INDIANA DEPARTMENT OF FIRE AND BUILDING SERVICES
TECHNICAL SERVICES AND RESEARCH

Title: Variance filing process

Brief Description of Subject Matter: Enforcement of filing process

This nonrule policy provides for sufficient time for review by staff and submittal to the Fire Prevention and Building Safety Commission for action.

Contrary to the requirements detailed in the General Administrative Rules (GAR), many variance applications and additional information supplementing variance applications are being submitted after the cut-off date established in the rules. In addition, many variance applications are being submitted that do not contain the information that is clearly required by the GAR.

Besides being a legal requirement, the cut-off date provides sufficient time for the variance applications to be copied and mailed so that the Commission members will have an adequate opportunity to review the variance information prior to the Commission meeting.

Since these cut-off dates are established more than a year in advance, for the overwhelming majority of the variance applications, there is no legitimate reason why a variance application should be late. The GAR prohibits placing a late variance application on the agenda unless the applicant would be prejudiced by having to wait for a later meeting because of excessive loss of time or unreasonable cost.

Also, the GAR clearly establishes the information that is required in a variance application. This information should be included with the application by the cut-off date so that the Commission will have an opportunity to review the variance application in its entirety before the Commission meeting. In addition, unless this information is provided before the cut-off date, the Staff will not be able to adequately review the variance application.

With all the above stated, please let this serve as notice that, beginning with the October 2001 Commission meeting variance cut-off date the following will apply:

Variance applications without signatures will not be processed and will not be placed on the Agenda.

If all required information is not submitted by the cut-off date (except for LBO & LFO notification), the staff will classify the variance as an "I" (Incomplete) category on the agenda, and will recommend that the Commission table the application to allow the staff and the Commission an adequate time to review the application. In addition, the submitter has the responsibility to distribute any such additional information to the members of the Commission.

Variances filed after the cut-off date will be accepted only if they are complete and have been approved by the State Building Commissioner. As stated above, under the GAR, a late variance application shall not be placed on the Commission's agenda unless the applicant would be prejudiced by having to wait for a later meeting because of excessive loss of time or unreasonable cost. For these late variance applications that are placed on the agenda, the submitter is responsible for ensuring that copies are sent to the members of the Commission.

INDIANA DEPARTMENT OF LABOR
POLICY:
BuSET TRAINING COURSES
Effective April 1, 2001

Courses

Bureau of Safety Education and Training (BuSET) consultants conduct OSHA 10-Hour and 20-Hour training courses, and other courses related to safety and health, according to the policies set forth in this document, which are subject to change at BuSET's discretion. The 20-Hour courses require an OSHA 10-Hour certification within the previous six months. To efficiently utilize state resources, BuSET will not conduct continuous OSHA 30-Hour courses; however, the timely completion of the OSHA 10-Hour and 20-Hour courses will qualify for an OSHA 30-Hour certification. Sponsorship of each course/seminar will be determined on a case-by-case basis, and sponsors and courses must conform to the policies set forth in this document.

Topics

Subjects to be covered during each OSHA 10-Hour and 20-Hour course are attached in Appendices A and B. BuSET consultants may be available to perform specific training seminars, in relation to an identified hazard, a new or updated standard, or a hazardous industry. Topics and length of the short seminars will vary according to each request.

Length

Each OSHA 10-Hour course will be conducted in a minimum of 10 hours. Each 20-Hour course will be conducted in a minimum of 20 hours. Extra hours for each course will remain at the discretion of BuSET. Other seminars may be conducted based on the sponsor's request.

Scheduling & Priority

The number and timing of general industry and construction OSHA 10-Hour courses conducted by BuSET during the fiscal year will be determined by BuSET.

OSHA 10-Hour courses will be scheduled on a first-come, first-served basis according to written request. Course assignments will be made to consultants or other personnel deemed appropriate by BuSET. Requests for specific consultants will be considered, but BuSET retains the right to conduct courses with personnel deemed appropriate by BuSET.

20-Hour general industry courses, which require attendees to hold an OSHA 10-Hour certification card obtained in the previous six months, will be scheduled four (4) times per year, once per fiscal quarter.* The locations for these courses are as follows:

- Indianapolis area (60-mile radius from I-465)
- Southern Indiana
- Indianapolis area (60-mile radius from I-465)
- Northern Indiana

Sponsorship of the 20-Hour courses will be assigned on a rotating basis, and sponsorship assignments will be made by BuSET.

Special-topic and short seminars will be assigned on a first-come, first-served basis.

* Due to the publication date of this policy, three (3) 20-Hour courses will be conducted in 2001.

Attendee Requirements

For each OSHA 10-Hour course, the sponsor must ensure that no less than twenty (20) attendees are registered three (3) weeks prior to the beginning date of the course, and must confirm this number with the lead BuSET consultant for the course. The sponsor will also confirm, with the lead BuSET consultant, the number of paid attendees one (1) week prior to the beginning date of the course. If the number of attendees falls below twenty (20) one week prior to the course, BuSET reserves the right to cancel their participation in the course. The maximum number of attendees is fifty (50); however, this number may be modified at the BuSET consultant's discretion.

For each 20-Hour course, the sponsor must ensure that no less than thirty (30) attendees are registered three (3) weeks prior to the beginning date of the course, and must confirm this number with the lead BuSET consultant for the course. The sponsor will also confirm, with the lead BuSET consultant, the number of paid attendees one (1) week prior to the beginning date of the course. If the number of attendees falls below thirty (30) one week prior to the course, BuSET reserves the right to cancel their participation in the course. The maximum number of attendees is sixty (60); however, this number may be modified at the BuSET consultant's discretion.

For each short seminar, the sponsor must ensure that no less than fifteen (15) attendees are registered one (1) week prior to the date of the seminar. The sponsor will confirm the number of attendees with the scheduled BuSET consultant one (1) week prior to the date of the seminar, and BuSET reserves the right to cancel their participation in the course if the number of attendees falls below fifteen (15).

General Requirements

The following requirements are mandated by BuSET for sponsorship of a training course that is conducted by BuSET personnel:

<u>The Training Program Sponsor will furnish:</u>

- Appropriate facilities suitable for training, including a room large enough for each attendee to have adequate table space. The room must be equipped with a functional Internet connection method, which may consist of an activated phone line or direct connection to an Internet service provider. (Please contact the lead consultant assigned to your training course in advance for discussion of this issue.)
- Food and drink, as appropriate, for morning and afternoon breaks
- Lunches, or a listing of eating establishments in the area which will allow attendees to return within one hour
- Large projection screen
- Printed outreach ring binder, with all sections as contained in the BuSET master, and with the sections numbered and tabbed*
    - Master may be obtained from BuSET and returned to BuSET
    - Copies will be provided by the sponsor
- Occupational Safety and Health Standards Books, subject to the following qualifications:
    - Books must contain:
        - The entire 29 CFR 1910 or 1926, as appropriate for the course
        - 29 CFR 1903 and 29 CFR 1904
    - Books must be the current year's edition, as of the date of the course
    - One book for each attendee
    - Books may be purchased from BuSET at BuSET's current pricing, or from outside sources.
- Highlighter pen for each attendee
- Pen or pencil for each attendee

- Note paper tablet for each attendee
- Name card or name tag for each attendee
- TV and VCR (if applicable)

* Not required for attendees to a 20-Hour course who previously attended an OSHA 10-Hour course. Attendees are requested to bring materials previously obtained at the OSHA 10-Hour course, or they must purchase new materials.

The Training Program Sponsor will:

- Make the training course available to personnel outside the confines of the sponsoring company or organization
- Provide notice to the BuSET trainers of the course schedule and assigned topics, in advance of the course
- Provide an agenda of the course to attendees
- Create and mail program advertisement fliers (if applicable)
- Ensure that the mandated number of attendees is met
- Collect all fees assessed by the sponsor
- Mail all certificates of completion and OSHA cards to attendees
- Allow BuSET to post the training program on their website
- Make miscellaneous copies of documents used in the course
- Sign BuSET's Training Courses Policy sponsor agreement
- Utilize all training material and supplies as deemed appropriate by BuSET.

In addition to these requirements set forth for the training program sponsors, BuSET will abide by the following requirements:

BuSET will:

- Provide instructors, at BuSET's discretion
- Provide an OSHA card and certificate of completion for each 10-Hour and 20-Hour course attendee who has attended all required portions of the specified course, and one certificate per company per company location. Exception: The sponsor may distribute the cards and certificates; however, the cards and certificates shall not be issued prior to the attendees' completion of the course.
- Mail the cards and certificates to the sponsor for distribution
- Ensure that the topics outlined in the appendices to this policy are covered appropriately
- Maintain a database of scheduled training courses
- Provide a method of evaluation of its instructors for each OSHA 10-Hour, 20-Hour, and 30-Hour course
- Distribute BuSET publications as deemed appropriate by BuSET.

BuSET will furnish:

- Instructors
- Computer
- Projector
- An evaluation worksheet for each attendee.

Sponsor Agreement

By signing below, I signify that I understand and agree to abide by the terms and conditions contained in the course policy. I also agree and understand that BuSET reserves the right to cancel their participation in a training course or seminar if the sponsor fails to meet the requirements contained in the policy.

_____ _____

Sponsor Representative Date

_____

Sponsor Organization

DEPARTMENT OF STATE REVENUE

1597016IFTA.LOF

LETTER OF FINDINGS NUMBER: 97-016 IFTA
IFTA
For the Period: 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. Tax Administration)Penalty

Authority: IC 6-6-4.1-20; IC 6-8.1-10-4; 45 IAC 15-11-4; 45 IAC 15-5-7(3); IC 6-8.1-10-2.1

The taxpayer protests the assessment of 100% fraud penalty.

STATEMENT OF FACTS

The taxpayer is engaged in the trucking industry, transporting products. The Indiana Department of Revenue audited the taxpayer in the early part of 1997. The auditor found several "variances" and errors in the taxpayer's records, including alterations in the information on the taxpayer's IFTA summaries (and also alterations to non-IFTA jurisdictions). The auditor noted that tax liability was reduced by these alterations. The auditor also found that the taxpayer did not use any internal controls to reduce tax errors. Based upon these variances and errors, and the fact that the taxpayer subtracted out Indiana toll road miles, a 100% fraud penalty was imposed. More facts will be provided below as needed.

I. Tax Administration)Penalty

DISCUSSION

The taxpayer protests the imposition of a 100% fraud penalty. As the taxpayer states in a letter, dated September 9, 1997:

I am requesting a hearing to settle the matter of the 100% penalty that your state [Indiana] is charging me. It is my understanding that the International Fuel Tax Agreement [IFTA] is regulated by a common standard that all states must abide by.

And further:

I am aware … that the tax owed was a mistake on our part. But I am [still] protesting the 100% penalty.

At the hearing the taxpayer explained, in its defense, that the variances and errors were based on: (1) the taxpayer's reliance on the taxpayer's bookkeeper; and (2) that toll road miles are not assessed in most other jurisdictions and that its belief was that Indiana toll road miles were not taxable. The taxpayer's basic argument is that it did not intentionally avoid taxation, and thus the 100% fraud penalty should not be imposed.

Several statutes are relevant to the Department's imposition of the 100% fraud penalty. Indiana Code 6-6-4.1-18 deals with motor fuel tax and fraud for the purpose of "reduction of liability" for tax. Further, Indiana Code 6-6-4.1-20 deals with the failure to keep proper books and records, and points to Indiana Code 6-8.1-10-4 for elaboration of the penalty. Finally, IC 6-8.1-10-4 sets out the statutory requirements for the assessment of the 100% penalty. The pertinent part of IC 6-8.1-10-4 is the following:

(a) If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, he is subject to a penalty.

'Fraudulent intent' is defined by 45 IAC 15-11-4:

An act is fraudulent if it is an actual, intentional wrongdoing, and the intent required is the specific purpose of evading tax believed to be owing.

There are five elements used to establish fraud: (1) Misrepresentation; (2) Scienter; (3) Deception; (4) Reliance; and (5) Injury. (*See* 45 IAC 15-5-7(3)). All five elements must be met by "clear and convincing evidence" to show fraud.

The Department has not met its burden regarding element of Scienter--thus an analysis of the other elements is not necessary. The Scienter element is defined in the administrative code as:

Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.

The Department's failure to meet its burden of proof regarding the Scienter element is evidenced by the Department's own reports. For instance, the Department noted that the taxpayer did not have a computerized system, did not keep individual truck information from past quarters, and that there were many clerical errors. The Department has only shown that the taxpayer made several errors and used what can only be dubbed "sloppy" record keeping procedures.

Regarding the issue of toll road mileage, this is a contentious issue that was litigated in the early 1990's. In Area Interstate Trucking v. Indiana Dept. of State Revenue, 605 N.E.2d 272, 278 (Ind. Tax 1992), the Indiana Tax Court held that the motor carrier fuel tax "as applied to the consumption of fuel by motor carriers in operating on the Indiana toll road, offends neither the United States nor the Indiana Constitution." Although the Department is correct on the merits of the substantive issue, namely that the taxpayer erroneously subtracted the toll road miles out, nonetheless the taxpayer may have believed that it was in comportment with the law.

Although the Department has not met its burden of proof regarding the 100% fraudulent penalty, it has shown negligence on the taxpayer's part. The negligence penalty imposed under IC 6-8.1-10-2.1 subjects a taxpayer to a ten percent penalty if the taxpayer incurs a deficiency that is due to negligence. However, the penalty shall be waived if the taxpayer shows the deficiency was due to reasonable cause and not due to willful neglect. The failure to have internal controls, the failure to be familiar with Indiana law (e.g.,

Area Interstate Trucking) on the issue of toll roads, the alteration of figures, and that fact that the taxpayer has been in the trucking industry for numerous years and operates in several jurisdictions shows negligence on the taxpayer's part.

The final argument that the taxpayer makes is that the International Fuel Tax Agreement (IFTA) sets the "standard" on penalties. The taxpayer's September 9, 1997, letter states:

> [The IFTA] laws state that the penalty on unpaid fuel tax is $50.00 or 10% of the tax owed which ever is greater. … It is my understanding that [IFTA] is regulated by a common standard that all states must abide by.

The taxpayer fails to address the fact that the IFTA Articles of Agreement provide that "Nothing in the Agreement limits the authority of a jurisdiction to impose any other penalties provided by the laws of the base jurisdiction." (*See* Commentary for IX.C.7 with IX.B.).

FINDING

The taxpayer's protest is sustained regarding the imposition of the 100% fraud penalty; however the taxpayer is denied regarding the lesser penalty imposition, namely, the negligence penalty.

DEPARTMENT OF STATE REVENUE

02970234.LOF

LETTER OF FINDINGS NUMBER: 97-0234 ITC
GROSS INCOME TAX
For Years 1991, 1992, 1993, and 1994

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

ISSUES

I. Adjusted Gross Income Tax–State Income Tax addback

Authority: First Chicago NBD Corp., f/k/a NBD Bancorp, Inc., et al., v. Dept. of State Revenue, 708 NE2d 631, (Ind. Tax Court, 1999)

Taxpayer protests add back of Michigan single business taxes as part of state income taxes.

II. Adjusted Gross Income Tax–Federal Credit

Authority: IC § 6-3-1-3.5(b)

Taxpayer protests adjustments increasing the Indiana adjusted gross income by the taxpayer's Federal fuel tax and the Federal jobs tax credit.

III. Adjusted Gross Income Tax–Non-Business Income

Authority: IC § 6-3-1-3.5(b)

Taxpayer protests inclusion of income from activities involving the lease of tracts of timberland, one for commercial activities such as a railroad right of way, and the other granting rights for mineral exploration in its apportionable Indiana adjusted gross income.

IV. Adjusted Gross Income Tax–Partnership Income

Authority: 45 IAC 3.1-1-153

Taxpayer contends that its share of partnership property, payroll, and sales derived from its corporate partner should be included in taxpayer's apportionment formula, if it is found that taxpayer is unitary with its corporate partner.

V. Tax Administration–Waiver of Penalty

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

Taxpayer seeks waiver of the penalties because the tax liabilities were due to reasonable cause and not due to willful neglect.

STATEMENT OF FACTS

The taxpayer's business is paper and wood product production. Taxpayer directly, and indirectly through corporate partnership, owns timberlands for the purpose of extracting natural resources for use in its primary function, the production of wood and paper products. Taxpayer is also approached by various unrelated third parties who pay a fixed fee to allow them to investigate and test a tract of land for natural resources. If minerals are discovered, future payments are charged based on a percentage of sales or the amount of natural resources extracted by the third party. Additionally, taxpayer has signed leases for the use of its land for other above ground activities such as a rail line across one tract and the government leasing land for a lighthouse on another.

I. Adjusted Gross Income Tax–State Income Tax Addback

DISCUSSION

Pursuant to First Chicago NBD Corp., f/k/a NBD Bancorp, Inc., et al., v. Dept. of State Revenue 708 NE2d 631, (Ind. Tax Court, 1999), the Michigan single business tax is not to be added back to taxpayer's Indiana adjusted gross income.

FINDING

Taxpayer appeal is sustained.

