**ISSUE(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 an Indiana corporation headquartered out of state. Taxpayer has an Indiana location that manufactures and markets its products. Upon audit it was discovered that the taxpayer failed to include its entire Indiana payroll in the apportionment factor.

**I. Tax Administration – Penalty**

**DISCUSSION**

Taxpayer was assessed a negligence penalty for failure to include all of its Indiana wages in the payroll apportionment factor.

Taxpayer, at hearing, states there is only one issue and it paid tax to Michigan and Ohio originally. Taxpayer further states that it has never avoided paying its taxes and the taxes resulted from a misinterpretation of how to treat wages in the State Apportionment process. After the audit, it filed amended returns with the two states.

Taxpayer, however, is incorporated and located in Indiana. Corporate offices should have made itself aware of the tax laws in the State of Indiana.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000422P.LOF

**LETTER OF FINDINGS NUMBER: 00-0422P**
**Sales Tax**
**Calendar Year 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 protests the penalty assessed due to an unintentional computer error.

Taxpayer operates a buy here, pay here used car lot. No repair or service is done and all vehicles are purchased at auction. Taxpayer qualifies and files as an Indiana Special Corporation.

At audit, it was determined that the taxpayer failed to report its entire gross income subject to sales tax.

**I. Tax Administration – Penalty**

**DISCUSSION**

Taxpayer failed to report all of its income subject to sales tax.

Taxpayer requests a waiver of penalties because there was an unintentional computer error that was not discovered until the audit.

Taxpayer's audit revealed that the taxpayer failed to report sales subject to sales tax on twenty percent (20%) of its sales in 1998. Sales tax is a trust tax that is due upon collection.

The taxpayer was negligent in failing to remit the sales tax collected and has not provided reasonable cause for failure to do so.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000428P.LOF

**LETTER OF FINDINGS NUMBER: 00-0428P**
**Sales Tax – Penalty**
**For the Month Ended July 31, 2000**

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

**ISSUE(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 two days late.

Taxpayer protests the penalty and requests a waiver.

**I. Tax Administration – Penalty**

**DISCUSSION**

Taxpayer states it had difficulties with its phone line during the second half of the day on Friday, August 18. When the Electronic Fund Transfer of the tax due the State of Indiana was completed on the following Monday, August 21, the funds could only have been taken out of its account on the following day, Tuesday, August 22. Taxpayer states that these circumstances were beyond its control and the assessment did not result from negligence or willful neglect. Taxpayer requests a waiver of the penalty.

A review of taxpayer's payment history indicates it had a late payment for the period ended May 2000. The Department waived the penalty based upon reasonable cause. Taxpayer was made aware that only the first penalty would be waived and it should assure that no further late payments are made. Consistent with statute, late payments are subject to a penalty. It is a Taxpayer's responsibility to assure all payments are timely.

The department finds that a negligence penalty is proper.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0320000463P.LOF

**LETTER OF FINDINGS NUMBER: 00-0463P**
**Withholding 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; 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

**STATEMENT OF FACTS**

Taxpayer is an importer and manufacturer of automobile body parts for an equipment manufacturer and is owned by out-of-country companies. All production is dedicated to one customer.

The audit examination of the taxpayer's books and records revealed that it made payments to nonresident contractors that performed work in Indiana and were not registered with the Secretary of State as required under 45 IAC 1-1-214.

The audit adjusted withholding tax for payments made to nonresident contractors that were not registered with the Department of Revenue for work performed in Indiana.

**ISSUE**

**I. Tax Administration – Penalty**

Taxpayer protests the imposition of penalty.

**DISCUSSION**

Taxpayer states it was unaware of the requirement to withhold tax for payments made to out of state contractors and did not attempt to avoid paying the proper amount of tax due. Taxpayer requests a penalty waiver.

45 IAC 1-1-213 clearly states that Indiana gross income tax is required to be withheld from any and all payments made to a nonresident contractor for performance of any work or services which are taxable to the State of Indiana. 45 IAC 1-1-216 defines withholding agent as any person, firm, organization or governmental entity of any kind making payments to nonresident contractors and prime contractors making payments to sub-contractors are considered to be withholding agents.

Taxpayer did not comply with the regulations nor did it provide reasonable cause to allow the Department to waive the penalties assessed.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0220000469P.LOF

**LETTER OF FINDINGS NUMBER: 00-0469P**
**Income Tax**
**Calendar Years 1995**

**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 assessment of penalty.

**STATEMENT OF FACTS**

The taxpayer is a provider of diagnostic testing, information and services for laboratories and patient service centers. The taxpayer was assessed penalty as the result of a 1995 underpayment of gross income tax.

**I. Tax Administration – Penalty**

The taxpayer has protested the assessment of penalty. In 1995 the taxpayer acquired a new location in Indiana. The taxpayer states the new location was erroneously coded as being located in Illinois, and that in the preparation of the 1995 tax return, the receipts were reported for Illinois rather than Indiana. Taxpayer further states that for 1996, they became aware of the problem and corrected it accordingly.

While taxpayer admits to becoming aware of the problem in 1996, taxpayer made no attempt to correct the 1995 return which was filed in error. It was not until the completion of the audit in September 2000, that the additional tax due was assessed and subsequently paid by the taxpayer.

The Department finds that the taxpayer failed to properly report Indiana gross income tax for 1995. Further, while the taxpayer

became aware the location was miscoded in 1996, the taxpayer did not amend the 1995 return which was filed incorrectly. The taxpayer has failed to show reasonable cause, and the request for penalty waiver therefore, must be denied.

**FINDING**

The taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0120000471.LOF

**LETTER OF FINDINGS NUMBER: 00-0471 AGI**
**Adjusted Gross Income Tax**
**For Tax Periods: 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**

**Adjusted Gross Income Tax – Imposition**

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

Taxpayer protests the imposition of the adjusted gross income tax.

**STATEMENT OF FACTS**

The Indiana Department of Revenue issued the taxpayer a refund of taxes for 1998. The Indiana Department of Revenue determined that the refund was issued in error. The Indiana Department of Revenue then issued an assessment for adjusted gross income tax, interest and penalty for 1998. Further facts will be provided as necessary.

**Adjusted Gross Income Tax – Imposition**

**DISCUSSION**

An adjusted gross income tax is imposed upon all Indiana residents. IC 6-3-2-1. The taxpayer argues that he has no Indiana Adjusted Gross Income for 1998 and therefore does not owe any tax. The taxpayer notes that the Indiana Code borrows some of its definitions from the Internal Revenue Code. For instance, "gross income" is defined at IC 6-3-1-8 as having the meaning as defined by section 61(a) of the Internal Revenue Code." Section 61 (a) which states in part:

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

The taxpayer contends that since the word "wages" is not listed in Section 61, wages are not taxable income. Therefore he filed a return entering "zero" on the line titled "Wages, Tips, other Compensation." He then entered a federal adjusted gross income of "zero" on his Indiana return. Following this erroneous logic, the taxpayer protested the assessment of additional tax, penalty and interest for 1998.

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

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

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

**FINDING**

The taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000472.LOF

**LETTER OF FINDINGS NUMBER: 00-0472**
**Sales and Use Tax**
**For Tax Periods: 2000**

**NOTICE:** Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of

publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUES**

**1. Sales and Use Tax – Medical Equipment and Devices**

**Authority:** IC 6-2.5-2-1, IC 6-2.5-5-18(a), IC 6-8.1-5-1, 45 IAC 2.2-5-28(h), Indiana Bell Telephone Co. v. Indiana Department of Revenue, 627 N.E. 2d 1386, Ind. Tax Court, (1994)

The taxpayer protests the imposition of tax on a van and adaptive equipment.

**2. Tax Administration – Penalty**

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

The taxpayer protests the imposition of the penalty.

**STATEMENT OF FACTS**

The Indiana Department of Revenue assessed gross retail tax, interest and penalty on a van. The taxpayer protested the assessment in a timely fashion. Further facts will be presented as necessary.

**1. Sales and Use Tax – Medical Equipment and Devices**

**DISCUSSION**

The taxpayer lost the lower part of both of his legs in a 1986 industrial accident. On October 2, 2000, the taxpayer purchased a van for his personal transportation. The taxpayer also purchased adaptive equipment such as a wheel chair lift and hand controls so that he could operate the van. The taxpayer had the automotive dealer fill out an exemption statement indicating that the van was exempt from sales tax because the van and the adaptive equipment had been prescribed for the taxpayer by a medical practitioner. The taxpayer presented this statement to the Bureau of Motor Vehicles which titled the van without collecting sales tax.

Retail transactions made in Indiana are subject to sales tax. IC 6-2.5-2-1. There are several statutory exemptions from the tax including one for medical equipment and devices. IC 6-2.5-5-18 (a). It is established law that all tax exemptions must be strictly construed against taxpayers. Indiana Bell Telephone Co. v. Indiana Department of Revenue, 627 N.E. 2d 1386, Ind. Tax Court (1994). The presumption is that all Indiana Department of Revenue tax assessments are accurate and taxpayers bear the burden of proving that an assessment is incorrect. IC 6-8.1-5-1.

The taxpayer contends that the van and adaptive equipment qualify for exemption pursuant to the following provisions of IC 6-2.5-5-18 (a):

> Sales of artificial limbs, orthopedic devices, dental prosthetic devices, eyeglasses, contact lenses, and other medical equipment, supplies and devices are exempt from the state gross retail tax, if the sales are prescribed by a person licensed to issue the prescription.

To qualify for this exemption from the state gross retail tax, the van and adaptive equipment must meet two tests. The van and adaptive equipment must have been prescribed by a medical practitioner licensed to issue prescriptions. In this instance, the taxpayer produced a copy of a prescription for the van and adaptive equipment and a statement from a doctor of osteopathy. This test is, therefore, met.

It must also be determined if the van and adaptive equipment are the types of items referred to in the exemption. The statute provides exemption for "medical equipment, supplies and devices." That term is defined at 45 IAC 2.2-5-28 (h) as "those items, the use of which is directly required to correct or alleviate injury to malfunction of, or removal of a portion of the purchaser's body." The issue to be determined is whether the van and the adaptive equipment meet that definition.

The taxpayer contends that the van and adaptive equipment meet the regulatory definition because they allow him to access life's necessities such as the grocery store and medical professionals. The Indiana Department of Revenue agrees that the van and adaptive equipment allow the taxpayer to access life's necessities. That is not, however, the standard as stated in the regulation. The regulatory definition requires that the van and the equipment are "directly required to alleviate injury to malfunction of, or removal of a portion of the purchaser's body." The van provides the taxpayer with the opportunity to travel on the roads just like a van does for any other person in Indiana. The van does not meet the tests of the regulatory definition and does not qualify for exemption. The adaptive equipment such as the chair lift and hand controls are the

equipment which allow the taxpayer to drive the van despite the loss of his legs. The adaptive equipment meets the two tests of the regulatory definition and qualifies for exemption.

The taxpayer did not offer any evidence that the sales tax charged by the Indiana Department of Revenue was based on the sale of exempt adaptive equipment. The sales tax was computed based upon the sales price of the van from the automobile dealer. Therefore the taxpayer owes the entire assessment of sales tax.

The taxpayer also contends that other vans have been afforded tax exempt status and therefore this van should also be afforded tax exempt status. The only van and adaptive equipment under consideration in this proceeding is the van the taxpayer purchased on October 2, 2000. For the reasons enumerated above, this van is subject to the sales tax and the adaptive equipment is exempt from the sales tax.

**FINDING**

The taxpayer's protest is denied.

**2. Tax Administration – Penalty**

**DISCUSSION**

The taxpayer's final point of protest concerns 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.