II. Adjusted Gross Income Tax–Federal Credit

DISCUSSION

Taxpayer protests Audit adjustments increasing taxpayer's Indiana adjusted gross income. In computing its Indiana adjusted gross income tax liabilities, taxpayer deducted certain amounts of federal fuel tax paid. Taxpayer doesn't cite a specific code violation in the auditor's determination and fails to reconcile the claim made with IC § 6-3-1-3.5 (b) "Adjusted Gross Income" defined, which derives Indiana's adjusted gross income from Federal "'taxable income' (as defined in Section 63 of the Internal Revenue Code) adjusted as follows." The statute's adjustments do not permit a reduction of Indiana adjusted gross income by these federal credits and taxes. Consequently, the statute's omission of these credits requires the addition of the federal fuel tax and federal jobs tax credit to taxpayer's adjusted gross income.

FINDING

Taxpayer protest is denied.

III. Adjusted Gross Income Tax – Non-Business Income

DISCUSSION

IC § 6-3-1-20 defines business income as:

…income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.

In determining business income, 45 IAC 3.1-1-30 provides for the following relevant factors to be reviewed:

(1) The nature of the taxpayer's trade or business.

(2) The substantiality of the income derived from activities and transactions and the percentage that income is of the taxpayer's total income for a given tax period.

(3) The frequency, number, or continuity of the activities and transactions involved.

(4) The length of time the property producing income was owned by the taxpayer.

(5) The taxpayer's purpose in acquiring and holding the property producing income.

Reviewing the taxpayer's activities in light of the above factors, the nature of the taxpayer's business is paper and wood product production. The property is owned by the taxpayer to produce raw material for the production of paper.

No information is provided as to the proportional amounts of income from the activities at issue to the taxpayer's overall income; however, as taxpayer notes in the appeal, the mineral leases occur because "it is simply common knowledge in the business world that a major paper company would have access to timberlands that could be explored for natural resources." (Letter from Taxpayer to Dept. of Revenue of April 21, 1997, at 2). The activity is a frequent and predictable aspect of ownership of large tracts of timberland.

No specific information on the length of taxpayer's ownership of the property in question is given, but information is contained within the audit notes that taxpayer grows and harvests crops of trees on the land, indicative of substantial time of ownership.

The taxpayer owns the property for the purpose of extracting natural resources for use in its primary function, the production of wood and paper products. Taxpayer is approached by various unrelated third parties who pay a fixed fee to allow them to investigate and test a tract of land for natural resources. If minerals are discovered, future payments are charged based on a percentage of sales or the amount of natural resources extracted by the third party. Additionally, taxpayer has signed leases for the use of its land for other above ground activities such as a rail line across one tract and the government leasing land for a lighthouse on another.

Taxpayer presents these income-producing activities as passive and not subject to apportionment as unitary income, however the ownership of timberlands plays an integral role in the taxpayer's business of manufacturing and selling paper and wood products. Part of the purchase price of the timberlands included the potential return on minerals and other natural resources through royalty income. Part of the purpose of acquiring the timberland was not only to derive timber for the manufacture and sale of wood and paper products, but also to extract minerals and other natural resources. Furthermore, taxpayer need not satisfy all five (5) criteria under Regulation 45 IAC 3.1-1-30 to establish a trade or business. Due to frequency of deriving royalty income and the substantial period of time the taxpayer owned the income producing property, the royalty income shall be considered business income.

Under the Constitutional principle, affirmed by the U.S. Supreme Court in Allied-Signal, Inc. v. Director, Division of Taxation, 112 S.Ct. 4554, 119 L.Ed.2d 533,1992): "The principle that a State may not tax value earned outside its borders rests on the fundamental requirement of both the Due Process and Commerce Clauses that there be some definite link, some minimum connection, between a state and the transaction it seeks to tax. In the case of a tax on an activity, there must be a connection to the activity itself rather than a connection only to the actor the State seeks to tax."

Taxpayer maintains there is an insufficient connection between these income producing activities and the state. The taxpayer's timberlands are integral to taxpayer's business and the income being taxed is a normal, typical and customary source of income

derived from the taxpayer's timberlands, therefore, since the income is derived from income producing property for taxpayer's Indiana business activity, it is business income.

FINDING

Taxpayer protest is denied.

IV. Adjusted Gross Income Tax–Partnership Income

DISCUSSION

Taxpayer contends that its share of partnership property, payroll, and sales derived from its corporate partner should be included in taxpayer's apportionment formula, if it is found that taxpayer is unitary with its corporate partner. Taxpayer originally identified the income in question as non-business income, however the auditor determined that the corporate partner was unitary with the taxpayer and adjusted taxpayer's income from the partnership from nonbusiness to business income. The treatment of taxpayer's proportional interest in the partnership property, payroll, and sales derived from its corporate partner is governed by 45 IAC 3.1-1-153; which states in relevant part:

(b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year….

Based on the auditor's finding of a unitary relationship between the taxpayer and its corporate partner- and the subsequent applicability of IAC 3.1-1-153, - the taxpayer's proportionate interest in the partnership should be included in the apportionment formula of the taxpayer.

However, after reviewing audit adjustments and taxpayer's Indiana tax returns, it is unclear whether these unitary partnership factors have been included in taxpayer's apportionment calculus. Consequently, audit must review taxpayer's returns to determine if these partnership factors (sales, property, and payroll) were included in taxpayer's apportionment computations. If not, then audit must recompute the liability using these factors.

FINDING

Taxpayer protest is sustained subject to audit verification.

V. Tax Administration–Waiver of Penalty

DISCUSSION

Finding the liabilities were "due to negligence," IC 6-8.1-10-2.1 (a)(3), the Department imposed a ten percent penalty. The term "negligence" is defined in 45 IAC 15-11-2 (b), pertinently:

"Negligence" on behalf of a taxpayer is defined as the failure to use 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.

Taxpayer failed to make any adjustments that were specifically addressed in prior audits and Letters of Finding on the state tax returns from this audit period. No waiver of the penalty is appropriate.

FINDINGS

The taxpayer's appeal is denied.

DEPARTMENT OF STATE REVENUE

04980449.LOF

LETTER OF FINDINGS NUMBER: 98-0449
Sales Tax
Calendar 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. Tax Administration–Penalty

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

The taxpayer protests the negligence penalty.

STATEMENT OF FACTS

The negligence penalty was assessed on a sales tax assessment resulting from a Department audit conducted for the calendar years 1993, 1994, and 1995.

The taxpayer is an educational institute for technical and academic training in various occupations. The taxpayer operates in various states which includes Indiana. The taxpayer is solely owned by one individual.

I. Tax Administration–Penalty

DISCUSSION

The taxpayer requests the penalty assessment be waived. The Department points out the taxpayer had no company guidelines by which to assess and remit sales and use tax.

45 IAC 15-11-2(b) states, "Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer."

The Department finds the taxpayer did not act with reasonable care in that the taxpayer was inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the taxpayer's penalty protest is denied.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

02980712.LOF

LETTER OF FINDINGS NUMBER: 98-0712
Indiana Corporation Income Tax
For Tax Years 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.

ISSUES

I. Distributive Share of Corporate Partner)Including Partner's Loss as a Portion of the Distributive Share of a Corporate Partner

Authority: 45 IAC 1-1-17; 45 IAC 1-1-159.1; I.R.C. § 704.

The taxpayer has protested the auditor's calculation of its gross income tax base. Taxpayer maintains that the auditor improperly failed to include a distributive share of partnership loss.

II. Allocation of Income From Corporate Partners) Direct Allocation of Partner's Income to the Corporate Partners

Authority: IC 6-3-2-2; IC 6-3-2-2(l); IC 6-3-2-2(p); IC 6-3-2-2(q); Allied-Signal, Inc. v. Director, Div. Of Taxation, 112 S.Ct. 2251 (1992); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983); F.W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354 (1982); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980); 45 IAC 3.1-1-153(b); 45 IAC 3.1-1-153(c)

The taxpayer has protested the adjustment to its adjusted gross income tax base. The auditor determined there was no flow of goods and services between taxpayer and its corporate partners sufficient to provide evidence of a unitary business relationship. Taxpayer argues that a unitary relationship exists between the corporate partners since the primary function of each corporate partner is to hold an interest in their respective partnerships.

III. Abatement of 10 Percent Negligence Penalty)Reasonable Cause for Abatement

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

The taxpayer protests the assessment of the 10 percent negligence penalty believing that its determination of tax liability, however erroneous, was reasonable and that the Department should exercise its discretion to abate the consequent penalty.

STATEMENT OF FACTS

Taxpayer is a multi-media conglomerate consisting of numerous divisions, partnerships, and subsidiaries. The taxpayer provides entertainment, telecommunications, broadcasting, and publishing services. The taxpayer has business sites located within the state of Indiana.

DISCUSSION

I. Distributive Share of Corporate Partner

The taxpayer protests the Department's calculation of its gross income tax base. The taxpayer argues that distributive shares of partnership losses should have been included in the calculation of its gross income tax. The taxpayer maintains that under 45 IAC

1-1-159.1, a partner's distributive share includes the amount as determined under I.R.C. § 704. According to the taxpayer, the partners' distributive share under I.R.C. § 704 clearly includes a partnership's distributive share of income or loss.

The taxpayer is correct in its initial assertion. 45 IAC 1-1-159.1(a) defines the distributive share of a corporate partner as "the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations *before any modifications required by Indiana tax statutes*." (Emphasis added) The taxpayer is correct in its second assertion. I.R.C. § 704 does specifically make reference to a partner's distributive share as including "income, gain, loss, deduction with respect to property contributed to the partnership." I.R.C. § 704(c)(1)(A).

However, taxpayer errs in its ultimate conclusion because it ignores the supervening definition of "gross income" as set forth within the Department's regulations. 45 IAC 1-1-17 defines gross income as "the entire amount of gross income received by a taxpayer. This includes all income actually or constructively received...." The regulation continues by stating that "[a]mounts received or credited include not only cash and checks but notes or other property of any value or kind, services of any value or kind and receipts in any form received by or credited to the taxpayer in lieu of cash." Id. Accordingly, the state's gross income tax is applied to "the entire amount of gross income received by a taxpayer," and does not include a partnership's distributive share of *losses*. Although the statutes related to the state's gross income taxes contain certain specific exemptions and qualifications, they are inapplicable to the taxpayer.

FINDING

The taxpayer's protest is respectfully denied.

II. Allocation of Income From Corporate Partners

Audit determined that the taxpayer's corporate activities and the partnership's activities did not constitute a unitary business under established standards because there was no apparent flow of goods and services between taxpayer and its partnerships.

Taxpayer maintains that three of its corporate partners (hereinafter Partner 1, Partner 2, and Partner 3) are unitary with the taxpayer for the purpose of determining the taxpayer's Indiana adjusted gross income tax. Partner 1 and Partner 2 are described as holding companies, "special purpose corporation[s] formed for the primary function of holding a partnership interest." Partner 1 and Partner 2 were formed for the purpose of holding telecommunication assets in order to assure taxpayer's compliance with a court ordered divestiture.

Partner 3 is a direct marketer of consumer music products which are sold by mail order and the Internet. Partner 3 purchases and distributes certain music products produced by taxpayer's other subsidiaries. According to the taxpayer, "there is clearly a flow of goods between [Partner 3] and the [taxpayer's] corporate entities."

45 IAC 3.1-1-153(b) is relevant to taxpayer's assertion and provides that "[i]f the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors...." Alternatively, 45 IAC 3.1-1-153(c) sets out the means of attributing partnership income in those situations in which the corporate partner's activities and the partnership's activities do not demonstrate a unitary business relationship.

The issues of what constitutes a unitary relationship has been addressed by the Supreme Court. As defined by that Court, the hallmark of a unitary relationship is that there must be "some sharing of exchange or value not capable of precise identification or measurement-beyond the mere flow of funds arising out of passive investment or a distinct business operation-which renders formula apportionment a reasonable method of taxation." Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 166 (1983). In conducting a "unitary relationship" analysis, the Court will determine whether contributions to income of the subsidiary results from functional integration, centralization of management, and economies of scale. This means that the parties exhibit common ownership, common management, and common use or operation. Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425, 438-40 (1980); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 317 (1982); F.W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354, 365 (1982); Container Corp. 463 U.S. at 179 (1983); Allied-Signal, Inc. v. Director, Div. Of Taxation, 112 S.Ct. 2251, 2263-64 (1992).

Taxpayer asserts that Partner 1 and Partner 2 – taxpayer's two holding companies – are integral to taxpayer's operations and that "it is clear that there is a flow of goods and services" between Partner 1 and Partner 2. The Department is led to a differing conclusion. Other than taxpayer's bare assertion to the contrary, taxpayer has failed to provide substantive, specific evidence of a flow of goods or services between taxpayer and the two Partner holding companies which would "render formula apportionment a reasonable method of taxation." Container Corp. 463 U.S. at 166.

Taxpayer has offered certain evidence demonstrating a flow of goods between taxpayer's various divisions and Partner 3. As a distributor of recorded music, Partner 3 distributes products which are produced by various other taxpayer subsidiaries. Partner 3 distributes music products (CDs and cassette tapes) which are produced by three record labels owned by the taxpayer. Partner 3 distributes music products which are manufactured by one of taxpayer's subsidiaries. Partner 3 distributes CD packaging materials which are printed by one of the taxpayer's other subsidiaries. Accordingly, taxpayer has provided information demonstrating a certain – if unverified – flow through of goods and services between itself, taxpayer's various subsidiaries, and Partner 3.

However, taxpayer is required to demonstrate more than an incidental flow of goods and services between itself, its various subsidiaries, and Partner 3. In determining whether the taxpayer has demonstrated the requisite hallmarks of "functional integration, centralization of management and economies of scale," (Allied Signal 112 S.Ct. at 2264) the Court in Container Corp. 463 U.S. 159, stated that these hallmarks could be established by evidence of transactions not undertaken at arms length, 463 U.S. at 180, a management role by the parent which is grounded in its own operational expertise and operational strategy, Id., and the fact that the corporations are engaged in the same line of business. Id. at 178. Other than generalized assertions describing the relationship between itself and its numerous divisions and corporate partners, taxpayer has provided little upon which to base a determination that the hallmarks of a unitary relationship are present between itself and Partner 3.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of 10 Percent Negligence Penalty

Taxpayer has requested that the Department to exercise its discretionary authority to abate the ten-percent negligence penalty assessed pursuant to IC 6-8.1-10-2.1. According to the taxpayer, the additional tax due was based primarily on an audit adjustment made to include the distribute share of certain partnership income in the gross income tax base of the taxpayer's corporate partners. Taxpayer initially reported the distributive share of the partnership income in the gross income tax base of the corporate partners at the high rate but then erroneously subtracted the entire amount as nontaxable receipts in an attempt to exclude sales outside of Indiana. Taxpayer asserts that it made a good faith effort prepare its return and that "clearly there was no willful neglect of the pertinent laws and regulations."

Under IC 6-8.1-10-2.1(d), the Department is empowered to waive the ten-percent negligence penalty if the taxpayer can establish that its failure to pay the tax deficiency was due to reasonable cause and not due to willful neglect. Under 45 IAC 15-11-2(c), in order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying our failing to carry out a duty giving rise to the penalty imposed. Ignorance of the listed tax laws, rules, and/or regulations is treated as negligence.

Factors which may be considered to determine reasonable cause include the nature of the tax involved, judicial precedents set by Indiana courts, judicial precedents established by jurisdictions outside Indiana, published Department instructions, information bulletins, letters of findings, rulings, and letters of advice. 45 IAC 15-11-2(c).

Even assuming that taxpayer's failure to pay the appropriate amount of tax was entirely attributable to an innocent mistake, taxpayer is unable to establish a "reasonable cause" for that error. Taxpayer is a sophisticated and experienced business entity fully able to calculate – with a reasonable degree of precision – its state tax liabilities. Taxpayer can point to no precedents, instructions, bulletins, statutes, or regulations which justifies its failure to pay the full amount of its state tax.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04990204.LOF

LETTER OF FINDINGS NUMBER: 99-0204 ST
Sales and Use Tax
For Tax Periods: 1992 through 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 specific issues.

ISSUE

Sales and Use Tax)Imposition

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

Taxpayer protests the assessment of tax on its sales to Indiana customers.

STATEMENT OF FACTS

Taxpayer is a Kentucky retailer who sells to Indiana customers. Taxpayer protested an assessment of Indiana sales and use tax, interest and penalty. Further facts will be provided as necessary.

Sales and Use Tax)Imposition

DISCUSSION

Indiana imposes a sales tax "on retail transactions made in Indiana." IC 6-2.5-2-1(a). As the retail merchant, Taxpayer has an obligation to collect the sales tax and remit it to the state of Indiana. IC 6-2.5-2-1(b).

Taxpayer, a Kentucky retailer, sells waterbeds and spas to Indiana customers. Taxpayer contends that its sales to Indiana customers are not subject to the Indiana sales tax because title to the personal property transfers in Kentucky when the sale is consummated. Taxpayer alleges that another corporation then transports the property to Indiana and installs it for a separate delivery and installation fee.