The taxpayer has purchased vans and adaptive equipment in the past. On one occasion, the taxpayer paid the tax, filed a claim for refund and appealed the denial of the claim for refund in the Indiana Tax Court. The Court found in an unpublished decision that the taxpayer owed gross retail tax on the van and that the adaptive equipment qualified for exemption from the gross retail tax. The taxpayer's failure to pay the sales tax on the purchase of a van after the court decision constitutes negligence because the ordinary reasonable taxpayer would realize that the court decision was dispositive of the issue.

**FINDING**

The taxpayer's protest of the negligence penalty is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000475P.LOF

**LETTER OF FINDINGS NUMBER: 00-0475P**
**Sales Tax –- Penalty For the Month Ended August 31, 2000**

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

**ISSUE(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 two days late.

Taxpayer protests the penalty and requests a waiver.

**I. Tax Administration – Penalty**

**DISCUSSION**

Taxpayer states it had been experiencing difficulties with its phone lines which prevents it from receiving phone calls as well as completely entering the necessary information via keypad. Taxpayer states that these circumstances were beyond its control and the assessment did not result from negligence or willful neglect. Taxpayer requests a waiver of the penalty.

A review of taxpayer's payment history indicates it had a late payment for the period ended May 2000. The Department waived the penalty based upon reasonable cause. Taxpayer had another late payment for July 2000 and currently the August late payment. All reasons for its failure to remit payment timely are relatively the same. Taxpayer was made aware that only the first penalty would be waived and it should assure that no further late payments are made. Consistent with statute, late payments are subject to a penalty. It is a Taxpayer's responsibility to assure all payments are timely.

The department finds that a negligence penalty is proper.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000478P.LOF

**LETTER OF FINDINGS NUMBER: 00-0478P**
**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's audit covers location no. 2 that consists of sales and repair services. At audit, it was determined that the taxpayer failed to pay tax on office supplies, promotional products, fixed assets, and other miscellaneous items.

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 purchases such as office supplies, promotional products, fixed assets, and other miscellaneous taxable items.

Taxpayer states that it files its tax returns and payments in a timely manner. Taxpayer asks that the department look back at its history that shows that it made a good faith effort to report is taxes properly and accurately. Taxpayer requests a penalty waiver due to its monthly effort to report accurate information.

A review of the audit indicates that the purchases for which no use tax was accrued or paid amounted to twenty-two percent (22%), nineteen percent (19%), and thirty-eight percent (38%) of the use tax due (net of refunds) for calendar years 1997, 1998, and 1999 respectively. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000479P.LOF

**LETTER OF FINDINGS NUMBER: 00-0479P**
**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's audit covers location no. 4 that consists of sales, installation and repair services. At audit, it was determined that the taxpayer failed to pay tax on fuel oil, promotional products, fixed assets, and other miscellaneous items.

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 purchases such as fuel oil, promotional products, telephone equipment, generator, and other miscellaneous taxable items.

Taxpayer states that it files its tax returns and payments in a timely manner. Taxpayer asks that the department look back at its history that shows that it made a good faith effort to report is taxes properly and accurately. Taxpayer requests a penalty waiver due to its monthly effort to report accurate information.

A review of the audit indicates that the purchases for which no use tax was accrued or paid amounted to twenty-one percent (21%), twenty-four percent (24%), and twenty-five percent (25%) of the use tax due (net of refunds) for calendar years 1997, 1998, and 1999 respectively. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000480P.LOF

**LETTER OF FINDINGS NUMBER: 00-0480P**
**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's audit covers locations 1, 5, 6, and 9, which consists of sales, manufacturing, administrative services, and training. At audit, it was determined that the taxpayer failed to pay tax on magazine subscriptions, rental of tangible personal property, office supplies, promotional products, fixed assets, and other miscellaneous items.

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 purchases such as magazine subscriptions, uniform rentals, office supplies, promotional products, computers, and other miscellaneous taxable items.

Taxpayer states that it files its tax returns and payments in a timely manner. Taxpayer asks that the department look back at its history that shows that it made a good faith effort to report is taxes properly and accurately. Taxpayer requests a penalty waiver due to its monthly effort to report accurate information.

A review of the audit indicates that the purchases for which no use tax was accrued or paid amounted to thirty-one percent (31%), forty percent (40%), and thirty-two percent (32%) of the use tax due for calendar years 1997, 1998, and 1999 respectively. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420000483P.LOF

**LETTER OF FINDINGS NUMBER: 00-0483P**
**Sales Tax**
**Calendar Years 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 retail merchant registered with the Indiana Department of Revenue and a seasonal filer for Indiana Sales and Use Taxes. Taxpayer operates only in August and is a retail vendor selling tangible personal property at an annual Arts and Crafts festival. At audit, it was determined that the taxpayer failed to pay tax on taxable sales.

Taxpayer failed to file ST103 returns for 1999. The tax assessment was paid prior to the completion of the audit.

**I. Tax Administration – Penalty**

**DISCUSSION**

Taxpayer's audit report revealed that it failed to remit sales tax on taxable sales. The investigation revealed that the merchant's sales as reported to the promoter did not coincide with the amount reported for sales tax purposes. For 1999, the taxpayer failed to file ST103 returns.

Taxpayer states it paid the amount requested in July prior to the audit being completed. In a letter dated July 11, 2000, the department's auditor advised the taxpayer that additional Sales Tax in the amount of $250.15 and $251.10 was due for calendar years 1998 and 1999 respectively. The letter also states that penalties and interest would be added if no response was forthcoming within ten days of the letter. The taxpayer did not respond in letter form but sent checks, one dated July 31, 2000 in the amount of $250.15 and another in the amount of $251.10 dated August 7, 2000. A penalty waiver is requested.

Taxpayer made no attempt to file ST103 returns in 1999 and failed to remit all of its sales tax in 1998 although it is registered with the State. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

0420010029P.LOF

**LETTER OF FINDINGS NUMBER: 01-0029P**
**Use 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 protests the penalty assessed on an audit completed on September 27, 2000.

Taxpayer is incorporated in Indiana and prior to July 2000 operated an agency in Indiana. Corporate Offices were also located in Indiana during the audit period. Taxpayer was assessed a negligence penalty because if failed to have a use tax accrual system in place.

**I. Tax Administration – Penalty**

**DISCUSSION**

At issue is whether the taxpayer was negligent in failing to remit use tax due.

Taxpayer failed to remit use tax on clearly taxable items and had no use tax accrual system in place.

Taxpayer states that most of the errors can be assigned to vendor errors that unfortunately were not caught and these errors were probably less than.1%. Taxpayer requests an abatement of penalties.

Taxpayer has not provided reasonable cause for failing to comply with Indiana Sales and Use Tax statutes. Failure to make itself

aware of Indiana tax laws when doing business in the state is considered negligence.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

28970604.SLOF

**SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0604 CSET**
**Controlled Substance Excise Tax**
**For Tax Periods: 1997**

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

**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 October 23, 1997 in a base tax amount of $5,768.70. Taxpayer filed a protest to the assessment. Taxpayer did not appear for the hearing. A Letter of Findings denying Taxpayer's protest was issued on January 28, 2000. Taxpayer requested and was granted a rehearing. The rehearing was held by telephone with Taxpayer's representative. Taxpayer requested and was granted additional time to submit exculpatory evidence. Taxpayer never furnished any additional evidence. Further facts will be provided as necessary.

**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).

Officers in an Indiana State Police helicopter sighted marijuana growing near a barn on a routine flyover. Ground units investigated and Taxpayer, as owner, gave them permission to search the house, outbuildings and the farm. The officers found five marijuana plants growing about 20 feet from the east side of the barn with a clear path to the mown lawn. Officers also found potting soil and a watering can in the barn. In the house officers found marijuana residue, marijuana seeds and marijuana smoking implements.

Taxpayer argued that others have access to her property for hunting and fishing. She also contended that the marijuana residue, seeds and smoking implements belonged to her deceased husband.

In this case, Taxpayer owned and controlled the property. She did not sustain her burden of proving that the assessment was incorrect.

**FINDING**

Taxpayer's protest is denied.

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**DEPARTMENT OF STATE REVENUE**

04980195.SLOF

**SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 98-0195**
**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.

**ISSUE**

**I. Gross Retail Tax on Materials Incorporated Into Realty – Agreements to Improve Taxpayer's Realty Characterized as Lump Sum Contracts**

**Authority:** IC 6-2.5-8-9; IC 6-8.1-5-1(b); Wabash Grain, Inc. v. Smith, 700 N.E.2d 234 (Ind. Ct. App. 1998); Farrington v. Allsop,

670 N.E.2d 106 (Ind. Ct. App. 1996); 45 IAC 2.2-4-22(e); 45 IAC 2.2-4-26(a); 45 IAC 2.2-8-16(c)

Taxpayer has requested a rehearing for the limited purpose of determining whether 12 agreements, entered into between the taxpayer and various contractors, constituted lump sum contracts for the improvement to realty.

**STATEMENT OF FACTS**

Taxpayer is a steel producer operating steel plants throughout the world including a facility located in Indiana. At various times, the taxpayer and certain contractors entered into agreements for the improvement of the property and buildings at the Indiana facility. These agreements were one of the topics addressed in a Letter of Findings previously issued by the Department. However, at that time the issue of whether the agreements were lump sum contracts was intertwined with the issue of the appropriateness of the taxpayer's use of its Direct Pay Permit in arriving at those agreements.

**DISCUSSION**

**I. Gross Retail Tax on Materials Incorporated Into Realty**

Taxpayer has requested a rehearing for the purpose of determining whether certain agreements, entered into between itself and its contractors, constituted lump sum contracts for the improvement to realty. The significance of this distinction lies in the fact that the taxpayer is not subject to use tax liability for those transactions, entered into for the purpose of improving the taxpayer's realty, in which the agreement was couched in terms of a lump sum contract. Under 45 IAC 2.2-4-22(e), "With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner: (1) He converts the construction material into realty on land he owns and then sells the improved real estate; (2) He utilizes the construction material for his own benefit; or (3) Lump sum contract. *He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price."* (Emphasis added). Accordingly, the contractor will either pay the gross retail tax "up-front" when he initially purchases the construction materials or he will pay the gross retail tax in the form of use taxes when the materials are incorporated into the construction project. Either up-front or at the point where the materials are incorporated into the taxpayer's realty, in lump sum contracts between the taxpayer and its contractors, it is the contractors who are ultimately responsible for paying the tax on the construction materials. 45 IAC 2.2-4-26(a) provides that "[a] person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of the all material so used."

The taxpayer has described its contracting process as typically encompassing a series of specific steps. The first step involves taxpayer's in-house development of project specifications. The second step involves the issuance of a "purchase order" which constitutes the initial and primary agreement between the taxpayer and contractor. This purchase order, quite abbreviated in form, incorporates by reference the taxpayer's standard contract terms. (*See* Exhibit B, C, Taxpayer Fax, Dec. 4, 2000; Taxpayer Fax, Standard Specifications Part 2.0, Dec. 8, 2000). The purchase order includes a single price specification that is intended as the unit price for the project and is intended to represent both the contractor's labor and material costs. (Exhibit C, Taxpayer Letter, Dec. 4, 2000). Also incorporated, by indirect reference, into certain of the purchase orders, is a provision whereby the contractor is entitled to progress payments. A provision to that effect is found at Exhibit C3, page 2, wherein it states that the contract payments may be made in the form of progress payments. These progress payments, issued during the period during which the project is underway, are initiated by the contractor in the form of a "progress payment request." That request states the cost of materials incorporated and the cost of labor expended within a particular construction project up to a certain point in that construction project. These "progress payment requests" generate paperwork which includes specific references to both the labor and material costs. Purportedly, this paperwork is ancillary to the parties' initial agreement (purchase order) and does not transform what was intended by the parties as a lump sum contract into a time and materials contract. Rather the detailed information included in the progress payment request is intended to justify the contractor's request for the payment.