Indiana Department of Revenue tax assessments are presumed to be correct. Taxpayers bear the burden of proving that any assessment is incorrect. IC 6-8.1-5-1(b). Although Taxpayer was given ample opportunity to submit evidence substantiating this contention, Taxpayer did not do so. Therefore, Taxpayer did not sustain its burden of proving that the tax assessment is incorrect.

Finding

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990245.LOF

LETTER OF FINDINGS NUMBER: 99-0245
Sales and Use Tax
For Tax Periods: 1995 through 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 specific issues.

ISSUES

1. Sales and Use Tax)Machinery

Authority: IC 6-2.5-3-2(a), Gross *Income Tax Division v. National Bank and Trust Co.,* 226 Ind. 298, 79 N.E. 2d 651**,** (1948), *Income Tax Division v. National Bank and Trust Co.,* 226 Ind. 298, 79 N.E. 2d 651, (1948), IC 6-2.5-5-3, 45 IAC 2.2-5-10(c).

The taxpayer protests the imposition of tax on certain items of machinery.

2. Sales and Use Tax)Inventory Tags

Authority: IC 6-2.5-5-3, 45 IAC 2.2-5-8(c)

The taxpayer protests the imposition of tax on inventory tags.

3. Sales and Use Tax)Safety Equipment

Authority: IC 6-2.5-5-3, 45 IAC 2.2-5-10(h)(1).

The taxpayer protests the imposition of tax on certain items of safety equipment.

4. Sales and Use Tax)Cleaning Supplies

Authority: 45 IAC 2.2-5-12(e).

The taxpayer protests the imposition of tax on certain cleaning supplies.

5. Sales and Use Tax)Paint

Authority: IC 6-2.5-5-5.1, 45 IAC 2.2-5-12.

The taxpayer protests the imposition of tax on paint.

6. Tax Administration)Negligence Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 2.2-5-10(h)(1).

The taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

The taxpayer is a steel tube manufacturer. The taxpayer's process is akin to that of a "job shop" in that production is driven by custom orders for specific shapes and lengths of steel tubing. After an audit, the taxpayer was assessed additional sales and use tax. Taxpayer timely protested the assessment. Further facts will be provided as necessary.

1. Sales and Use Tax)Machinery

DISCUSSION

Pursuant to IC 6-2.5-3-2(a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.* 226 Ind. 298, 79 N.E. 2d 651(1948). IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication... of tangible personal property." In *Indiana Department of Revenue v. Cave Stone,* Ind. 457 N.E. 2d 520 (1983)*,* the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as qualifying for the directly used in direct production exemption if the machinery and tools have an immediate effect on the property in production.

The taxpayer's first point of protest concerns the imposition of use tax on an uncoiler and flooper. The raw material steel arrives at the taxpayer's plant in the form of a coiled spool of steel. The uncoiler unrolls the steel from the spool. Then the flooper transfers the steel to machines which form and cut the steel to meet the customers' specifications. The taxpayer contends that both of these items qualify for the directly used in direct production exemption. The production process includes the forming, cutting and welding of the steel. The uncoiler and the flooper are used prior to the beginning of the actual production process and thus do not qualify for exemption.

The taxpayer also protests the assessment of use tax on overhead cranes which are used to replace dies and molds. The cranes do not have a direct effect on the steel which the taxpayer processes into custom steel tubing. Rather, the cranes actually move the dies and molds which process the steel tubing. As such, the cranes do not have an immediate effect upon the steel tubing. The cranes are used outside the direct production process and do not qualify for exemption from the use tax.

FINDING

The taxpayer's protest to the assessments on the uncoiler, flooper and cranes is denied.

2. Sales and Use Tax)Inventory Tags

DISCUSSION

The taxpayer also protests the assessment of use tax on inventory tags. The inventory tags display the customer's name or number, the gauge or thickness of the tubing and other pertinent manufacturing information. The taxpayer tracks inventory on their computer system by bundle and location within the plant. Typically, the tags are stapled to skids holding the tubing, taped to the boxes that hold the tubing or placed inside one of the tubes in a bundle with the finished tubes. The finished tubes, including the tags, are then shipped to the customer. A skid or box may contain as few as five pieces of tubing or as many as several hundred pieces of tubing; thus, the tags are used as the skid or box identifier. The inventory tags remain on the bundles of tubing when they are shipped to customers.

The taxpayer contends that these inventory tags qualify for exemption pursuant to IC 6-2.5-5-6, because the inventory tags are incorporated "as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business." This statutory exemption is further clarified at 45 IAC 2.2-5-14(c) as follows:

> (c) This regulation does not exempt from tax tangible personal property to be used in production, such as supplies, parts, fuel, machinery, etc., refer to Regs. 6-2.5-5-5(010) and 6-2.5-5-(020) (dealing with material consumed in direct production) for the application of those regulations to taxpayers engaged in the production of tangible personal property.

Inventory control is an administrative rather than a production process. The inventory tags are merely stapled or taped to the boxes and skids holding the tubing or placed inside the tubing. The inventory tags do not become a material part of the steel tubes as required by the law to qualify for exemption. Further, the inventory tags are primarily used by the taxpayer during the production process for identification of the product and inventory control. The tags are supplies which are used during the production process in an administrative capacity. The cited Regulation clearly does not exempt supplies used during the production process. Therefore, the inventory tags do not qualify for exemption from the use tax.

FINDING

The taxpayer's protest to the assessment of use tax on the inventory tags is denied.

3. Sales and Use Tax)Safety Equipment

DISCUSSION

The taxpayer also protests the assessment of use tax on certain items of safety equipment. Safety equipment qualifies for the directly used in direct production exemption found at IC 6-2.5-5-3 if it meets the standard set at 45 IAC 2.2-5-8(c)(2) as follows:

> (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.
>
> (F) Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

The taxpayer specifically protests the assessment of use tax on hard hats, gloves and coveralls. The taxpayer's production process includes welding metals and cutting steel. These processes can endanger the health and safety of the taxpayer's employees. Therefore the taxpayer provides its employees with hard hats and heavy cotton gloves to protect them during the production process. These items meet the standard of the regulation. The hard hats and heavy cotton gloves qualify for exemption. The taxpayer has not upheld its burden of proof that the coveralls are actually used to protect its employees during the production process. Rather, the coveralls appear to be supplied as a convenience for the taxpayer's employees. Therefore the coveralls do not qualify for exemption from the use tax.

FINDING

The taxpayer's protest to the assessment of tax on safety items is sustained in part and denied in part.

4. Sales and Use Tax)Cleaning Supplies

DISCUSSION

Tax was imposed on the taxpayer's purchase and use of cleaning supplies during the audit period. The taxpayer contends that

twenty percent (20%) of the cleaning supplies qualify for exemption because they were used to clean manufacturing machinery. 45 IAC 2.2-5-12(e) provides exemption for items "having an immediate effect upon the article being produced." In this case, the cleaning supplies used to clean the manufacturing machinery have a direct effect upon the machinery. The cleaning supplies do not have an immediate effect on the steel tubes which the taxpayer manufactures. Therefore, none of the cleaning supplies qualify for exemption from the use tax.

FINDING

The taxpayer's protest to the imposition of use tax on the cleaning supplies is denied.

5. Sales and Use Tax)Paint

DISCUSSION

The taxpayer contends that the paint, which it sprays on the steel tubing for inventory control, qualifies for exemption because it is consumed in the production process pursuant to IC 6-2.5-5-5.1. That statute is further explained at 45 IAC 2.2-5-12 which states as follows:

(f) Other taxable transactions. Purchases of materials consumed in manufacturing, processing, refining, or mining activities beyond the scope of those described in subsection B above are taxable. Such activities include... management and administration;...

Inventory control is clearly a management and administrative function rather than a production function. Therefore, the taxpayer's use of the paint does not qualify for exemption from the use tax.

FINDING

The taxpayer's protest to the imposition of tax on the paint is denied.

6. Tax Administration)Negligence Penalty

DISCUSSION

Taxpayer's final point of protest concerns the imposition of the ten percent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) states,

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

The taxpayer, under different ownership, has been audited on similar issues in the past and continued to fail to accrue use tax on all the taxable items. Many of these items were clearly taxable such as office supplies, soft drinks and snow shovels. The taxpayer's failure to set up an accurate tax accrual system constitutes negligence.

FINDING

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

DEPARTMENT OF STATE REVENUE

04990289P.LOF

LETTER OF FINDINGS NUMBER: 99-0289P
Sales and Use Tax
Calendar Years 1995, 1996, and 1997

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

ISSUE(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 manufactures, sells, and installs automated teller machine housings. At audit, it was determined that the taxpayer did not have a use tax accrual system in place and failed to pay tax on fixed assets and miscellaneous expense items. Taxpayer also failed to collect and remit tax on sales to banks where no sales tax exemption certificate was on file.

Taxpayer failed to remit use tax on clearly taxable purchases.

I. Tax Administration–Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to remit use tax on clearly taxable purchases, had no use tax accrual system in place, and failed to collect and remit tax on taxable sales.

Taxpayer previously protested tax assessed for sales to banks that had paid use tax plus delivery and installation charges. A supplemental audit removed those assessments totaling $3,343.37 in tax to which the taxpayer agrees. Taxpayer protests only the penalty and has submitted the following arguments.

1) In the time immediately prior to the audit periods, the taxpayer suffered a substantial fire loss, disrupting business operations. In this same time frame, it incurred unusual turnover in the controllership position.

2) With the resulting turmoil and employee turnover, use tax tracking and reporting were not properly handled. Procedures to properly record and pay this tax were instituted as soon as the company became aware of the problem.

3) On the sales tax side, a portion of the assessment involved installation and delivery charges. The company believed that such charges were not subject to the sales tax. Again, as soon as the problem was recognized, procedures were put in place to properly bill and remit these taxes.

4) The company fully cooperated in the audit and immediately instituted new procedures for future compliance.

5) At hearing, taxpayer also states that use tax was not assessed in fixed assets because it was rental equipment it believed was not subject to tax.

A review of the audit indicates the taxpayer remitted no use tax and had no use tax accrual system in place, therefore, the penalty applies.

Regarding the sales tax, audit has already eliminated the installation and delivery charges that would reduce the penalty on that portion of the audit.

Taxpayer had a prior audit completed on October 11, 1994 that had the same issues as the current audit. No corrections were made; therefore, the negligence penalty applies to both the sales and use tax issues.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02990352.LOF

LETTER OF FINDINGS NUMBER: 99-0352
Indiana Adjusted Gross Income Tax
For Tax Years 1995, 1996, and 1997

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

ISSUE

I. Apportionment of Out-of-State Taxpayer's Indiana Source Franchise Fee Income

Authority: IC 6-3-1-1 et seq.; IC 6-3-2-2(a)(5); IC 6-3-2-2(f)(2); IC 6-3-2-2.2; Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. 425 (1980); Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992); Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264 (Ind. 1994); 45 IAC 3.1-1-38; 45 IAC 3.1-1-38(7); 45 IAC 3.1-1-55.

Out-of-state taxpayer protests the determination that franchise fee income, derived from Indiana based franchisees, should be included in the numerator of the sales factor for the purpose of determining taxpayer's Indiana adjusted gross income tax liability.

STATEMENT OF FACTS

Taxpayer is restaurant franchisor incorporated in Delaware with its headquarters in another state. Taxpayer owns the right to market and license local franchises, a trade name registered with the United States Patent Office, and various associated product trademarks. Within its assigned territory, the use of the trade name and related trademarks is under taxpayer's exclusive control and supervision. Taxpayer enters into agreements with Indiana licensees to use taxpayer's operating system, the associated trade name, and trademarks. In turn, the Indiana franchisees pay taxpayer a percentage of their gross income for their license privileges. What the individual Indiana franchisees receive in return for the payment of the franchise fees is the right to locally exploit taxpayer's trade name, trademarks, and national reputation. The Indiana franchisees also receive the benefit of certain services which are performed at taxpayer's headquarters. These headquarters-based services include new product research and development and the creation of company-wide advertising materials. The audit characterized these headquarters-based services as "minute." Audit Summary, p. 5.

Taxpayer also collects other charges from the Indiana franchisees which are unrelated to the franchise fees at issue. These

separately billed charges include construction fees, new building plan fees, engineering fees, franchise transfer fees, training fees, national advertising fees, and fees for the costs associated with taxpayer provided training materials, local advertising, and local promotional materials.

To oversee the operation of its Indiana franchisees, taxpayer maintains a regional office located in Indiana. The Indiana regional office serves as a headquarters for its field consultants who visit each Indiana franchisee for a semi-annual inspection. The field consultants are responsible for insuring that each of the Indiana franchisees maintains the standards established by taxpayer and to answer local franchisees' requests for advisory services. The Indiana franchisees are independently responsible for their own building, equipment, maintenance, personnel recruitment, inventory, and all other normal operations associated with an independent business.

The audit determined that these franchisee fees should be included in the numerator of the sales factor for the purpose of determining taxpayer's adjusted gross income tax.

DISCUSSION

I. Apportionment of Out-of-State Taxpayer's Indiana Source Franchise Fee Income.

The audit determined that taxpayer's franchisee fee income was earned from the use of taxpayer's intangible trademark. According to audit, the trademark was a valuable commodity providing taxpayer with its principal source of income. The audit decided that taxpayer's franchisee fees could not be characterized as "service income" because the franchise fees were not received for services performed by the taxpayer. Audit distinguished franchise income received as a result of the parties' franchise agreement and that income unrelated to the agreement itself. In making that distinction, audit determined that services provided to Indiana franchisees derivative of the franchise agreement, were unrelated to those services – advertising, promotional materials, training materials – received when the local franchisee paid one of the separate service charges. Having made the distinction, audit determined that the cost of providing those services derivative of the franchise agreement itself, was less than five percent of the taxpayer's franchise fee income.

Because audit decided that the franchise fee income was actually income earned for the use of an intangible – the taxpayer's trade name, trademarks, and associated good will and reputation – the audit concluded that, under the provisions 45 IAC 3.1-1-55, the taxpayer's trademark had acquired a "business situs" in the state of Indiana and the income derived from the exploitation of that trademark was subject to apportionment under the state's adjusted gross income tax scheme.

Taxpayer argues that the franchise fees should not be apportioned to Indiana. The taxpayer maintains that the sale of its intangible – the licensing of its trademark to its Indiana franchisees – may not be taxed under IC 6-3-2-2(f)(2) because the greater proportion of the cost of the activities which produce the franchise fee income were not incurred in Indiana.

Additionally, taxpayer challenges the determination that the franchise intangible had acquired a business situs in Indiana under 45 IAC 3.1-1-55. Taxpayer argues that the concept of "business situs," as described within 45 IAC 3.1-1-55, does not reflect current Indiana law. That administrative provision, as far as relevant, states that;

> Income producing activity is deemed performed at the situs of real, tangible and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e. the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which the intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property.

Taxpayer maintains that it would be impossible for its franchise intangible to acquire an Indiana business situs because the franchise intangible is not a divisible asset. Therefore, the "situs" of the franchise intangible can only be found at taxpayer's headquarters.

In summary, taxpayer's position is that the income from its franchise intangible cannot be attributed to Indiana because the intangible is not employed as capital in Indiana and has not acquired an Indiana business situs. Further, according to taxpayer, whether or not the franchise intangible has a situs in Indiana is finally irrelevant because taxpayer does not perform a greater proportion of its income producing activity in Indiana such that the receipts of that intangible may not be attributed to Indiana.

Indiana imposes an adjusted gross income tax on income derived from sources within this state. The adjusted gross income tax, IC 6-3-1-1 et seq., is an apportioned tax specifically designed to reach income derived from interstate transactions. Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264, 266 n. 4 (Ind. 1994). The legislature has defined "adjusted gross income" as "(1) income from real and tangible or tangible personal property located in this state; (2) income from doing business in this state; (3) income from a trade or profession within this state; (4) compensation for labor or services within this state; and (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter...." IC 6-3-2-2(a). IC 6-3-2-2(a)(5) includes an internal reference to IC 6-3-2-2.2. IC 6-3-2-2.2 is limited in its effect acting only to describe the manner in which interest and dividend income are attributed to the state.

The transactions here at issue – the receipt of franchisee fees from taxpayer's Indiana franchisees – are inextricably related to taxpayer's activities within the state. The receipt of the franchisee fees is an amount determined by and directly related to the sales generated by Indiana franchisees. Those sales are attributable to taxpayer's purposeful Indiana activities. It cannot be said that the

transactions occur entirely within the headquarter's State because, absent the Indiana "connection" and the taxpayer's Indiana activity, the franchise agreements become abstract paper agreements of no value to the taxpayer and of no interest to the Indiana taxing authorities. In addition, the substantial portion of the activities performed in exchange for the franchise fees take place in Indiana. Those headquarter-based activities, performed in exchange for the franchise fee, are limited to new product development and the production of certain advertising materials.

Taxpayer has established a physical Indiana presence by virtue of its decision to maintain an Indiana regional office, direct its field consultants to make periodic inspections of the Indiana franchisees, and to make its field consultants available when Indiana franchisee request advisory services. The taxpayer's physical presence within the state – evidenced by its regional office and activities of its Indiana based representatives – helps to demonstrate that the income derived from taxpayer's Indiana franchise agreements originates in and is attributable to Indiana income producing activities. Taxpayer's Indiana activities exceed the minimum standard, set out in 45 IAC 3.1-1-38 (adopting P.L. 86-272) by which an out-of-state taxpayer is found to have established a nexus within the foreign state. 45 IAC 3.1-1-38 states that "[f]or apportionment purposes, a taxpayer is 'doing business' in a state if it operates a business enterprise or activity in such state including, but not limited to... (4) Rendering services to customers in the state... (7) Any other act in such state which exceeds there mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income." Taxpayer's rendering of services to its Indiana franchisees exceeds the "mere solicitation standard" established in 45 IAC 3.1-1-38(7) and as defined by the Supreme Court in Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992).

Taxpayer places undue reliance on a mechanistic interpretation of the "business situs" restriction. The Supreme Court in Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. 425 (1980) stated that "[a]lthough a fictionalized situs of intangible property sometimes has been invoked to avoid multiple taxation for ownership, there is nothing talismanic about the concepts of 'business situs' or 'commercial domicile' that automatically renders those concepts applicable when taxation of income from intangibles is at issue." Id. at 444. The Court has also stated that "the reason for a single place of taxation no longer obtains when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction."

Taxpayer argues that 45 IAC 3.1-1-55 – under which the audit determined that taxpayer's intangible franchise agreements had acquired an Indiana business situs – is inapplicable because the regulation interprets a prior and different version of the relevant apportionment statute (IC 6-3-2-2(a)(5)). When 45 IAC 3.1-1-55 was promulgated, the regulation interpreted an earlier version of IC 6-3-2-2(a)(5) which stated that adjusted gross income included "income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property having a situs in this state." Taxpayer correctly notes that the statute has been amended. Currently IC 6-3-2-2(a)(5) states that "income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property *if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.*" (Emphasis added). Taxpayer contends that the elimination of the "situs" language is significant and that the referenced statute, IC 6-3-2-2.2, currently makes no reference to "situs." Taxpayer misapprehends the significance of the amended language. The referenced statute, IC 6-3-2-2.2, only affects the attribution of interest and dividend income and does not touch upon or affect the other income sources – including trademarks and franchises – previously and currently listed within IC 6-3-2-2(a)(5). Because the legislature made no change in the language regarding the tax treatment of franchise and trademark income when it amended IC 6-3-2-2(a)(5), there is no reason to presume that Departmental regulation 45 IAC 3.1-1-55 was in any way affected. There is no reason to presume that 45 IAC 3.1-1-55, and its reference to the business situs of intangible property, does not continue to apply with full force to Indiana taxpayers.

Taxpayer argues that its intangible asset – its brand name, associated reputation, and good name–is an indivisible asset incapable of acquiring an Indiana business situs under 45 IAC 3.1-1-55. Taxpayer's argument is counterintuitive. The very nature of taxpayer's intangible asset is its ability to be parceled out to various locations and exploited at those various locations. If, as taxpayer maintains, the intangible asset had only a headquarter's state location, the value of the intangible to both taxpayer and the Indiana franchisees would be negligible. What taxpayer sells, and what the Indiana franchisees purchase, is the right to vigorously exploit the intangible asset within the state of Indiana. Taxpayer's Indiana source income results from the utilization of the intangible within the state of Indiana made possible by the taxpayer's decision to establish a physical presence within the state of Indiana. Taxpayer's income is not derived from entering into theoretical paper franchise agreements created, performed, and executed entirely within headquarter's state. Taxpayer's income derives from and is directly linked its decision to purposefully avail itself of an Indiana business opportunity, a decision to recruit and license Indiana franchisees, and the decision by Indiana citizens to patronize those Indiana franchisees. Taxpayer's ability to derive income from its Indiana activities is made possible by the protections, benefits, and opportunities provided by the state of Indiana. Indiana has made it possible for taxpayer to enter into this state and to obtain income from its franchise agreements. Indiana, in turn, is entitled to tax that portion of taxpayer's income attributable to this state.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04990501.LOF

LETTER OF FINDINGS NUMBER: 99-0501
Use Tax
For Tax Years 1996 through 1998

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

ISSUES

I. Use Tax—Steel Floor Grates

Authority: 45 IAC 2.2-5-8

Taxpayer protests imposition of use tax on steel floor grating.

II. Use Tax—Boiler Vacuum

Authority: 45 IAC 2.2-5-8

Taxpayer protests imposition of use tax on a boiler vacuum.

III. Use Tax—Steel Drain Covers

Authority: 45 IAC 2.2-5-8

Taxpayer protests imposition of use tax on steel grate drain covers.

IV. Use Tax—Front Loader Tractor

Authority: IC 6-2.5-5-4; 45 IAC 2.2-5-8

Taxpayer protests imposition of use tax on a front loader tractor.

STATEMENT OF FACTS

Taxpayer is engaged in the production of flowers. Taxpayer forces the flowers to grow out of season via artificial temperature and humidity control. As a result of an audit for the tax years in question, the Department issued proposed assessments on several items. Taxpayer protests four of the items assessed use tax. Further facts will be provided as necessary.

I. Use Tax—Steel Floor Grates

DISCUSSION

Taxpayer uses steam tubes in a trench (steam pit) to regulate heat and humidity in its greenhouse. Taxpayer purchased steel grates to replace the all-wood cover over the trench to allow a forklift to run over the trench without breaking the steam tubes or the wood trench cover. The grates are covered with plywood sheets in order to regulate the release of heat and to facilitate the passage of workers and a forklift over the steam pipes. The Department assessed use tax on the grating. Taxpayer protests that the grating is necessary since it is directly used to produce its flowers. 45 IAC 2.2-5-8(c) states:

> 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.

Taxpayer believes that the grates qualify for this exemption. Taxpayer explained that the flowers must have a specific temperature in order to mature properly. 45 IAC 2.2-5-8(g) states, in part:

> "Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integrated part of an integrated process which produces tangible personal property.

Here, the grates allow the forklift and workers to travel over the steam pit without breaking the plywood covers. The grates serve as protection for the steam pipes, which is a practical necessity. The steam pipes provide the heat and humidity control necessary to keep the greenhouse at the proper temperature and humidity levels. The grates do not provide that control, however, and are therefore not an integral part of an integrated process which produces tangible personal property.

FINDING

Taxpayer's protest is denied.

II. Use Tax—Boiler Vacuum

DISCUSSION

Taxpayer protests imposition of use tax on a vacuum system used to clean tubes in a coal-fired boiler. Taxpayer explains that

the boiler burns coal to produce steam which is used to heat the greenhouse where the flowers mature. The boiler requires frequent cleaning in order to operate efficiently. Taxpayer explains that if the boiler was not cleaned at least once a week, it would cease functioning completely.

The relevant regulation is 45 IAC 2.2-5-8(h)(1), which states:

Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

The cleaning of the boiler tubes is maintenance and therefore 45 IAC 2.2-5-8(h)(1) establishes that the vacuum system is taxable.

FINDING

Taxpayer's protest is denied.

III. Use Tax—Steel Drain Covers

Taxpayer protests imposition of use tax on steel drain covers it purchased. Taxpayer explains that it switched from hand loading of the flowers in the various growing phases to using a forklift. The forklift broke through the original cast iron drain covers and taxpayer had to use steel covers to accommodate the forklift.

The Department refers to 45 IAC 2.2-5-8(c)(4), which offers examples of equipment that is not exempt:

(F) Ceiling lights for general illumination in the plant area.

Here, the drains are for general drainage, which is similar to the example of ceiling lights used for general illumination listed in 45 IAC 2.2-5-8(c)(4)(F). The drains, and therefore drain covers, do not have an immediate effect on the tangible personal property being produced. The drain covers are taxable.

FINDING

Taxpayer's protest is denied.

IV. Use Tax—Front Loader Tractor

Taxpayer protests the imposition of use tax on the purchase of a front loader tractor. Taxpayer uses the tractor to dig up soil from its fields to plant the flowers in, and also to treat the soil for various diseases found in it which are harmful to the flowers taxpayer grows. Taxpayer believes that these functions are essential parts of the production process, and should therefore be tax exempt.

The Department refers to 45 IAC 2.2-5-8(d), which explains in part:

Pre-production and post-production activities. "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.

Taxpayer explains that all growers of this type of flower use the same method and that taxpayer does not know of any other way to move the soil. 45 IAC 2.2-5-8(g) states, in part:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced". Instead, in addition to being essential for one of the above reasons, the property must also be an integrated part of an integrated process which produces tangible personal property.

The tangible personal property in question here is flowers. The tractor is used to move and treat the soil in which the flowers grow. The moving of the growing medium (soil) is not exempt, as described in 45 IAC 2.2-5-8(g).

However, the tractor also is used to perform the separate function of treating the soil for disease prior to use in the production of flowers. IC 6-2.5-5-4 explains:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described in section 2 or 3 of this chapter.

Treating the soil for disease is direct use in the direct production of the growing medium used in the production of the flowers, and is therefore exempt as described in IC 6-2.5-5-4.

The fact that these activities are required by practical necessity does not automatically mean that the tractor used to perform them is exempt, as provided by 45 IAC 2.2-5-8(g). The function of moving the soil occurs prior to the production of the flowers, and is properly taxable under 45 IAC 2.2-5-8(d). The function of producing the growing medium (the disease-free soil) is exempt under IC 6-2.5-5-4. Therefore, the tractor is properly subject to use tax to the extent it is used to move soil, and exempt to the extent it is used to treat soil for disease.

FINDING

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

DEPARTMENT OF STATE REVENUE

0420000056.LOF
0420000057.LOF

LETTER OF FINDINGS NUMBER: 00-0056 and 00-0057
State Gross Retail Tax
For the Tax Years 1994 through 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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Assessment of Sales Tax on Equipment Leased by Parent Corporation from Taxpayer Subsidiary Corporations

Authority: Bethlehem Steel Corp. v. Ind. Dept. of State Revenue, 597 N.E.2d 1327 (Ind. Tax Ct. 1992); 45 IAC 1.1-2-10; 45 IAC 2.2-4-27.

Taxpayers protest the imposition of the state's gross retail (sales tax) on the transfer of construction equipment from taxpayers (two subsidiary corporations) to the parent corporation. Taxpayers maintain that the sales tax was paid at the time the equipment was purchased by subsidiary corporations from independent third parties and that no additional sales tax liability accrued at the time of the transfer of the equipment from the subsidiaries to the parent company.

STATEMENT OF FACTS

Taxpayers are two companies which purchase and then rent construction equipment. During the tax years at issue, taxpayers purchased certain construction equipment and then transferred the equipment to the parent company. The equipment was used exclusively by the parent corporation.

Neither taxpayer had any dealings with other equipment lessees or with the general public. Purportedly, all incidents of ownership were borne by parent company with the taxpayers consisting of "nothing more than a checkbook." According to taxpayers, their function, as subsidiary companies, was to "provide protection for leased equipment against creditors in the event that [parent company] encountered financial difficulties."

Majority shareholder owned 100% of parent company. Majority shareholder and his wife owned 100% of taxpayer subsidiary one. Majority shareholder and employee owned 100% of taxpayer subsidiary two. Both taxpayers originally paid sales tax on the initial purchase of the equipment.

DISCUSSION

I. Assessment of Sales Tax on Equipment Leased by Parent Corporation from Taxpayer Subsidiary Corporations

The audit assessed both taxpayers for failure to collect sales tax on the rental of tangible personal property. The assessment was made under the authority of 45 IAC 2.2-4-27 which states in relevant part that "the gross receipts from renting or leasing tangible personal property are taxable." 45 IAC 2.2-4-27(a). The regulation further states that "[e]very person engaged in the business of the rental or leasing of tangible personal property, other than a public utility, shall be deemed to be a retail merchant in respect thereto and such rental or leasing transaction shall constitute a retail transaction subject to the state gross retail tax on the amount of the actual receipts from such rental or leasing." 45 IAC 2.2-4-27(b).

The audit determined that the two taxpayers and the parent company were each separate legal entities and that the substance of the equipment transactions indicated that the transactions were leases subject to the gross retail tax under 45 IAC 2.2-4-27. According to the audit, the essence of the equipment transactions was that parent company was the lessee, taxpayers as the subsidiary companies were lessors, and that the transactions between them were equipment leases subject to the sales tax.

Taxpayers counter with two distinct arguments. In the first argument, taxpayers state that the two subsidiary companies were "pass through" entities for all tax purposes. Taxpayers maintain that the purchase and subsequent transfer of the equipment to parent company were transparent, pass-through transactions, and that they correctly paid sales tax on the transfer value of the equipment at the time the equipment was initially purchased. According to the taxpayers, all incidents of ownership remained with parent company, that the two taxpayers consisted of "nothing more than a checkbook," that majority shareholder was the sole decision maker for all three entities, and that assessing sales taxes on the otherwise transparent equipment transfers would be inequitable.

In its second argument, taxpayers argue that the transactions between themselves and parent company were not leases but financing agreements. In effect, the taxpayers were selling the equipment to parent company and entering into agreements to finance the equipment's purchase. According to taxpayer, because the transactions were not leases but financing arrangements, parent company was "buying" the equipment and the tax was due at the beginning of the transactions.

Taxpayer's first argument is that the equipment leases were pass-through transactions between closely held entities to which no sales tax liability could equitably adhere. The formal lease agreement submitted by taxpayers establishes with some precision the parties' relationships, responsibilities, liabilities, and duties. Taxpayers have indicated that its lease form is identical for all

transactions except for the amount of the lease payment. The lease agreement identifies the equipment to be leased, the amount of each lease payment, the term of the lease, and the taxpayers' available remedies in the event that the parent company should default on the agreement. The agreement specifies that parent company will maintain the equipment, pay all licensing fees, insure the equipment, and bear any and all risk of the equipment's loss, theft, or destruction. Parent company is permitted to use the equipment in its "normal and ordinary business activities" but that use is restricted to a four-state area. Taxpayers retain the right to assign their ownership interest in the equipment to a third-party. At the taxpayers' option, the taxpayers may require parent company to fasten labels on the equipment indicating that the equipment is owned by the taxpayers. Taxpayers requests that the Department look past the language of its densely written lease agreements and look to the "reality and substance" of its transactions.

Taxpayers are correct in their assertion that in determining tax consequences, the Department is required to look at "the substance rather than the form of the transaction." Bethlehem Steel Corp. v. Ind. Dept. of State Revenue, 597 N.E.2d 1327, 1331 (Ind. Tax Ct. 1992). However, in asking the Department to ignore the realities of the parties' relationship and the nature of the transactions conducted between those parties, taxpayers ask too much from the Department. The three entities – taxpayers and parent company – were established with and continue to maintain separate legal identities. Although the three entities share a certain measurable degree of common ownership, that common ownership is not perfect because separate persons share in the ownership of each of the two subsidiary taxpayers. Taxpayers' assertion, that the parent company retains all indicia of the equipment's ownership, is erroneous. The parties' lease agreement clearly states that "[t]he Equipment shall at all times be the sole and exclusive property of [taxpayers], and... [parent company] shall have no right, title, or interest in or to the Equipment...." Taxpayers may have been formed for the exclusive purpose of protecting the interests of parent company. However, having taken on the protections and advantages of the corporate structure, entered into transactions which meticulously distinguish and limit the parties' relationships, liabilities, and duties, taxpayers may not then avoid the consequences of their business relationships and transactions.

Taxpayer's secondary argument is that the lease transactions are capital leases. If, as taxpayers maintain, the equipment transactions were capital leases, a financing arrangement and not a lease is created and the sales tax is due on the purchase price at the beginning of the transaction.

45 IAC 1.1-2-10 establishes a standard for determining if a lease agreement "is a financing device for a sale of tangible personal property...." Under that regulation, "The department will consider many factors in determining the intent of the parties, including the following:

(1) Whether the lease payments are to be applied to any equity to be acquired by the lessee.

(2) Whether the lessee will acquire title to the goods upon the lessor's receipt of a stated amount of payments under the contract.

(3) Whether the total lease payments for a relatively short period of use make up an inordinately large proportion of the total payments needed for the lessee to secure title.

(4) Whether the lease payments exceed the current fair rental value of like goods.

(5) Whether the lease contains an option to buy at a price nominal in comparison to the value of the property when the option may be exercised.

(6) Whether a part of the lease payments is designated or recognizable as interest or its equivalent. Id.

The audit determined that the equipment transactions between taxpayers and parent company were operating leases. As evidence of this, the audit determined that both taxpayers included a rent and royalty schedule on their federal tax return and that both taxpayers claimed a depreciation allowance for the equipment.

Taxpayer's lease agreements include a provision by which parent company may exercise an option to purchase the leased equipment during the term of the lease. Paragraph 14 of the lease agreement provides that "[parent company] shall have the option during the term of this lease and for a period of thirty (30) days thereafter to purchase all or any portion of the equipment described in schedule A...." Under the option to purchase paragraph, the purchase price for the equipment was "established by Schedule A to this Lease." "By attaching a copy of the invoice of the original purchase price the parties were establishing the value of the equipment referred to in the second sentence of paragraph #17." Therefore, parent company could purchase the equipment at any time during the term of lease – or within 30 days after the conclusion of the lease – for what taxpayers originally paid for the equipment.