Taxpayer has requested a determination that 12 specific contracts are lump sum contracts. This request necessitates a listing of those contracts which is as follows:

| Vendor | Purchase Order | Taxable Amount | Total Amount |
|---|---|---|---|
| 1. Contractor 1 | 559970 | 201.00 | 4,900.00 |
| 2. Contractor 2 | 564124 | 2,950.00 | 403,500.00 |
| 3. Contractor 3 | 563936 | 22,500.00 | 1,140,000.00 |
| 4. Contractor 4 | 563650 | 3,083.00 | 5,433.00 |
| 5. Contractor 5 | 560204 | 1,010.00 | 5,866.00 |
| 6. Contractor 6 | 560403 | 4,074.00 | 9,898.60 |
| 7. Contractor 7 | 564567 | 48,250.00 | 82,472.20 |
| 8. Contractor 8 | 562487 | 5,000.00 | 79,900.00 |
| 9. Contractor 9 | 562454 | 60,337.00 | 335,290.00 |

| | | | |
|---|---|---|---|
| 10. Contractor 10 | 924496 | 19,000.00 | 20,000.00 |
| 11. Contractor 11 | 559514 | 255,684.00 | 840,000.00 |
| 12. Contractor 12 | 562764 | 1,113,977.00 | 28,490,539.00 |

The taxpayer has met its burden of demonstrating that the first 11 of the purchase orders, to the extent that those purchase orders are enumerated within this letter of findings, are lump sum contracts for making improvements to the taxpayer's realty. Accordingly, the taxpayer typically would not be liable for use tax on any portion of the contract cost when it is the contractor who is responsible for paying that use tax. As set out in Information Bulletin Number 60, Dec. 2, 1987, "A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase of all material so used." The fact that taxpayer received requests for progress payments from its contractors, relevant to these particular lump sum contracts, which included a listing of both material and labor costs, does not vitiate this determination. "The fact that the seller subsequently furnishes information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material." Id.

However the analysis of taxpayer's contracts one through eleven does not end with the determination that they constitute lump sum contracts. On four of the eleven contracts (one, five, six, and eleven) the taxpayer has included a printed claim that it is "exempt from state sales tax." Taxpayer apparently predicates this rather sweeping assertion on the ground that taxpayer possesses a Direct Pay Permit. The statutory provision governing the use of Direct Pay Permits is somewhat more restrictive than that which the taxpayer has apparently represented to its contractors. The taxpayer's Direct Pay Permit is not a global declaration that the taxpayer is entitled to any tax exemption. Rather, the Direct Pay Permit is an agreement between the taxpayer and the department that the taxpayer "will pay the tax... directly to the Department." IC 6-2.5-8-9(b). The Direct Pay Permit merely allows taxpayer the option of determining the taxability of the purchased items at a later time. If, at that later time, those purchased items are determined to be taxable, the taxpayer pays the tax. However, taxpayer cannot escape the fact that, when using its Direct Pay Permit, the ultimate responsibility for the tax remains with the taxpayer.

The taxpayer's assertion to its contractors that it is "exempt from state sales tax" is entirely inappropriate. 45 IAC 2.2-8-16(c) clearly states that "[a] direct payment permit is not a declaration that the issuer is entitled to [an] exemption, but is rather a declaration that the issuer will remit use tax on any purchase on which sales tax was due."

For contracts numbers one, five, six, and eleven – otherwise determined to be lump sum contracts – the taxpayer is precluded from asserting an exemption for the use tax liability otherwise available under 45 IAC 2.2-4-22(e) and 45 IAC 2.2-4-26(a), on two grounds. First, the taxpayer is precluded from claiming the exemption from use tax liability on equitable estoppel grounds. "Equitable estoppel is available if one party, through its representations or course of conduct, knowingly misleads or induces another party to believe and act upon his conduct in good faith and without knowledge of the facts." Wabash Grain, Inc. v. Smith, 700 N.E.2d 234, 237 (Ind. Ct. App. 1998). "The basis for the doctrine of equitable estoppel is fraud, either actual or constructive, on the part of the person estopped." Farrington v. Allsop, 670 N.E.2d 106, 109 (Ind. Ct. App. 1996). "Constructive fraud is fraud that arises by operation of the law from conduct which, if sanctioned by the law, would secure an unconscionable advantage." Id. Although no evidence has been presented which establishes that taxpayer, by making an unsubstantiated claim that it was "exempt from sales tax," intended to commit fraud, no direct evidence of fraud is required to assert the doctrine. Rather, "in order to prevail on a theory of constructive fraud, one need not establish the existence of an actual intent to defraud." Id. Instead, it is the taxpayer's "conduct [that] triggers the application of the theory." Id. When taxpayer states on its purchase orders that it is "exempt from sales tax," one can come to the reasonable conclusion that the statement was intended to lead taxpayer's contractors to believe that taxpayer was "exempt from sales tax." Taxpayer may not so mislead its contractors, claim a lump sum contract exemption, and escape the tax liability it willingly assumed to itself when the taxpayer applied for its Direct Pay Permit – the very basis on which it now incorrectly asserts a tax exempt status.