If parent company decided to exercise its option to purchase the equipment, parent company was entitled to a credit for the total value of the lease payments which parent company had previously paid to the taxpayers. The lease states that the value of the equipment "shall be reduced by a portion of the rental paid in respect of the purchased Equipment under this lease." That portion of the rental credited to the equipment lease "shall be equal to the total amount of rental payments made under this Lease...." The option to purchase paragraph includes a formula for apportioning accrued rental payments when the particular lease covers more than one item of equipment and parent company decides to purchase only one of those items of equipment.

In the sample lease provided by taxpayers, the initial purchase for the equipment was $111,085, the lease payments were $5,100, and the lease ran for 60 months. If parent company simply made lease payments for the entire term of the lease, it would have paid taxpayers $306,000. Under the terms of the sample lease, at the end of 22 months, parent company would have paid

$112,200 and would have been entitled to unilaterally exercise its option to purchase the equipment at no additional cost.

A comparison of the taxpayers' lease agreements with the standards set out in 45 IAC 1.1-2-10 leads to the conclusion that taxpayers' lease agreements are simply financing devices for the sale of construction equipment to parent company. Taxpayers' lease agreements provide a means by which the lease payments are effectively applied to the equity acquired by the parent company. 45 IAC 1.1-2-10(c)(1). The lease agreements provides a means by the "[parent company] will acquire title to the goods upon the [taxpayers'] receipt of a stated number of payments under the contract." 45 IAC 1.1-2-10(c)(2) "[T]he total lease payments for a relatively short period of use make up an inordinately large proportion of the total payments needed for the [parent company] to secure title." 45 IAC 1.1-2-10(c)(3) Under the terms of the parties' lease agreements, "the lease payments exceed the current fair rental value of the goods." 45 IAC 1.1-2-10(c)(4) In addition, the parties' "lease contains an option to buy at a price nominal in comparison to the value of the property when the option may be exercised." 45 IAC 1.1-2-10(c)(5). In effect, the taxpayers' lease agreements constitute a contractual means by which the parent company is able to purchase construction equipment – at the conclusion of a specified period of time for a specified number of payments – at no additional cost to itself.

Setting aside the issue of which of the parties is entitled to take the depreciation allowance for the construction equipment, it is apparent that taxpayers are not in the business of leasing construction equipment. Taxpayers are in the business of entering into financing arrangements which allow the parent company to purchase construction equipment. Accordingly, taxpayers are obligated to collect sales tax at the inception of the lease transactions.

FINDING

Taxpayers' protest is sustained.

DEPARTMENT OF STATE REVENUE

1820000059.LOF

LETTER OF FINDINGS NUMBER: 00-0059
Financial Institutions Tax
For Tax Periods 1995-1997

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

ISSUES

I. Financial Institutions Tax—Resident Taxpayer Credit

Authority: Mechanic Laundry & Supply, Inc. v. Indiana Department of State Revenue, 650 N.E.2d 1223 (Ind.Tax 1991); IC 6-5.5-2-4; IC 6-5.5-2-5; IC 6-5.5-2-5.3

Taxpayer protests the denial of Resident Taxpayer Credit for member banks included in Illinois unitary return.

II. State Tax Liability Credits—Enterprise Zone Loan Interest Tax Credit

Authority: IC 6-3.1-7-1; IC 6-3.1-7-2; Information Bulletin # 66

Taxpayer protests the denial of credit for income from interest on loans to Enterprise Zone businesses.

STATEMENT OF FACTS

Taxpayer, a bank holding company with bank subsidiaries operating in Indiana and two other states, files a combined Financial Institutions Tax return in Indiana with its subsidiaries. The Department of Revenue ("Department") conducted an audit for the years in question. As a result of this audit, the Department issued proposed assessments for 1996 and 1997, and reduced a refund for 1995. Taxpayer protests two issues. Further facts will be supplied as needed.

I. Financial Institutions Tax—Resident Taxpayer Credit

DISCUSSION

Taxpayer protests the Department's denial of credit taxpayer claimed against a Financial Institutional Franchise Tax for tax paid on a unitary income return filed in Illinois. IC 6-5.5-2-4 states:

For a taxpayer filing a combined return for its unitary group, the group's apportioned income for a taxable year consists of:

(1) the aggregate adjusted gross income, from whatever source derived, of the resident taxpayer members of the unitary group and the nonresident members of the unitary group; multiplied by

(2) the quotient of:

(A) all the receipts of the resident taxpayer members of the unitary group from whatever source derived plus the receipts of the nonresident taxpayer members of the unitary group that are attributable to transacting business in Indiana; divided by

(B) the receipts of all the members of the unitary group from transacting business in all taxing jurisdictions.

IC 6-5.5-2-5 states:

(a) A resident taxpayer or a resident member of a unitary group is entitled to a credit against the tax due under this article.

(b) The amount of the credit equals the lesser of:

(1) the amount of creditable tax actually paid by the resident taxpayer or member to any other taxing jurisdiction; or

(2) an amount equal to the amount of creditable tax that would be due at the tax rate set forth in this article on:

(A) the taxpayer's adjusted gross income or apportioned income that is subject to taxation by the other taxing jurisdiction; or

(B) the taxpayer's adjusted gross income or apportioned income that is attributable to the other taxing jurisdiction using the rules for attributing gross receipts under IC 6-5.5-4.

(c) As used in this section, "creditable tax" means in the case of a taxing jurisdiction that:

(1) measures its tax using net income:

(A) a direct net income tax; or

(B) a franchise or other tax measured by net income; or

(2) is not covered by subdivision (1):

(A) a tax based on deposits, investment capital or shares, net worth or capital, or a combination of these tax bases; or

(B) any other tax that is imposed instead of an income tax.

IC 6-5.5-2-5.3 states:

A credit provided in section 5 of this chapter may be allowed only after the taxpayer provides to the department satisfactory evidence of the payment of taxes to the other taxing jurisdiction.

The Department did not allow taxpayer this credit on the grounds that the statute applies to individual resident taxpayers, rather than the unitary group as a whole.

The language of IC 6-5.5-2-5(a), or more specifically, the legislature's use of the words "a resident taxpayer" and "a resident member" clearly shows the legislature's intent to identify a single taxpayer and for the credit to be calculated based upon a single resident taxpayer. The legislature also used the word "is" instead of the word "are" in order to show that the term "resident" should be singular and not plural. The Indiana Tax Court has addressed applying rules of grammar to interpret a statute, and has stated, "When the meaning of a statute is in doubt, a court may apply the rules of grammar to interpret the statute." Mechanic Laundry & Supply, Inc. v. Indiana Department of State Revenue, 650 N.E.2d 1223, 1228 (Ind.Tax 1995)(citing Leehaug v. State Bd. Of Tax Commissioners, 583 N.E.2d 211, 212 (Ind.Tax 1991)). Therefore, the credit is to be calculated with the word resident restricted to a single resident taxpayer or a single resident member.

In evaluating the individual resident's tax liability, IC 6-5.5-2-5(b) explains that the credit equals the lesser of the amount actually paid or the amount that would be due at the rate set forth under Indiana law. The numerator for the Indiana banks on the Illinois return was zero, therefore the amount actually paid by the Indiana member banks of the unitary group to Illinois is zero. Therefore, the amount of the credit for taxes paid by the Indiana banks is zero. Taxpayer has not met the burden of providing satisfactory evidence of payment of taxes to the other taxing jurisdiction imposed by IC 6-5.5-2-5.3.

FINDING

Taxpayer's protest is denied.

II. State Tax Liability Credits—Enterprise Zone Loan Interest Tax Credit

Taxpayer protests the denial of credit for five percent of the interest it received on loans to businesses in enterprise zones. The Department removed all interest received from loans for the purchase of real estate that was not leased or rented out. The Department referred to IC 6-3.1-7-1, which states in part:

"Qualified loan" means a loan made to an entity that uses the loan proceeds for:

(1) a purpose that is directly related to a business located in an enterprise zone;

(2) an improvement that increases the assessed value of real property located in an enterprise zone; or

(3) rehabilitation, repair, or improvement of a residence.

Also, IC 6-3.1-7-2 states, in part:

(a) A taxpayer is entitled to a credit against his state tax liability for a taxable year if he receives interest on a qualified loan in that taxable year.

(b)The amount of the credit to which a taxpayer is entitled under this section is five percent (5%) multiplied by the amount of interest received by the taxpayer during the taxable year from qualified loans.

The Department also referred to Information Bulletin # 66, which deals with the subject of Enterprise Zones. The Information Bulletin explains in part:

The loan proceeds must be used for a purpose directly related to a business located in an enterprise zone or for an improvement that increases the assessed value of real property located in an enterprise zone. Thus, interest from mortgage loans to acquire property does not qualify unless the property is used for business purposes (such as renting or leasing).

Taxpayer asserts that neither the statute nor the information bulletin requires purchased real estate to be leased or rented out

in order for the loans to qualify for the credit. Upon review, IC 6-3.1-7-1 and Information Bulletin # 66 do not require that the property be leased or rented in order to qualify. The only requirement is that the loan be used for a purpose that is directly related to a business located in the enterprise zone. Leasing and renting are examples of purposes directly related to businesses. These are not the only purposes a business might have. Since the loans were to businesses located in enterprise zones, and the loans were used for purposes directly related to those businesses, the loans are qualified as provided in IC 6-3.1-7-1(a).

The Department also removed some loans that went to not-for-profit organizations that were in the Enterprise Zones on the basis that the organizations did not pay property taxes. Taxpayer protests that there is no basis for this distinction. Upon review, no basis could be found for this distinction. There was no evidence that the loans to these organizations did not otherwise meet the criteria for "qualified loans" as described in IC 6-3.1-7-1.

The Department removed some loans on the basis that the loans were for businesses or other property that was not located in the Enterprise Zone. To qualify for the credit, the property must be in the Enterprise Zone. Therefore, any loans for businesses or other property that was not located in the Enterprise Zone were properly removed from the credit.

Taxpayer's protest is sustained with regard to the loans that were removed because they were not for property that was leased or rented out. Taxpayer's protest is sustained with regard to loans made to not-for-profit organizations. Taxpayer's protest is denied with regard to loans made to businesses not located in the enterprise zones or other property not located in the enterprise zones.

FINDING

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

DEPARTMENT OF STATE REVENUE

0220000126.LOF

LETTER OF FINDINGS NUMBER: 00-0126
Gross Income Tax
For Tax Years 1995 through 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

Gross Income Tax—Construction Allowances

Authority: *First National Bank of Richmond v. Turner*, 154 Ind. 456, 461-62, 57 N.E. 110, 112-113 (1990); *Bailey v. Clark*, 88 U.S. 284, 22 L.Ed. 651 (1874); *Hamilton Airport Advertising v. Hamilton*, 462 N.E.2d 228, 238 (Ind.App. 1984); *Brown Shoe Co., Inc. v. Commissioner*, 339 U.S. 583, 70 S.Ct. 820 (1950); *Detroit Edison Co. v. Commissioner*, 319 U.S. 98, 63 S.Ct. 902 (1943); *United States v. Chicago, Burlington & Quincy R. Co.*, 412 U.S. 401, 93 S.Ct. 2169 (1973); IC 6-2.1-1-2(c)(14); IC 6-2.1-2-2(a); 45 IAC 1-1-58; 45 IAC 1.1-6-5

Taxpayer protests the assessment of Indiana gross income tax on the amount taxpayer received from the landlord/developer as a construction allowance.

STATEMENT OF FACTS

Taxpayer is an operator of retail bookstores. As part of its business, taxpayer enters into lease agreements with landlords/developers to lease building space for its stores. Although the landlord/developer owns the building, taxpayer has an exclusive right to the building space during the term of the lease.

Upon taking possession of the space (which is generally delivered to taxpayer as a "vanilla box", a building shell, or a previously occupied space), taxpayer bears the responsibility of completing or improving the store interior, including fixtures, furniture and equipment. As a part of the lease agreement, taxpayer negotiates with the landlord/developer to receive a construction allowance as reimbursement for part or all of its construction costs. Landlords/developers are willing to provide construction allowances because they induce would-be tenants to locate within the shopping center. Upon termination of the lease agreement, taxpayer has no right to the improvements to the leased premises. The improvements are the property of the landlord/developer.

After a routine audit for the years in question, the Department of Revenue issued a notice of proposed assessments for gross income tax and interest on the construction allowance taxpayer received from the landlord/developer as reimbursement for construction costs taxpayer incurred in completing and improving the interior space of an Indiana location. Taxpayer excluded the construction allowance from its taxable gross income.

Gross Income Tax—Construction Allowances

DISCUSSION

In dispute is taxpayer's exclusion of the construction allowance from its taxable gross income. Indiana's Gross Income Tax encompasses most receipts of income. Pursuant to IC 6-2.1-2-2(a), "[a]n income tax, known as the gross income tax, is imposed

upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana..." Except as expressly provided in IC 6-2.1 et. seq., gross income means all of the gross receipts a taxpayer receives. However, some exceptions do exist.

Taxpayers are not subject to Indiana's gross income tax on the income they receive as contribution to capital. 45 IAC 1-1-58. More specifically, under IC 6-2.1-1-2(c), "[t]he term 'gross income' does not include:... (14) the receipt of capital by a corporation, partnership, firm, or joint venture from the sale of stock or shares in such corporation, partnership, firm, or joint venture, or contributions to the capital thereof;..." IC 6-2.1-1-2(c)(14).

In Indiana, the term "capital" is defined by our case law as follows: "When used with respect to the property of a corporation or association the term has a settled meaning; it applies only to the property or means contributed by the stockholders as the fund or basis for the business or enterprise for which the corporation or association was formed..." *First National Bank of Richmond v. Turner*, 154 Ind. 456, 461-62, 57 N.E. 110, 112-113 (1990) (citing *Bailey v. Clark*, 88 U.S. 284, 22 L.Ed. 651 (1874)). This definition has not been altered in Indiana case law to negate that capital must be contributed by stockholders. *See Hamilton Airport Advertising v. Hamilton*, 462 N.E.2d 228, 238 (Ind.App. 1984). The common meaning of "capital contribution" is stated in Black's Law Dictionary 7th Edition (1999) as: "... 1. Cash, property, or services contributed by partners to a partnership. 2. Funds made available by a shareholder, usu. without an increase in stock holdings."

Taxpayer's landlord/developer is not a partner or shareholder of taxpayer. The construction allowance is remitted to taxpayer by landlord/developer as an incentive to taxpayer to locate within landlord/developer's shopping center. As such, the purpose for which the allowance is remitted to taxpayer demonstrates that a genuine question can be raised as to whether the allowance falls outside of the scope of the plain and ordinary meaning of IC 6-2.1-1-2(c)(14) and 45 IAC 1-1-58 with respect to a contribution to capital. The question we now address is whether the construction allowance received by taxpayer from the landlord/developer was a contribution to taxpayer's capital within the purview of IC 6-2.1-1-2(c)(14) and 45 IAC 1-1-58.

The argument that non-partners and non-shareholders may contribute capital to a corporation is supported by *Brown Shoe Co., Inc. v. Commissioner*, 339 U.S. 583, 70 S.Ct. 820 (1950). In *Brown Shoe*, local communities provided cash contributions as incentives to a manufacturer to locate in their towns. The Court held that the cash contributions were "'contributions to capital' within the meaning of [1939 Internal Revenue Code] Sec. 113(a)(8)(B)", [(now Sec. 362(a))] and were therefore entitled to be depreciated. *Id*. at 589, 70 S.Ct. at 825; *see also* I.R.C. Sec. 362(c). The holding in *Brown Shoe* which recognized that non-shareholders could make contributions to capital was narrowed by the Court to those instances where there are neither customers nor payments for services. *Brown Shoe*, 339 U.S. at 589, 70 S.Ct. at 824. The Court in *Brown Shoe* stated that:

> The contributions to petitioner were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large. Under those circumstances, the transfers manifested a definite purpose to enlarge the working capital of the company. *Id*. at 591, 70 S.Ct. at 824.

In reaching its decision, the Court in *Brown Shoe* distinguished the case before it from the earlier case of *Detroit Edison Co. v. Commissioner*, 319 U.S. 98, 63 S.Ct. 902 (1943). In so doing, the Court stated that:

> [The *Detroit Edison*] decision denied inclusion in the base for depreciation of electric power lines the amount of payments received by the electric company for construction of the line extensions to the premises of applicants for service. It was held that to the extent of such payments the electric lines did not have cost to the taxpayer, and that such payments were neither gifts nor contributions to the taxpayer's capital.... *Brown Shoe*, 339 U.S. at 591, 70 S.Ct. at 824.

In *Detroit Edison*, "[t]he payments were to the customer the price of the service [provided by taxpayer.]" *Detroit Edison*, 319 U.S. at 103, 63 S.Ct. at 904. Therefore, the Court concluded, "it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company." *Id*. at 102, 63 S.Ct. at 904.

The Court in *United States v. Chicago, Burlington & Quincy R. Co.*, 412 U.S. 401, 93 S.Ct. 2169 (1973), summarizes the distinctions made by *Detroit Edison* and *Brown Shoe* with regard to whether non-shareholders can remit monies to corporations as contributions to capital.

> Where the facts were such that the transferors could not be regarded as having intended to make contributions to the corporation, as in *Detroit Edison*, the assets transferred were not depreciable. But where the transfers were made with the purpose, not of receiving direct service or recompense, but only of obtaining advantage for the general community, as in *Brown Shoe*, the result was a contribution to capital.
>
> *Chicago, Burlington*, 412 U.S. at 411, 93 S.Ct. at 2175.
>
> We can distill from these two cases [*Detroit Edison* and *Brown Shoe*] some of the characteristics of a non-shareholder contributor to capital under the Internal Revenue Codes. It certainly must become a permanent part of the transferee's working capital structure. It may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee. It must be bargained for. The asset transferred foreseeably must result in benefit to the transferee in an amount commensurate with its value. And the asset ordinarily, if not always, will be employed in or contribute to the production of additional income and its value assured in that respect.
>
> *Id*. at 413, 93 S.Ct. at 2176.

By this measure, the assets with which this case is concerned clearly qualify as contributions to capital. Taxpayer negotiated and entered into a lease agreement with the landlord/developer of the shopping center for the lease of building space. As part of the agreement, landlord/developer agreed to provide taxpayer with a construction allowance. Once the space was delivered to taxpayer, taxpayer completed and improved the interior store space. Taxpayer could not open its doors to the public and begin generating income until the improvements were made to the space. Upon completion of the interior of the space, taxpayer received the construction allowance from landlord/developer as reimbursement for construction costs taxpayer incurred in competing and improving the interior store space.

Since in this case there are neither customers nor payments for service, we infer a different purpose in the transactions between taxpayer and the landlord/developer than the purpose found by the Court in *Detroit Edison*. The promise of a construction allowance was in no way a payment for any direct service or recompense. The landlord/developer's offer to provide a construction allowance to taxpayer was made with the expectation that taxpayer would agree to locate its store in the landlord/developer's shopping center. The improvements taxpayer made to the space would have been made whether or not landlord/developer agreed to provide a construction allowance. In short, the landlord/developer's construction allowance falls within the practical working definition of "contributions to capital" that was recognized by the Court in *Brown Shoe*, and not within the narrow exception of payments for services that the Court found significant in *Detroit Edison*. We, therefore, find that the construction allowance received by taxpayer from the landlord/developer was a contribution to taxpayer's capital within the purview of IC 6-2.1-1-2(c)(14) and 45 IAC 1-1-58, and is, thus, excludable from gross income.[1]

FINDING

Taxpayer's protest is sustained.

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[1] Although the regulation promulgated by the Department in effect during the tax period 1995-1997 (*i.e.*, 45 IAC 1-1-58) did not contain examples, the capital contribution exception is explained in the most recently promulgated regulations concerning capital contributions, *i.e.*, 45 IAC 1.1-6-5, which states in relevant part that:

> ... [A] contribution to the capital of a taxpayer, whether or not from the sale of an interest in such taxpayer is not included in the gross income of such taxpayer.
>
> ...
>
> (c) To qualify as a contribution to capital, it must be shown that the principal benefit derived from a contribution is a capital improvement, a strengthening of the capital structure of the taxpayer, or an enhancement of the contributor's ownership interest. The following are examples of a contribution to capital:
>
> ...
>
> (3) A contribution by a shopping center developer of land and building costs to a corporation to attract it as the anchor tenant for a shopping center.

45 IAC 1.1-6-5. The example of a non-taxable capital contribution, set forth in IAC 1.1-6-5, is similar to the construction allowance contribution received by taxpayer.

DEPARTMENT OF STATE REVENUE

0420000236.LOF
0420000237.LOF

LETTER OF FINDINGS NUMBER: 00-0236 and 00-0237
Sales/Use Tax Assessments
For Tax Periods: 1996 through 1998

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

ISSUES

I. Sales/Use Tax — Duplicate Assessments

Authority: IC 6-2.5-3-2

Taxpayer protests duplicate assessments of Indiana use tax on purchases of supplies and materials.

II. Sales/Use Tax — Characterization of Restaurant Equipment

Authority: *Indianapolis Fruit Co., v. Department of State Revenue*, 691 N.E.2d 1379 (Ind.Tax 1998); *Sales Tax Information Bulletin #55*

Taxpayer protests Audit's characterization of restaurant equipment.

III. Sales/Use Tax — Electric Utility Study

Authority: C 6-2.5-4-5(c); IC 6-2.5-5-5.1

Taxpayer protests Audit's modifications of taxpayer's utility study.

STATEMENT OF FACTS

Taxpayer owns and operates two (2) restaurants in the state of Indiana. An examination of taxpayer's invoices for the calendar years 1996, 1997, and 1998 shows that taxpayer failed to pay sales tax on certain items of tangible personal property for which no exemption applied. Audit also questioned taxpayer's conclusions concerning the use of certain metered utilities. This audit resulted in proposed assessments of use tax. Taxpayer now protests these assessments.

I. Sales/Use Tax — Duplicate Assessments

DISCUSSION

Taxpayer purchased certain items exempt from Indiana gross retail (sales) tax—i.e., coupon books, charge sales tickets, letterhead stationary, checks and envelopes, order and batch tickets, and birthday club postcards and registrations. According to Audit, taxpayer purchased these items for *use* by its two Indiana restaurants as well as for *resale* to other restaurateurs. Audit proposed assessments of use tax on the items *purchased and used* by taxpayer.

Taxpayer does not protest the substance of these assessments. Rather, after reviewing the audit report, taxpayer noticed that each proposed assessment appeared twice—one time for each restaurant. At first blush, it appeared as if two assessments were proposed for each nonexempt purchase made. After further investigation, taxpayer recognized that while each proposed assessment was listed twice, the dollar amounts associated with these "duplicate entries" represented each restaurant's apportioned share of a single assessment. Taxpayer has withdrawn its protest of this issue.

FINDING

Taxpayer's protest has been withdrawn. No further action is required.

II. Sales/Use Tax — Characterization of Restaurant Equipment

DISCUSSION

Taxpayer questions the characterization of some of its restaurant equipment for purposes of determining the percentage of electricity consumed in its production process. Specifically taxpayer contends that a large walk-in refrigeration unit and an exhaust filter system should have been characterized as production equipment for purposes of computing exempt utility consumption.

Taxpayer cuts and "ages" its own steaks. According to taxpayer, the aging process requires restaurant personnel to store purchased beef in a refrigeration unit prior to final cutting and subsequent cooking. Taxpayer believes the refrigeration unit is an essential an integral part of its production process. The "aging process" at issue consists of placing meat in a controlled refrigerated environment. Cold storage allows natural enzymes to breakdown the hard connective tissues. The result is a tender, more flavorful product. Given the refrigerator's utility, taxpayer contends the unit is essential to its integrated production process.

The Indiana Tax Court has heard, and rejected, similar arguments. In *Indianapolis Fruit Co., v. Department of State Revenue*, 691 N.E.2d 1379 (Ind.Tax 1998), taxpayer (Indianapolis Fruit) argued that tomatoes were ripened and made more marketable through storage "in a tightly controlled environment." *Id* at 1385. The Tax Court rejected this argument and found that tomato ripening did not constitute production. As the Court stated:

> This Court finds that the tomato ripening does not constitute production within the meaning of any of the exemption provisions. It is indisputable that, like the bananas, the tomatoes have undergone a substantial physical and chemical change while ripening. Although this transformation undoubtedly made the tomatoes far more marketable, the transformation was not triggered by Indianapolis Fruit. Instead, it passively awaited the ripening of the tomatoes. The ripening was not actively induced by Indianapolis Fruit and was merely incidental to the proper storage of the tomatoes.
>
> *Id* at 1385-86.

This same logic precludes the Department from arriving at a different conclusion. Taxpayer's "aging" of beef does not represent a production activity. Audit's refusal to characterize the refrigeration unit as production equipment was correct.

Additionally, taxpayer argues that an exhaust filter system (exhaust system located in cooking areas) should be characterized as production equipment. However, from taxpayer's description of the exhaust filtration system, the Department understands the system's function to be one of safety and health—not production. Characterization of this equipment as production for purposes of determining the amount of electricity consumed in taxpayer's *production* process, therefore, would be incorrect.

Sales Tax Information Bulletin #55: Application of Sales Tax to Sales of Utilities Used in Manufacturing or Production, May 31, 1989 (Revised), provides the following relevant example:

> The taxpayer is a restaurant that purchases electricity used to power air conditioning and ventilating equipment. The equipment environmentally conditions the kitchen area of the restaurant. The equipment is not exempt under 45 IAC 2.2-5-8 through 45 IAC 2.2-5-11 because it does not operate in an integrated fashion with the food production process and is not essential to making that process possible. Consequently, the electricity used in conjunction with that equipment is not exempt under Indiana Code 6-2.5-4-5.

FINDING

Taxpayer's protest is denied.

III. Sales/Use Tax — Electric Utility Study

DISCUSSION

Taxpayer questions the methodology used by Audit for determining the percentage of taxpayer's exempt utility consumption. Taxpayer contends over fifty percent (50%) of the electricity purchased is consumed in production activities. Given predominant use, taxpayer believes it is entitled to the one hundred percent (100%) exclusion provided by IC 6-2.5-4-5(c).

Electricity directly consumed in the direct production of other tangible personal property by a business engaged in "manufacturing, processing, refining…" is exempt from sales tax. IC 6-2.5-5-5.1. This *exemption* is applied on a pro rata basis. An *exclusion* is provided for sales made by public utilities if the services sold (i.e., the electricity purchased) are "consumed as an essential and integral part of an integrated process that produces tangible personal property and those sales are separately metered for the excepted uses…or if those sales are not separately metered but are predominately used by the purchaser for the excepted uses listed in this subdivision." IC 6-2.5-4-5(c).

In this instance, Taxpayer's electricity purchases were not separately metered. Therefore, sales to taxpayer would qualify for the predominant use exclusion if over fifty percent (50%) of taxpayer's electricity purchases were consumed in production activities.

Taxpayer provided the Auditor with a listing of electrical equipment, usage (hours), and draw (KWH), by location. Taxpayer's calculations showed that both Indiana locations qualified for the predominant use utility exclusions. Audit questioned the usage assigned to selected equipment. As Audit explained, "[t]he taxpayer's hours were adjusted to what the [D]epartment consider[ed] to be a normal operating range based on experience with similar taxpayers." Taxpayer disagreed.

The Department believes that taxpayer's usage of electrical utilities for production purposes should have been derived from empirical evidence. Audit, therefore, must revisit taxpayer's locations in order to compute these production percentages.

FINDING

Audit will revisit this issue pursuant to the aforementioned language.

DEPARTMENT OF STATE REVENUE

0120000481.LOF

LETTER OF FINDINGS NUMBER: 00-0481 AGI
Adjusted Gross Income Tax
for Tax Periods: 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

Adjusted Gross Income Tax)Imposition

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

Taxpayer protests the imposition of the adjusted gross income tax.

STATEMENT OF FACTS

The Indiana Department of Revenue issued Taxpayer a refund of withheld taxes for 1998. The Indiana Department of Revenue determined that the refund was issued in error. The Indiana Department of Revenue also assessed additional taxes for tax year 1999. Further facts will be provided as necessary.

Adjusted Gross Income Tax)Imposition

DISCUSSION

An adjusted gross income tax is imposed upon all Indiana residents. IC 6-3-2-1.Taxpayer argues that he has no Indiana Adjusted Gross Income for 1994 and therefore does not owe any tax. Taxpayer notes that the Indiana Code borrows some of its definitions from the Internal Revenue Code. For instance, "gross income" is defined at IC 6-3-1-8 as having the meaning as defined by section 61(a) of the Internal Revenue Code." Section 61 (a) that states in part:

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

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

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

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

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

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010021P.LOF

LETTER OF FINDINGS NUMBER: 01-0021P
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

I. Tax Administration–Penalty

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

The taxpayer protests the negligence penalty.

STATEMENT OF FACTS

The negligence penalty was assessed on a sales tax assessment resulting from a Department audit conducted for the calendar years 1998 and 1999.

The taxpayer is a diagnostic center that provides x-ray treatment for patients in Northwest Indiana. The taxpayer is located in Indiana. The taxpayer files as a partnership and is a limited liability company.

I. Tax Administration–Penalty

DISCUSSION

The taxpayer requests the penalty assessment be waived based on the fact the taxpayer is a new company and the error was unintentional. The Department points out the taxpayer had no company policies or procedures on which to pay use tax on purchases, particularly large out-of-state purchases. The Department also points out the assessment is significant.

45 IAC 15-11-2(b) states, "Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer."

The Department finds the taxpayer did not act with reasonable care in that the taxpayer was inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the taxpayer's penalty protest is denied.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0220010043P.LOF

LETTER OF FINDINGS NUMBER: 01-0043P
Income Tax
Calendar Year Ended 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 for the year ended December 31, 1998. Taxpayer filed its original return on November 1, 1999 with a payment of $243,375 in tax due. The late payment generated a ten percent (10%) penalty and updated interest.

Taxpayer made a $150,000 payment on April 19, 1999 and a final payment in the amount of $243,375 on November 1, 1999, both of which are late payments. The department assessed a late payment penalty in the amount of $39,337.50.

I. Tax Administration–Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states the underpayment of estimated payments is due to reasonable cause and not willful neglect. Taxpayer provided several reasons for its underestimated tax payments.

The issue, however, is not the underpayment of estimated income taxes but the late payment of its tax liability. Taxpayer made estimated payments for the first three quarters but failed to remit its fourth quarter payment timely. In addition, taxpayer made a final payment in the amount of $243,375 on November 1, 1999 that also generated a late payment penalty.

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

Taxpayer has not provided reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010109P.LOF

LETTER OF FINDINGS NUMBER: 01-0109P
Use Tax
Calendar Years 1997, 1998, and 1999

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

ISSUE(S)

I. Tax Administration–Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on an audit completed on January 3, 2001.

Taxpayer had a use tax accrual system in place at one of its locations in the latter part of 1998 and into 1999. Taxpayer did not accrue use tax at its other two Indiana facilities and utilized exemption certificates to lease and buy items.

Taxable items assessed in the audit consisted of building supplies, truck and forklift parts, books and subscriptions, office supplies, tools, rental equipment, pre and post production supplies, and various miscellaneous items.

I. Tax Administration–Penalty

DISCUSSION

Taxpayer's audit report revealed that it remitted a minimal amount of use tax and had no use tax accrual system in place for two of the three Indiana business locations. The taxpayer failed to self assess tax as required by statute. For the three years at audit, the taxpayer remitted less than two percent (2%) of its use tax due.

The taxpayer believes it can demonstrate that it had acted in a reasonable manner, not due to willful neglect, and respectfully requests that the penalty assessed under IC 6-8.1-10.2.1 be waived. Taxpayer states it created policies and procedures to identify those items that should be taxable and to collect and remit use tax due. Taxpayer further instructed each location how to properly report the use tax to its Corporate Tax Department in Michigan on a monthly basis.

Taxpayer states it experienced turnover both within the corporate tax department and accounts payable departments at each of its Indiana locations in 1997 and 1998. During the subsequent transition period, taxpayer states it made a good faith attempt to

ensure that all the required policies and procedures were being followed by engaging a public accounting firm to handle both the monthly tax compliance and the training of the new purchasing and accounts payable staff.

Taxpayer's audit revealed that it remitted less than two percent of its use tax due. Taxpayer has not established reasonable cause and has not exercised ordinary business care and prudence in carrying out its duty to remit tax due.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010110P.LOF

LETTER OF FINDINGS NUMBER: 01-0110P
Sales and Use Tax
Calendar Years 1997, 1998, and 1999

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

ISSUE(S)

I. Tax Administration–Penalty

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

Taxpayer protests the penalty assessed.

II. Tax Administration–Interest

Authority: IC 6-8.1-10-1

Taxpayer protests the interest assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty and interest assessed on an audit completed on January 8, 2001.

Taxpayer failed to self assess use tax on clearly taxable items and had no use tax accrual system in place until the audit began. Taxpayer also failed to report all of its taxable sales and failed to retain exemption certificates from its customers.

I. Tax Administration–Penalty

DISCUSSION

Taxpayer's audit report revealed that no use tax accrual system was in place. The taxpayer failed to self assess tax as required by statute. In addition, taxpayer made sales to its employees without charging sales tax and failed to have exemption certificates on file for its customers.

Taxpayer merely states that it did not understand use tax and believed that most of its customers were exempt from sales tax because they were Christian camps or not for profit organizations.

Taxpayer, however, should be aware of Indiana Tax laws when doing business in this state. Failure to have a use tax accrual system in place constitutes negligence.

FINDING

Taxpayer's protest is denied.