Second, the taxpayer is barred from claiming the lump sum contract exclusion, for those contracts on which it claimed that it was "exempt from sales tax," based upon the obligations it assumed when it applied for and received its Direct Pay Permit. The Direct Pay Permit is a convenience made available to a taxpayer permitting that taxpayer an opportunity to defer the payment of gross retail tax but in no way alleviating the taxpayer from the responsibility for the tax liability. IC 6-2.5-8-9(a), (b). Having taken upon itself the opportunity of acquiring a Direct Pay Permit, having represented to its contractors that it is "exempt from sales tax," and having presented no evidence that its contractors paid the gross retail tax on those materials incorporated into the taxpayer's realty, the taxpayer is left with the statutory obligation – voluntarily assumed by the taxpayer – to "pay the tax on that purchase directly to the department. IC 6-2.5-8-9(b). Having made certain representations to its contractors, apparently predicated on its possession of a Direct Pay Permit, the contractors were quite reasonably entitled to assert that they "had no duty to collect or remit the state gross retail or use tax on [each] transaction." IC 6-2.5-8-9(b).

Taxpayer has failed to meet its burden of demonstrating that purchase order number 12 is a lump sum contract. 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." In regard to purchase order number 12, the taxpayer has set forth a bare assertion, unsupported by documentary evidence of the original

agreement, that purchase order number 12 is a lump sum contract. Taxpayer has submitted secondary evidence, relating to a later modification of the original purchase order, which purportedly gives evidence of the parties' intent to consummate a lump sum agreement. Taxpayer Facsimile, Dec. 15, 2000. However, that secondary evidence, standing alone, is insufficient to establish the nature of the original purchase order and is insufficient to rebut the presumption afforded under IC 6-8.1-5-1(b).

Having determined that the seven remaining contracts are lump sum contracts for which the taxpayer is not obligated to pay the gross retail tax, it is fitting to remind the taxpayer concerning the appropriateness of representations set forth on those contracts. On those seven contracts, the taxpayer has included the statement that it possesses a "direct payment authorization." Exhibit C, Taxpayer Letter, Dec. 4, 2000. Taxpayer's purpose in making this representation remains obscure but, nonetheless, the taxpayer is reminded that "[d]irect payment permits do not certify that the issuer is entitled to an exemption and *may not be issued to flat bid (lump sum) contractors."* Ind. Dept. of Revenue Application for Direct Pay Authorization (Emphasis added).

**FINDING**

The taxpayer's protest is denied in part and sustained in part.

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**DEPARTMENT OF STATE REVENUE**

04990036.SLOF

**SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 99-0036**
**Sales and Use Tax**
**For Tax Periods: 1995-1997**

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

**ISSUE**

**Sales and Use Tax – Purchase for Resale Exemption**

**Authority:** IC 6-2.5-3-2(a), IC 6-2.5-5-8, IC 6-8.1-5-1(b)

Taxpayer protests the imposition of gross retail tax on an airplane.

**STATEMENT OF FACTS**

Taxpayer is in the business of selling, servicing and repairing recreational vehicles along with over the counter sales of parts and accessories. After an audit, additional sales and use tax, interest and penalty were assessed. Taxpayer protested a portion of the assessment and a hearing was held. A Letter of Findings was issued on September 22, 2000. Taxpayer was granted a rehearing on one issue. Taxpayer submitted additional information. Further facts will be provided as necessary.

**DISCUSSION**

In 1996 Taxpayer purchased an airplane without paying sales or use tax. IC 6-2.5-3-2 (a) imposes the use tax "on the storage, use, or consumption of tangible personal property in Indiana." There are several statutory exemptions to the use tax. Taxpayer contends that its purchase and use of the airplane qualifies for exemption pursuant to IC 6-2.5-5-8 as follows:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.

The tax assessment is presumed to be correct. Taxpayer bears the burden of proving that the assessment is incorrect and the airplane qualifies for the resale exemption. IC 6-8.1-5-1 (b).

At the original hearing Taxpayer submitted a copy of its aircraft dealer license, documentation that the dealer aircraft inventory tax was paid on this airplane, copies of advertisements for this and another airplane, evidence that it traded for and sold airplanes in its regular course of business and evidence that the subject airplane was actually sold. The Indiana Department of Revenue held against Taxpayer because Taxpayer held the airplane for almost three years before it was sold and the insurance policy indicated that the airplane was insured for personal use.

As additional evidence that the airplane qualified for the purchase for resale exemption, Taxpayer submitted a letter from an airplane repair concern. That letter indicated that the repair concern took control of the airplane on November 25, 1997 for repairs. Because of several problems, the airplane repair work was not completed until October 14, 1998. Taxpayer contends that it could not sell the airplane while it was under repair and this explains why it held the plane for almost three years before it was sold. It was, however, a year before the plane was taken in for repairs. The problem appears to have been a rubber grommet which was sucked into the engine causing major repairs. This problem indicates that the plane was flown during the first year Taxpayer owned it.

Taxpayer also submitted a letter from the insurance agent. That letter indicated that the plane was insured for business and personal use. A plane insured for personal use clearly is not being held merely for resale.

Taxpayer failed to sustain its burden that the airplane qualified for the purchase for resale exemption.

**FINDING**

Taxpayer's protest is denied.

**DEPARTMENT OF STATE REVENUE**
**Revenue Ruling #2001-02 IT**
**February 6, 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 – Agency**

**Authority:** IC 6-2.1-2-2, Rule 45 IAC 1.1-6-10, Rule 45 IAC 1.1-1-2, Policy Management Systems Corp. v. Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999), Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994)

The taxpayer requests the Department to rule whether or not the reimbursement of wages and taxes paid to, and for, temporary employees represents income received in an agency capacity, therefore, exempt from Indiana gross income tax.

**STATEMENT OF FACTS**

The taxpayer and subsidiaries, hereinafter "taxpayer", provides temporary employees through both company-owned offices and franchise agent offices. The temporary employees perform various services, including word processing, administrative and receptionist services, assembly line work, machine operation, packaging, inspection, and home healthcare services. The taxpayer is responsible for the payroll of all regular staff. In addition, the taxpayer is also responsible for the payroll of temporary employees. The taxpayer withholds and remits federal and state income tax and FICA, and pays federal and state unemployment tax and worker's compensation premiums on behalf of all regular staff and temporary employees.

**The Temporary Employee Placement Process**

The taxpayer procures temporary employees to fulfill the short-term labor needs of its clients. Clients utilize the taxpayer because the taxpayer provides administrative services such as employee recruitment and payroll, which would otherwise be burdensome for the client to perform on a temporary basis.

Because clients generally provide the taxpayer with minimal advance notice when requesting the services of temporary employees, the taxpayer maintains a list of potential employees who are qualified to meet the needs of its various clients. The taxpayer advertises in local newspapers and phone books to attract potential employees. The recruitment process generally involves completing a job application, conducting an interview, performing a skill evaluation, and checking references. If the taxpayer has a job assignment currently available that matches the applicant's skills, the taxpayer will offer the assignment to the applicant at the end of the interview. The applicant can either accept or decline this specific assignment, but can remain on the taxpayer's potential temporary employee list regardless of whether a specific assignment is declined.

In many cases, the interview is the only face-to-face contact the taxpayer has with applicants. The taxpayer generally contacts the applicants by phone to offer future assignments as openings become available. Nothing prohibits applicants from registering with multiple employment agencies; therefore, many applicants may have multiple registrations to increase the likelihood of finding employment.

When an applicant accepts an assignment, the taxpayer communicates the details of the assignment to the employee, such as the location, when the client expects the employee to arrive, and the estimated duration of the assignment. With the exception of payroll-related activities, this is the only interaction the employee has with the taxpayer. When an employee first arrives at the client site, there is a four-hour "test" period during which the client has the right to request another employee from the taxpayer. The taxpayer's standard Customer Service Contract, in part, states that, "[y]ou [the client] may direct us to replace any of our personnel assigned to you, in which event we will endeavor to promptly replace that person with another."

**Right to Hire/Fire Employees and Duration of Employment**

The taxpayer's applicants are not engaged for a job until a specific assignment is obtained. The taxpayer will not "hire" an applicant absent a specific assignment. Rather, the taxpayer retains all qualified applicants on its employee lists until assignments become available. Ultimately, the client has the authority to determine whether or no employees are retained on a job assignment and the duration of each job assignment. When an assignment is complete, the taxpayer no longer pays the worker because the client is no longer reimbursing the taxpayer for its procurement and paymaster services. In cases where a client is not using the services of an employee, the employee is considered unemployed and the taxpayer may or may not retain the person on the applicant list until he or she is offered another specific temporary assignment.

**Job Assignments/Instructions/Evaluations**

Once the taxpayer assigns an employee to a client for a particular assignment, the client exercises complete and exclusive

control over the employee's job responsibilities, and the client gives all instructions regarding how the job is to be performed. The client has the exclusive ability to evaluate the employee's performance and to decide whether to retain the employee based on this evaluation.

**Supervision and Control**

While on assignment, the employee is under the exclusive supervision and control of the client. The taxpayer's standard Customer Service Contract, in part, states that "[y]ou [the client] will **supervise, direct, and control** our personnel in the manner and method of performing their work" (emphasis added). As the contractual language makes clear, the taxpayer has no responsibility for the employee's day-to-day activities. The taxpayer merely procures the employee for its clients, who supervise and control the employees.

**Office Space/Work Premises/Days and Hours**

In all cases, the client provides the work space/premises where the employee performs his or her duties. Hence, it is the client who has the ultimate control of determining when and where the work is performed. Even in the home health care field, the taxpayer's client (the physician) controls which patients the temporary employee visits, and how often the temporary employee visits each patient.

**Tools and Materials**

The client generally provides all tools and other required materials, except in a few situations where the general business expectation is for the employee to supply his own tools and safety supplies. Some temporary employees may not have all required tools when first taking on an assignment. In this situation, the taxpayer may supply basic safety equipment such as back braces, goggles, and gloves in order to facilitate the hiring process. The employee generally pays for this safety equipment over a period of time.

**Compensation**

The taxpayer does not dictate the hourly wage of its employees. Based on job classification and local competition, the wage for each job is negotiated and agreed upon. Wages range from $6 per hour for low-skill positions to $40 per hour for some high-skill employees. The taxpayer charges its clients the employee's hourly rate, plus a mark for the taxpayer's services. Clients can increase the employee's wage in order to retain the employee.

The taxpayer offers employee benefits to temporary employees, including vacation pay, health insurance plans, referral bonuses, 401(k), and an employee stock purchase plan. Historically, however, few temporary employees elect to take advantage of these benefits. In large part, the offering of these benefits to temporary employees hinges on conformity to applicable federal laws or employment conditions in very competitive markets.

**Flow of Funds: Reimbursements**

Employees keep track of the hours they work on a timecard provided by the taxpayer. At the end of each week, an authorized representative of the client signs the timecard for the employee, approving the number of hours reported to the taxpayer. The employee then generally faxes or mails the timecard to the taxpayer. Upon receiving the timecard signed by the client, the taxpayer pays the employee's wages, less appropriate payroll deductions. As previously stated, the taxpayer is responsible for reporting and remitting income tax withholdings on behalf of those employees. Additionally, the taxpayer pays state unemployment insurance contributions and workers' compensation premiums.

**DISCUSSION**

IC 6-2.1-2-2 provides that gross income tax is imposed upon the entire gross receipts of a taxpayer who is a resident or domiciliary of Indiana and the gross receipts derived from business activity within Indiana by a taxpayer who is not a resident or domiciliary of Indiana. Rule 45 IAC 1.1-6-10, however, states that income received in an agency capacity is excluded from gross income. Rule 45 IAC 1.1-6-10 further states that "A reimbursement of a taxpayer's own expenses are never excluded from gross income." Rule 45 IAC 1.1-1-2 defines an agent as:

(a) "Agent" means a person or entity authorized by another to transact business on its behalf.

(b) A taxpayer will qualify as an agent if it meets both of the following requirements:

(1) The taxpayer must be under the control of another. An agency relationship is not established unless the taxpayer is under the control of another in transacting business on its behalf. The relationship must be intended by both parties and may be established by contract or implied from the conduct of the parties. The representation of one (1) party that it is the agent of another party without the manifestation of consent and control by the alleged principal is insufficient to establish an agency relationship.