II. Tax Administration)Interest

DISCUSSION

Taxpayer protests the interest assessed.

The Department has not authority to waive interest.

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is denied for Issues I and II.

DEPARTMENT OF STATE REVENUE

0220010120P.LOF

LETTER OF FINDINGS NUMBER: 01-0120P
Gross and Adjusted Gross Income Tax
Calendar Years Ended 1995, 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 was assessed a negligence penalty because it underreported its tax by 56% for 1995 and 25% for 1996 the majority of which arose from the reclassification of gains from the sale of divisions to business income. The sale of a company's operating division is clearly business income. The balance of the assessment arose from the throwback sales. Taxpayer correctly included these sales in Calendar Years 1997 and 1998 but made no effort to correct the prior years' returns.

I. Tax Administration–Penalty

DISCUSSION

Taxpayer merely states that the increase was due to a Revenue Agent's Audit and not willful neglect and there was no negligence or willful disregard for the tax provisions.

The penalty was assessed in this instance because the Taxpayer failed to include its gain from the sale of its divisions in adjusted gross income. Taxpayer incorrectly classified these sales as nonbusiness income. Taxpayer correctly included these sales in 1997 and 1998 but made no effort to correct the prior years' returns. Taxpayer also failed to correctly report all Indiana sales in Gross Income.

Taxpayer has not provided reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010133P.LOF

LETTER OF FINDINGS NUMBER: 01-0133P
Use Tax
Calendar Years 1997, 1998, and 1999

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

ISSUE(S)

I. Tax Administration–Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is an international specialty retailer with stores in the United States and several international locations. Taxpayer has several stores in Indiana. At audit, it was determined that the taxpayer failed to self assess use tax in excess of fifty percent (50%) in each year of the audit.

I. Tax Administration–Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to remit use tax on clearly taxable purchases and fixed assets.

Taxpayer states that it had an inability to accrue tax properly on fixed assets and store expenditures and has implemented a model which accrues tax on these types of purchases in June 1999. Taxpayer requests a penalty waiver based upon the above statement along with its excellent filing history.

A review of the audit indicates the taxpayer paid less than fifty percent (50%) of its use tax liability which consisted of general purchases and fixed assets. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010134P.LOF

LETTER OF FINDINGS NUMBER: 01-0134P
Use Tax
January 1996 through May 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(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 international specialty retailer with stores in the United States and several international locations. Taxpayer has several stores in Indiana. At audit, it was determined that the taxpayer failed to self assess use tax in one year of the audit and remitted less than 75% in the following five months. Taxpayer had a prior audit with the same issues completed on May 20, 1992.

I. Tax Administration–Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to remit use tax on clearly taxable purchases and fixed assets.

Taxpayer states that it had an inability to accrue tax properly on fixed assets and store expenditures and has implemented a model which accrues tax on these types of purchases in June 1999. Taxpayer requests a penalty waiver based upon the above statement along with its excellent filing history.

A review of the audit indicates the taxpayer had no use tax accrual system in place for one year of the audit and remitted approximately 75% in the following five months. Taxpayer underwent a prior audit with the same issues. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010136P.LOF

LETTER OF FINDINGS NUMBER: 01-0136P
Use Tax
Calendar Years 1996, 1997, and 1998

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

ISSUE(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 international specialty retailer with stores in the United States and several international locations. Taxpayer has two stores in Indiana. At audit, it was determined that the taxpayer failed to self assess use tax in two years of the audit period and paid a minimal amount in one year.

I. Tax Administration–Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to remit use tax on clearly taxable purchases and fixed assets.

Taxpayer states that it had an inability to accrue tax properly on fixed assets and store expenditures and has implemented a model which accrues tax on these types of purchases in June 1999. Taxpayer requests a penalty waiver based upon the above statement along with its excellent filing history.

A review of the audit indicates the taxpayer had no use tax accrual system in place for two years of the audit and remitted a minimal amount in one year although it is registered with the Department. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990055.SLOF

SUPPLEMENTAL LETTER OF FINDINGS 99-0055
State Gross Retail and Use Taxes
For Years 1994, 1995, 1996, and 1997

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

ISSUES

I. State Gross Retail Tax–Equipment Used in Retail Stores: **In-Store Equipment Used in the Preparation of Consumer Paint Products**

Authority: IC 6-2.5-2-1; IC 6-2.5-5-3(b); 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(g); 45 IAC 2.2-5-12(a)

Taxpayer seeks clarification of the determination, set out within the original Letter of Findings, that certain of the taxpayer's in-store equipment, subject to certain limitations, was exempt from the imposition of the Indiana gross retail tax.

II. Applicability of the State's Gross Retail Tax to Items of Manufacturing Equipment

Authority: IC 6-2.5-2-1; IC 6-2.5-5-3(b); 45 IAC 2.2-5-8; 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-8(b); 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(c)(2); 45 IAC 2.2-5-8(c)(2)(A); 45 IAC 2.2-5-8(c)(2)(G); 45 IAC 2.2-5-8(c)(3); 45 IAC 2.2-5-8(c)(3)(A); 45 IAC 2.2-5-8(d); 45 IAC 2.2-5-8(g); 45 IAC 2.2-5-8(i)

Taxpayer claims that certain items of equipment, not addressed within the original Letter of Findings, are exempt from the state's gross retail tax.

STATEMENT OF FACTS

Taxpayer is an Ohio Corporation headquartered in Ohio and authorized to do business in Indiana. Taxpayer is a manufacturer, wholesaler, and retailer of paint, powder coatings, and related products. Taxpayer operates approximately 30 primary manufacturing facilities located throughout the United States including a powder coatings manufacturing facility located in Indiana. During the tax years 1994 and 1995, taxpayer operated a warehouse in Indiana in which paint and paint related products were stored for shipment to locations within and outside of Indiana. Subsequent to the issuance of the original Letter of Findings, taxpayer requested an opportunity for a rehearing. In that request, the taxpayer argued that tax issues related to the purchase of certain items of equipment were not addressed within the Letter of Findings. Taxpayer has also sought clarification of language addressing the taxability of items of equipment purchased by taxpayer for use in its retail outlets. This Supplemental Letter of Findings revisits those issues.

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

DISCUSSION

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

Taxpayer produces a white base paint at its primary production facility. This white base paint is then shipped to taxpayer's various retail outlets. Not all the white base is identical because different colors require the use of different bases having different chemical qualities. The "gallon" containers of white base actually contain less than a full 128 fluid ounces in order to permit the eventual addition of colorants.

Taxpayer's retail customers may choose paint in one of two ways. The customer may select a paint color from one of the taxpayer's color cards. Alternatively, customer may bring in a color sample to be custom-matched. Once the customer selects or provides the desired color, taxpayer's employee begins a process by which the specified paint is produced. If the customer has

brought in a color sample, that sample is measured by the Color Matching System (a spectrophotometer or other color-sensing device). The resulting measurements are converted to a numerical value, which is sent to the taxpayer's computer equipment. The computer equipment in turn produces a unique color formula which is sent to an Automatic Colorant Dispenser.

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

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

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

Taxpayer originally argued that its purchase of four items of equipment, installed at its retail outlets, came within the ambit of IC 6-2.5-5-3(b), because the equipment was purportedly directly used "in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." Id. The four items of equipment addressed within the original Letter of Findings included: 1) Color Matching Systems, 2) Automatic Colorant Dispensers, 3) Related Computer Equipment, and 4) Shakers.

Subject to certain limitations set out in the original Letter of Findings, it was determined that taxpayer's purchase of Shakers was exempt from the imposition of sales tax pursuant to IC 6-2.5-5-3(b). Neither that original determination nor the associated limitations are at issue here. Instead the taxpayer has requested that the language setting out that determination be clarified. The remaining three items of equipment are irrelevant to this Supplemental Letter of Findings.

The language contained within the original Letter of Findings stated that "[t]o the extent that taxpayer's Shakers are used to mix customized paint products, the Shakers are exempt from the gross retail tax under IC 6-2.5-5-3(b). However, to the extent the Shakers are used to mix the taxpayer's non-customized paints, the Shakers are not entitled to the exemption. In addition, to the extent that the Shakers are used to re-mix paints previously sold but which may have over time become separated, the Shakers are also not entitled to the exemption."

The meaning, intent, and effect of the quoted language was to determine that taxpayer's purchase of the Shakers was not subject to the state's gross retail tax to the extent that the Shakers were used to mix certain, defined paint products as follows;

1. The purchase of the paint Shakers was exempt from the state's gross retail tax to the extent the Shakers were used to mix customized paint products for which the customer brought in a color sample and for which taxpayer created and executed a unique color formulation.
2. The purchase of the paint Shakers was exempt from the state's gross retail tax to the extent the Shakers were used to mix paint products which were formulated in accordance with a customer's selection from one the taxpayer's own standardized color cards.
3. The purchase of the paint Shakers was not exempt from the state's gross retail tax to the extent that the Shakers were used to re-mix paint products, previously sold to a customer, but which, over time, had become separated.
4. The purchase of the paint Shakers was not exempt from the state's gross retail tax to the extent that the paint Shakers were used to mix off-the-shelf paints in which colorants had previously been added and which were not modified by the retailer to conform to the customer's requirements or specifications.

II. Applicability of the State's Gross Retail Tax to Items of Manufacturing Equipment

DISCUSSION

In its request for a rehearing, taxpayer has requested that the Department address the taxability of items of equipment not adequately addressed within the original Letter of Findings. The taxpayer has requested that the taxability of the following items of equipment be addressed: wet dry vacuums (00017, 00018, 00019); sieve shaker (00023); convection ovens (00077, 00078), model and cup spray guns (00027, 00028); air compressor (00042); analytical balance scales and gram scales (00046, 00062, 00063, 00064); color eye system (00071); vacuum (00080); conveyor belt (00088). The original audit reference numbers are included to identify specifically the various items of equipment at issue.

Pursuant to IC 6-2.5-2-1, a sales tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. IC 6-2.5-5-3(b) provides that "[t]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." 45 IAC 2.2-5-8(c) defines "direct use" as that use having an immediate effect on the article being produced. Property has such an immediate effect if it is an essential and integral part of an integrated process that produces tangible personal property. 45 IAC 2.2-5-8(c).

A brief description of the taxpayer's production process is warranted. Raw materials are measured, mixed, heated, and transformed into a liquid state within a device called an extruder. As the liquid is discharged from the extruder, it passes through

cooling rolls which transform the product into a solid form. This solid material is transported by means of a conveyor to a crusher. The crusher is the first step in reducing the solid to its final, saleable form. The crushed material is transported to a grinding mill, which completes the transformation of the paint product to a uniformly fine powder. Attached to the grinding mill are various devices – including a sifter - which remove non-conforming particles and dust. At various times during production, powder coating samples are removed and subjected to quality control testing.

A. Wet Dry Vacuums

Taxpayer argues that its purchase of three Wet Dry Vacuum cleaners should not be subject to the state's gross retail tax. These vacuum cleaners are portable units used within the taxpayer's powder coatings plant. The Wet Dry Vacuums are used to clean the taxpayer's production equipment in order to assure that unwanted particles, remaining after the production of one batch of powder coating, are removed and do not contaminate the next batch.

The Wet Dry Vacuums do not fall within the manufacturing exemption and are, therefore subject to imposition of the state's gross retail tax. Although necessary to the production of uncontaminated powder coatings, the Wet Dry Vacuums are properly categorized as outside and independent of the taxpayer's actual production of powder coatings. In order to come within the manufacturing exemption, the equipment must be "directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property." 45 IAC 2.2-5-8(c). The Wet Dry Vacuums are not involved in the "direct production" of taxpayer's production process because " '[d]irect 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*...." 45 IAC 2.2-5-8(d) (Emphasis added).

B. Sieve Shaker

Taxpayer argues that the purchase of its Sieve Shaker is exempt from the imposition of the state's gross retail tax under 45 IAC 2.2-5-8 because the equipment is part of the taxpayer's integrated manufacturing process. During the production of powder coatings, the sieve shaker sifts through the powder coatings after the coatings have been processed through the grinding mill. The Sieve Shaker operates to detect and remove those particles which have not obtained a specified consistency. Absent the operation of the Sieve Shaker, taxpayer's customers would not receive a product which conforms to the customer's specifications or needs.

Taxpayer's Sieve Shaker is exempt from the imposition of state's gross retail tax because the Sieve shaker has "an immediate effect on the article being produced." 45 IAC 2.2-5-8(c). The device acts directly upon the taxpayer's powder coatings in such a way as to remove those particles which would otherwise render the final product unsatisfactory. The device is an "integral part of an integrated process which produces tangible personal property." 45 IAC 2.2-5-8(c).

C. Convection Ovens

Taxpayer maintains that the purchase of two Convection Ovens is exempt from sales tax because the ovens are purportedly testing equipment, which qualify for the manufacturing exemption. During the taxpayer's production of powder coatings, samples of the coatings are removed at pre-determined times and subjected to certain testing procedures to assure that the coatings conform to taxpayer's and customer's specifications. The Convection Ovens are used to bake panels upon which powder coatings have been applied. Once the panels have been baked, they are examined to determine if the finished coating meets thickness, gloss, color, and adhesion specifications. This testing process is intended to assure that the powder coatings then being produced within taxpayer's manufacturing process – once actually applied to one of the test bake panels – meet the specifications established by taxpayer and taxpayer's customer. If the testing process reveals that the powder coatings then being manufactured do not conform to the required specifications, the manufacturing process is halted and the powder coatings produced to that point are discarded. The manufacturing process is restarted only after the necessary adjustments have been made.

Taxpayer predicates its exemption claim on 45 IAC 2.2-5-8(i) which states that, "[m]achinery, tools, and equipment used to test and inspect the product as part of the production process are exempt." The regulation offers an example in which the testing equipment is exempt. The example provides a scenario in which;

> "[s]elected parts are removed from production according to a schedule dictated by statistical sampling methods. Quality control equipment is used to test the parts in a room in the plant separate from the production. Because of the functional interrelationship between the testing equipment and the machinery on the production line and because of the product flow, the testing equipment is an integral part of the integrated production process and is exempt."

Accordingly, to the extent that the Convection Ovens are employed to test the quality of taxpayer's powder coatings "as part of the [taxpayer's] production process" (45 IAC 2.2-5-8(i), the convection ovens are exempt from imposition of the gross retail tax. However, to the extent that the same Convection Ovens are used to test taxpayer's product subsequent or prior to the actual manufacturing process, the Convection Ovens are subject to sales tax because "off-line" testing no longer exhibits the "functional interrelationship between the testing equipment and the machinery on the production line" justifying the exemption. Id.

D. Model and Cup Spray Guns

Taxpayer argues that the purchase of the Spray Guns is exempt from sales taxes for the same reasons set forth in the discussion concerning the Convection Ovens. The Spray Guns are used to spray powder coatings on test panels during the taxpayer's testing process.

As with taxpayer's Convection Ovens, taxpayer's Spray Guns qualify for the gross retail tax exemption under 45 IAC 2.2-5-8(i) to

the extent the Spray Guns are used to test taxpayer's products "as part of the [taxpayer's] production process." Conversely, the Spray Guns to not qualify for the exemption to the extent the Spray Guns are used for testing prior and subsequent to the actual manufacturing process.

E. Color Eye System

Taxpayer maintains that its purchase of a Color Eye System is exempt from the sales tax under 45 IAC 2.2-5-8(i). The Color Eye System is a device capable of precisely measuring the color qualities of taxpayer's powder coatings. During the production of those coatings, samples of the powder coatings are removed from the production line and subjected to quality control testing. The coatings are applied to sample panels. The panels are then subjected to various tests including a test, conducted by means of the Color Eye System, to assure that the taxpayer's finished product will meet taxpayer's and customer's color specifications.

Similar to the finding concerning taxpayer's Convection Ovens and Model and Cup Spray Guns, taxpayer's Color Eye System – to the extent the system is employed to test taxpayer's powder coatings "as part of the [taxpayer's] production process" – is exempt from imposition of the gross retail tax under the provisions of 45 IAC 2.2-5-8(i). However, to the extent the Color Eye System is used to conduct product testing outside the taxpayer's actual production process, the Color Eye System remains subject to sales tax.

F. Air Compressor

Taxpayer argues that the purchase of its Air Compressor is exempt from the state's gross retail tax because it is an item of equipment having a direct and immediate effect on the taxpayer product. The Air Compressor is used to supply compressed air–acting as a power source–to certain items of manufacturing equipment. The purchase of the air compressor is entitled to the exemption. The most closely analogous regulatory example is found at 45 IAC 2.2-5-8(c)(2)(A) which states that "[a]ir compressors used as a power source for exempt tools and machinery in the production process" are part 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." 45 IAC 2.2-5-8(c)(2).

G. Analytical Balance Scale/Gram Scale

Taxpayer argues that its purchases of Analytical Balance and Gram Scales are exempt from the state's gross retail tax because the scales are a part of the taxpayer's manufacturing process. The scales are used to measure minute amounts of raw materials–including pigments and resins–which are then combined with other raw materials at the inception of the powder coatings manufacturing process. The scales are exempt because the scales are a part of the integrated process of producing powder coatings in which the scales are used to weigh and measure the powder coatings constituent ingredients. The most closely analogous example is found at 45 IAC 2.2-5-8(c)(2)(G) which states that an "automated scale process" employed to measure quantities of raw aluminum used in the next production step is exempt.

H. Vacuum

Taxpayer argues that the purchase of this Vacuum device should be exempt from the state sales tax because it is a constituent part of the taxpayer's integrated manufacturing process. The vacuum is connected to hoses which are, in turn, attached to the powder coatings production line. The Vacuum device is attached to the taxpayer's production lines and used to clean the production line of materials remaining after the production of a batch of powder coatings. These materials must be removed to assure that the next batch of powder coatings will not be affected or contaminated.

Although taxpayer intimates that the Vacuum device is capable of being employed during the production process, the device is primarily used as a pre-production or post-production item of equipment. As such, it does not qualify for a sales tax exemption under 45 IAC 2.2-5-8(b). As set out in 45 IAC 2.2-5-8(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...." The Vacuum device stands one step removed from taxpayer's production of powder coatings making its purchase price subject to the state's gross retail tax.

I. Conveyor Belt

Taxpayer argues that its purchase of a conveyor belt should be exempt from the state's gross retail tax because the conveyor belt is part of the taxpayer's manufacturing process. The conveyor belt is located between the cooling rolls and the crusher. The conveyor belt transports the solidified powder coatings material between intermediary steps of the taxpayer's production process and is entitled to the manufacturing exemption under 45 IAC 2.2-5-8(a). The conveyor belt is an item of manufacturing equipment directly used by the taxpayer to produce finished tangible personal property. 45 IAC 2.2-5-8(b). The conveyor belt has an immediate effect on the taxpayer's powder coatings because it is "an essential and integral part of an integrated process which produces tangible personal property." 45 IAC 2.2-5-8(c).

In summary, taxpayer's wet dry vacuums (00017, 00018, 00019) and vacuum (00080) are not entitled to an exemption from the state's gross retail tax. Taxpayer's convection ovens (00077, 00078), model and cup spray guns (00027, 00028), color eye system (00071) sieve shaker (00023), air compressor (00042), analytical balance scales and gram scales (00046, 00062, 00063, 00064), and conveyor belt (00088), subject to the limitations contained within this Supplemental Letter of Findings, are exempt from the gross retail tax.

FINDINGS

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

DEPARTMENT OF STATE REVENUE

0220000256.SLOF

SECOND SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 00-0256
Financial Institutions Tax
For the Tax Years 1996 and 1997

NOTICE: Under IC 4-22-7-7, this document is 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. Service Fee Income From Securitizations as a Qualifying Transaction Under the Financial Institutions Tax

Authority: IC 6-5.5 et seq.; IC 6-5.5-1-17; IC 6-5.5-1-17(d); IC 6-5.5-1-17(d)(2)(A), (B); 45 IAC 17-2-1(a); 45 IAC 17-2-4(b), (c); 45 IAC 17-2-4(b)(1)-(3); 45 IAC 17-2-4(e)(1); 45 IAC 17-2-4(e)(2)

Taxpayer protests the determination, contained within the previous Supplemental Letter of Findings (SLOF), that service fee income derived from the securitization of various loans, was not a "Qualifying Transaction" that could be accumulated in order to qualify taxpayer to file under Indiana's Financial Institutions Tax.

STATEMENT OF FACTS

Taxpayer is a non-resident corporation engaged in the business of leasing and financing the purchase of construction equipment and engines. Taxpayer does this by entering into various forms of transactions between itself, taxpayer's local dealerships, municipalities, individual customers, and certain third-parties.

The previous SLOF considered certain of these transactions and whether they constituted "Qualifying Transactions" serving to bring taxpayer within the purview of the state's Financial Institutions Tax. The previous SLOF concluded that income derived from the securitization of taxpayer's loans did not derive from a "Qualifying Transaction." Rather, the earlier SLOF concluded that when taxpayer marketed certain of its loans to third-parties, but continued to derive income from servicing the loans, the taxpayer was no longer in the business of extending credit.

Taxpayer requested and was granted an opportunity to revisit this issue.

DISCUSSION

I. Service Fee Income From Securitizations as a Qualifying Transaction Under the Financial Institutions Tax

Taxpayer's basic contention is that, because of the manner in which it conducts its business of leasing and financing the purchase of construction equipment and engines, taxpayer comes within the definition of a financial institution pursuant to 45 IAC 17-2-4(d)(1), (2).

Indiana imposes a franchise tax, know as the Financial Institutions Tax (FIT) on corporations transacting the business of a financial institution inside the state. IC 6-5.5 et seq. The FIT is imposed on residential financial institutions, nonresident financial institutions, and on certain non-bank entities that transact the business of a financial institution. 45 IAC 17-2-1(a). Non-resident corporations, such as the taxpayer, transacting the business of a financial institution, are subject to the FIT, when the non-resident corporation demonstrates that it has established an economic presence in Indiana pursuant to IC 6-5.5-3-1. It is not disputed that taxpayer has established an economic presence in Indiana.

Because the taxpayer is plainly not conducting the business of a traditionally regulated financial institution as defined in IC 6-5.5-1-17(d), taxpayer premises its claim to FIT status under the provisions of IC 6-5.5-1-17(d)(2)(A), (B) which grant FIT status to those corporations which obtain 80 percent of their gross income from the "[m]aking, acquiring, selling, or servicing loans or extensions of credit" or from the "leasing [of] real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes."

The benchmark for determining whether a taxpayer is "conducting the business of a financial institution" is if 80 percent of the corporation's gross income is derived from the economic equivalent of extending credit. 45 IAC 17-2-4(b), (c). The taxpayer may reach this 80 percent benchmark various ways. It may do so by deriving 80 percent of its income from "(1) Extending credit... (2) Leasing that is the economic equivalent of extending credit [or] (3) Credit card operations." 45 IAC 17-2-4(b)(1)-(3). However, in order to demonstrate that it is it is entering into leases which are the "economic equivalent extending credit," the taxpayer must demonstrate that the lease income is derived from a transaction which is both "the economic equivalent of the extension of credit" and from a lease transaction which is "*not* treated as a lease for federal income tax purposes." 45 IAC 17-2-4(e)(2).

Taxpayer, initially protesting the audit's determination that it did not qualify to file under the FIT, submitted evidence of various transactions which – under their cumulative weight – purportedly brought the taxpayer to the 80 percent benchmark figure. The Department determined that certain of those transactions were "Qualifying Transactions" because, under the standards set out in the original Supplemental Letter of Findings, the transactions were both the equivalent of extending credit and were *not* treated as a lease for federal income tax purposes.

However, the Department determined that certain income derived from one of the taxpayer's transactions did not originate from

a "Qualifying Transaction." The income at issue was "service fee income on securitizations." This income results when taxpayer markets to third-parties loans previously entered into with various local dealers and customers. Although taxpayer has "sold" the loan to a third-party, taxpayer continues to service the loan by collecting monthly payments and doing that which is necessary to enforce the terms of the loan. From the viewpoint of the customer or local dealer the transaction, whereby the taxpayer sold the loan to the third-party, is entirely transparent. The customer or local dealer continues to deal directly with the taxpayer. By continuing to service the loan and collect loan payments, taxpayer earns "service fee income on securitizations." This income is derived from the "spread" (difference) between what taxpayer collects from customer or local dealer and what the taxpayer then turns over to the third-party. As an example, taxpayer collects payments from customer or local dealer consisting of principal and 5 percent interest. Taxpayer forwards to third-party the amount of principal and 4 percent interest. Taxpayer retains 1 percent interest for itself. The 1 percent retained interest represents "service fee income on securitizations."

The Department originally determined that this "service fee income on securitizations" did not derive from a "Qualifying Transaction" on the grounds that that taxpayer had removed itself from the business of extending credit and was in the business of providing loan services on behalf of the third-party. The previous SLOF found that the taxpayer was one step removed from the actual loan transaction and was in the business of providing services ancillary to the actual loan.

IC 6-5.5-1-17 defines those taxpayers which are qualified to file under the state's FIT. In addition to extending credit and entering into leases which are the economic equivalent of extending credit, taxpayers may reach the 80 percent bench mark from activities which include "[m]aking, acquiring, selling, or servicing loans or extensions of credit." IC 6-5.5-1-17(d)(2)(A). The Department's regulation restates the identical principle. The taxpayer may reach the 80 percent bench mark by "[m]aking, acquiring, selling, or servicing loans or extensions of credit." 45 IAC 17-2-4(e)(1).

The Department's original determination concerning taxpayer's service fee income on securitizations was erroneous. Neither the statute nor the regulation evince any requirement that income derived from "servicing loans" must be income derived from servicing the taxpayer's *own* loans. *See* IC 6-5.5-1-17(d)(2)(A); 45 IAC 17-2-4(e)(1). The fact that taxpayer has marketed certain of its loans but continues to derive income from servicing those loans, on behalf of an unrelated third-party, is irrelevant to the analysis. Taxpayer's "service fee income on securitizations" represents income derived from servicing loans and may be accumulated to qualify taxpayer to file under the state's Financial Institutions Tax.

However, it should be noted that the determination reached within this Supplemental Letter of Findings does not affect the Department's ultimate conclusion concerning the taxpayer's qualifications to file under the FIT. Even after determining that taxpayer's "service income from securitizations" represents income derived from a Qualifying Transaction" and, after accumulating that income with the taxpayer's income from other Qualifying Transactions, taxpayer fails to meet the 80 percent benchmark necessary to file under the state's Financial Institution's tax.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE
REVENUE RULING 2001-05 ST
JUNE 28, 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 the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE I

Sales/Use tax: Application of sales/use tax to assignee of lease.

Authority: Ind. Code 6-2.5-2-1, 6-2.5-4-10(a).

The taxpayer requests the Department to rule on the collection of sales tax on leases by an assignee.

ISSUE II

Sales/Use tax: Conditional sales.

Authority: Ind. Code 6-2.5-2-1, 6-2.5-8-8

The taxpayer requests the Department to rule on the collection of sales tax and/or the securing of an exemption on a conditional sale transaction.

STATEMENT OF FACTS I

The taxpayer ("Bank") is an Indiana based financial institution involved in the assignment of leases and conditional sales. The bank's involvement is as the assignee of the leases and not as lessor or lessee. The Bank requests the Department to rule on the collection of sales tax on leases by an assignee. The first issue, the assigned lease, is described by the Bank as when "a lease is

perfected between the lessor and lessee of tangible personal property. The stream of payments is assigned to a third party for collection of payments. The assignee does not take title to the property. Title remains with the lessor. The assignee does acquire a security interest in the property. Title to the property may be taken by the assignee if the lease payments are defaulted."

DISCUSSION I

IC 6-2.5-4-10(a) states, "[a] person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person." The lessor is responsible for the collection of sales tax. "The retail merchant shall collect the [state gross retail] tax as agent for the state." IC 6-2.5-2-1. The lessor may, by agreement, assign an agent (de facto lessor) to collect the lease payment and sales tax. This agreement is accomplished through a properly executed assignment agreement. The lessor, however, remains secondarily liable if the assignee fails to collect the tax.

RULING I

The lessor is required to collect sales tax unless a specific agreement between the assignee [Bank] and the lessor exists. The lessor may, by agreement, assign an agent (de facto lessor) to collect the lease payment and sales tax. This agreement is accomplished through a properly executed assignment agreement. The lessor, however, remains secondarily liable if the assignee fails to collect the tax.

STATEMENT OF FACTS II

The Bank describes the second issue, conditional sales, as follows; "a broker arranges sale of tangible personal property between a retail merchant and a buyer. The broker finances the transaction. The streams of payment are assigned to a third party for collection."

DISCUSSION II

The responsibility for the collection of sales tax and of the securing of an exemption certificate lies with the retail merchant. In the instant case, the party responsible for the collection of tax is the seller and not the third party. IC 6-2.5-2-1 states, "the retail merchant shall collect the tax as agent for the state." To be considered a retail merchant, a person must be "engage[d] in selling at retail."

The seller may, by agreement, assign the collection of the payments and sales tax to a third party. The seller, however, remains secondarily liable if the assignee fails to collect the tax. The retail merchant in a conditional sales agreement is responsible for securing the exemption certificate. IC 6-2.5-8-8.

RULING II

A retail merchant shall collect sales tax as agent for the state in a conditional sale. IC 6-2.5-2-1. The seller, as the retail merchant in the conditional sales agreement, is responsible for securing the exemption certificate. IC 6-2.5-8-8. The lessor should advise the assignee if an exemption certificate has been secured.

The seller may, by agreement, assign the collection of the payments and sales tax to a third party. The seller, however, remains secondarily liable if the assignee fails to collect the tax. The retail merchant in a conditional sales agreement is responsible for securing the exemption certificate.

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

INDIANA DEPARTMENT OF REVENUE
REVENUE RULING 2001-06 ST
JULY 26, 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 the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE I

Sales tax: Application of sales tax to not-for-profit University.

Authority: Ind. Code 6-2.5-5-25, 45 IAC 2.2-5-55

The taxpayer requests the Department to rule on the application of sales tax to a not-for-profit University when renting a hotel room for a recruit.

ISSUE II

Innkeeper's Tax: Application of innkeeper's tax to not-for-profit University.

Authority: Indiana Code 6-9-8

The taxpayer requests the Department to rule on the application of innkeeper's tax to a not-for-profit University.

STATEMENT OF FACTS

The taxpayer ("school") is a not-for-profit University located in Indiana. When recruiting to fill a position, the school will bring candidates to Indiana for interviews, often requiring an overnight stay in a local hotel. All overnight stays are billed directly to the school.

DISCUSSION I

IC 6-2.5-5-25 states "transactions involving tangible personal property or service are exempt from the state gross retail tax, if the person acquiring the property or service: is an organization which is granted a gross income tax exemption under IC 6-2.1-3-20, IC 6-2.1 –3-21, or IC 6-2.1-3-22; primarily uses the property or service to carry on or to raise money to carry on the not-for-profit purpose for which it receives the gross income tax exemption; and is not an organization operated primarily for social purposes."

The exemption is further clarified by 45 IAC 2.2-5-55. "The organization is not operated predominantly for social purposes. The article purchased must be used for the same purpose as that for which the organization is being exempted. *Purchases for the private benefit* of any member of the organization or *for any other individual, such as meals or lodging, are not eligible for exemption* [italics added]."

For the school's purchase to qualify for tax-exempt status, it must 'primarily use the property or service to carry on…the not-for-profit purpose for which it receives the gross income tax exemption.' The school's tax-exempt status, the primary purpose, is its educational mission.

A purchase for the private benefit of an individual is a purchase for which the individual, and not the organization, receives the advantage.

RULING I

The taxpayer will not be exempted from paying sales tax on a hotel room used for recruits.

DISCUSSION II

An innkeeper's tax is levied on every person engaged in the business of renting or furnishing lodgings for less than 30 days in Marion County. IC 6-9-8-2 states that "All of the provisions of IC 6-2.5 relating to rights, duties, liabilities, procedures, penalties, definitions, exemptions, and administration shall be applicable to the imposition and administration of the tax imposed by this section except to the extent such provisions are in conflict or inconsistent with the specific provisions of this chapter or the requirements of the county treasurer."

An exemption does exist if the taxpayer is exempted under IC 6-2.5. The reasoning used in "Discussion I" of this ruling is also applicable to the liability for the Marion County innkeeper's tax.

RULING II

The school is also subject to the Marion County innkeeper's tax when renting a room for a recruit for a period of less than thirty (30) days.

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, changes in 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 #2001-07 ST
July 26, 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 affect 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.

Sales/Use Tax- Application of Sales/Use Tax to Banquet/Catering Service Charge
Authority: IC 6-2.5-4-1(g)

The taxpayer requests the Department to rule on the taxability of service charges related to banquets/catering.

STATEMENT OF FACTS

The taxpayer is in the hotel industry and charges a fee for service, not a voluntary gratuity, for banquet/catering events. The service fee is itemized and listed separately on the invoice.

DISCUSSION

IC 6-2.5-4-1(g) states:

Gross retail income does not include income that represents charges for serving or delivering food or beverages furnished, prepared, or served for consumption at a location, or on equipment, provided by the retail merchant. However, the exclusion under this subsection only applies if the charges for the serving or delivery are stated separately from the price of the food or beverages when the purchaser pays the charges.

This statute is intended to exempt only those services which are directly related to serving and/or delivering food. The intent is not to provide a blanket exemption for overhead charges while serving and/or delivering food. Therefore, a service charge to serve and/or deliver food would be exempt from sales/use tax. Service charges for insurance, depreciation, and other operational costs would not be exempt. Even a service charge for preparing food in this case is subject to sales/use tax, as the preparation of the food is not part of the serving and/or delivery of the food. In the case that the charges are exempt, they must be separately stated on the invoice and excluded from the calculation of the total tax due.

RULING

The Department rules that the separately stated service charges which are directly related to the serving and/or delivery of food are not subject to sales/use tax. Service charges for insurance, depreciation, and other operational costs are subject to sales/use 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.