(2) The taxpayer must not have any right, title, or interest in the money or property received from the transaction. The income must pass through, actually or substantially, to the principal or a third party, with the taxpayer being merely a conduit through which the funds pass between a third party and the principal.

The Indiana Tax Court, in Policy Management Systems Corp. v. Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999) and Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994), has reviewed the issue of agency as it applies to gross income taxation. The Court echoed Rule 45 IAC 1.1-1-2 and Rule 45 IAC 1.1-6-10 by finding that an agency relationship includes consent by the principal, acceptance of authority by the agent and control of the agent

by the principal. The Court, also, held that reimbursement of a taxpayer's own expenses is subject to gross income tax regardless of whether an agency relationship exists or not.

In the instant case, the relationship between the taxpayer and its client is not one of agent and principal, but rather, one of buyer and seller as the needed elements of consent, acceptance and control are lacking. Further, regardless of whether or not an agency relationship exists between the taxpayer and its clients, the reimbursement by the clients of the taxpayer's wages and taxes paid to, and for, temporary employees is reimbursement of the taxpayer's own expenses as the temporary employees, in fact, are employees of the taxpayer rather than the clients. The reimbursement of wages and taxes paid, therefore, is subject to Indiana gross income tax pursuant to the above referenced IC 6-2.1-2-2 and Rule 45 IAC 1.1-6-10.

**RULING**

The Department rules that the reimbursement of the taxpayer for wages and taxes paid to, and for, temporary employees by its clients does not represent income received in an agency capacity, hence, is subject to Indiana gross income tax.

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

**DEPARTMENT OF STATE REVENUE**
**Revenue Ruling 2001-03 IT**
**February 6, 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 – Agency**

**Authority:** IC 6-2.1-2-2, Rule 45 IAC 1.1-6-10, Rule 45 IAC 1.1-1-2, Policy Management Systems Corp. v. Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999), Universal Group Limited V. Indiana Department of State Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994)

The taxpayer requests the Department to rule whether or not the reimbursement of wages, payroll taxes and various other employee benefits paid to, and for, worksite employees represents income received in an agency capacity, therefore, exempt from Indiana gross income tax.

**STATEMENT OF FACTS**

The taxpayer is engaged in the business of providing professional employer services. The taxpayer submitted a copy of the "Client Service Agreement" which indicates the responsibilities of both the taxpayer and its client upon the client purchasing the taxpayer's employee services. The "Client Service Agreement" reveals that the taxpayer assumes certain rights and duties of an employer during the contract period which include:

1. paying the wages to, and payroll tax for, employees located at the client's worksite (worksite employees);
2. paying for various other employee benefits for worksite employees;

(It should be noted that the taxpayer's cost for items number one and two is reimbursed by the taxpayer's client. The taxpayer, also, receives a fee from its client for providing employer services.)

3. to hire, terminate, discipline and reassign worksite employees; and
4. to provide workers' compensation insurance coverage for worksite employees.

The "Client Service Agreement", further, provides that upon termination of the agreement the taxpayer is obligated to notify each worksite employee that the employee's employment with the taxpayer will be terminated.

**DISCUSSION**

IC 6-2.1-2-2 provides that gross income tax is imposed upon the entire gross receipts of a taxpayer who is a resident or domiciliary of Indiana and the gross receipts derived from business activity within Indiana by a taxpayer who is not a resident or domiciliary of Indiana. Rule 45 IAC 1.1-6-10, however, states that income received in an agency capacity is excluded from gross income. Rule 45 IAC 1.1-6-10 further states that "A reimbursement of a taxpayer's own expenses are never excluded from gross income." Rule 45 IAC 1.1-1-2 defines an agent as:

(a) "Agent" means a person or entity authorized by another to transact business on its behalf.

(b) A taxpayer will qualify as an agent if it meets both of the following requirements:

(1) The taxpayer must be under the control of another. An agency relationship is not established unless the taxpayer is under the control of another in transacting business on its behalf. The relationship must be intended by both parties and may be established by contract or implied from the conduct of the parties. The representation of one (1) party that it is the agent of another party without the manifestation of consent and control by the alleged principal is insufficient to establish an agency relationship.

(2) The taxpayer must not have any right, title, or interest in the money or property received from the transaction. The income must pass through, actually or substantially, to the principal or a third party, with the taxpayer being merely a conduit through which the funds pass between a third party and the principal.

The Indiana Tax Court, in Policy Management Systems Corp. v. Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999) and Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994), has reviewed the issue of agency as it applies to gross income taxation. The Court echoed Rule 45 IAC 1.1-1-2 and Rule 45 IAC 1.1-6-10 by finding that an agency relationship includes consent by the principal, acceptance of authority by the agent and control of the agent by the principal. The Court, also, held that reimbursement of a taxpayer's own expenses is subject to gross income tax regardless of whether an agency relationship exists or not.

In the instant case, the relationship between the taxpayer and its client is not one of agent and principal, but rather, one of buyer and seller as the required elements of consent, acceptance and control are lacking. Further, regardless of whether or not an agency relationship exists between the taxpayer and its clients, the reimbursement by the clients of the wages, payroll taxes and various other employee benefits paid to, and for, worksite employees is reimbursement of the taxpayer's own expenses as the worksite employees, in fact, are employees of the taxpayer rather than the clients. The reimbursement of wages, payroll taxes and various other employee benefits paid by the taxpayer, therefore, is subject to Indiana gross income tax pursuant to the above referenced IC 6-2.1-2-2 and Rule 45 IAC 1.1-6-10.

**RULING**

The Department rules that the reimbursement of the taxpayer for wages, payroll taxes and various other employee benefits paid to, and for, worksite employees by its clients does not represent income received in an agency capacity, hence, is subject to Indiana gross income tax.

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