INDIANA DEPARTMENT OF INSURANCE

Bulletin 107

January 10, 2002

VOLUNTARY EXPEDITED FILING PROCEDURE FOR TERRORISM EXCLUSIONS

There has been much uncertainty in the markets for commercial lines property and casualty insurance coverage in light of the substantial losses experienced by the industry on September 11, 2001. Soon after the events, many reinsurers announced that they did not intend to provide coverage for acts of terrorism in future reinsurance contracts. This led to a concerted effort on behalf of all interested parties to seek a temporary federal backstop to calm market fears over future terrorist attacks and the ability of the insurance industry to allocate capital to provide coverage for these unpredictable and potentially catastrophic events. Unfortunately, Congress has been unable to reach agreement on the terms of a temporary federal solution. As a result, state insurance regulators find themselves having to consider approval of certain coverage exclusions for acts of terrorism or risk possible solvency concerns in the insurance industry.

The intent of this Bulletin is to inform insurers of the Indiana Department of Insurance's ("Department's") decision to provide to insurers a voluntary procedure to expedite the filing and timely review of certain exclusions for acts of terrorism. The Department has participated in discussions of this issue with the National Association of Insurance Commissioners ("NAIC"). The members of the NAIC have adopted a resolution that states "If the Congress adjourns *[the 107th Congress, First Session adjourn sine die]* without enacting federal terrorism legislation, the states should grant conditional approval to commercial lines endorsements that exclude coverage for acts of terrorism consistent with the exclusion framework developed by the Insurance Services Office (ISO). To the extent permitted by state law, such approvals would sunset or be withdrawn 15 business days after the President signs into law a federal backstop to address insurance losses attributed to acts of terrorism, or be subject to other conditions of the approval consistent with state law." The Department intends to act in a manner consistent with the recommendation from the NAIC membership. The Department believes this to be the best course of action as it balances the needs of insurers to have some certainty related to solvency concerns with the business consumers' concerns that their businesses not be subject to uninsured events.

The Department has received many filings on this issue and has raised objections and concerns about the filings. The Department has completed its review of the following terrorism exclusions filed by the ISO. In order to provide guidance to the insurance industry and provide an expedited filing process this Department will not object to exclusions that are substantially similar to the series of optional endorsements developed by the ISO. These endorsements include the following:

COMMERCIAL PROPERTY INTERLINE ENDORSEMENT: IL 09 41 01 02
(N/A to Standard Fire Policy States)
COMMERCIAL PROPERTY INTERLINE ENDORSEMENT: IL 09 40 01 02
(Applies in Standard Fire Policy States)
COMMERCIAL PROPERTY INTERLINE ENDORSEMENT: IL 09 42 01 02
(Applies in Standard Fire Policy States)
COMMERCIAL GENERAL LIABILITY ENDORSEMENT: CG 21 69 0102
COMMERCIAL GENERAL LIABILITY ENDORSEMENT: CG 31 42 01 02
COMMERCIAL GENERAL LIABILITY ENDORSEMENT: CG 31 43 01 02
COMMERCIAL LIABILITY UMBRELLA ENDORSEMENT: CU 21 29 01 02
BUSINESSOWNERS ENDORSEMENT: BP 05 11 01 02 (N/A to Standard Fire Policy States)
BUSINESSOWNERS ENDORSEMENT: BP 05 12 02 (Applies in Standard Fire Policy States)
BUSINESSOWNERS ENDORSEMENT: BP 05 13 01 02
FARM LIABILITY ENDORSEMENT: FL 10 30 01 02

In an unprecedented move in recognition of the seriousness of the situation, ISO has indicated that it will permit the use of its copyrighted language by any insurer, including one that is not a current licensee of ISO for policy forms. Insurers that are current licensees of ISO for policy forms can use the new language pursuant to their current ISO agreements and filing of its forms with this Department. If an insurer is properly affiliated with ISO, and has given them authorization to file on its behalf, no further action is needed on the insurer's part.

Any insurer that does not have a license agreement in effect with ISO for policy forms is required to execute a short, limited license agreement that authorizes the use of the new language. ISO has indicated that there will be no fee for this limited license. Interested insurers should contact ISO's Customer Service department directly for more information at 1-800-888-4ISO(4476). Insurers may also contact ISO at "info@ISO.com." Insurers will be responsible for assuring compliance with this state's filing requirements and should find the expedited filing process outlined in this bulletin helpful in receiving prompt acknowledgement of their filings.

The Department will accept as filed, without additional questions or requests for information, terrorism exclusions for commercial property and casualty products that comply with this Bulletin and that do not exclude coverage beyond what the ISO endorsements exclude, as summarized below:

- For commercial property insurance coverage, acts of terrorism are excluded only if the acts result in industry-wide insured losses that exceed $25,000,000 for related incidents that occur within a 72 hour period, unless:
  - The act involves the use, release or escape of nuclear materials, or that directly or indirectly results in nuclear reaction or radiation or radioactive contamination;
  - The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
  - Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.
- For commercial liability insurance coverage, acts of terrorism are excluded only if the acts result in industry-wide insured losses that exceed $25,000,000 for related incidents that occur within a 72 hour period or fifty (50) or more persons sustain death or serious physical injury,
  - The act involves the use, release or escape of nuclear materials, or that directly or indirectly results in nuclear reaction or radiation or radioactive contamination;
  - The act is carried out by means of the dispersal or application of pathogenic or poisonous biological or chemical materials; or
  - Pathogenic or poisonous biological or chemical materials are released, and it appears that one purpose of the terrorism was to release such materials.

  For purposes of this provision, serious physical injury means:
  - Physical injury that involves a substantial risk of death;
  - Protracted and obvious physical disfigurement; or
  - Protracted loss of or impairment of the function of a bodily member or organ.

The Department will also accept the following ISO definition of acts of terrorism, or definitions that are more liberal to policyholders:

Terrorism means activities against persons, organizations or property of any nature:

1. That involve the following or preparation for the following:
   a. Use or threat of force or violence; or
   b. Commission or threat of a dangerous act; or
   c. Commission or threat of an act that interferes with or disrupts an electronic, communication, information, or mechanical system; and
2. When one or both of the following applies:
   a. The effect is to intimidate or coerce a government or the civilian population or any segment thereof, or to disrupt any segment of the economy; or
   b. It appears that the intent is to intimidate or coerce a government, or to further political, ideological, religious, social or economic objectives or to express (or to express opposition to) a philosophy or ideology.

To receive expedited review of a filing to exclude terrorism from a commercial property and casualty insurance policy the insurer should use this Department's P&C Filing Form and clearly indicate that the insurer is requesting expedited review under this Bulletin. Further, the insurer must certify that it is either using the ISO endorsements or using an endorsement that provides coverage at least as broad as the approved ISO endorsements. Finally, in the interest of fair disclosure of this important issue, the Department directs insurers to provide notice of this exclusion to all affected insureds upon renewal of the policy.

Indiana Department of Insurance
By: _____
Sally McCarty, Commissioner

DEPARTMENT OF STATE REVENUE
STATE OF INDIANA

IN REGARDS TO THE MATTER OF:
LOYAL ORDER OF MOOSE LODGE #2517
DOCKET NO. 29-20010152

FINDINGS OF FACT, CONCLUSIONS OF
LAW AND DEPARTMENTAL ORDER

An administrative hearing was held on Wednesday, October 17, 2001 in the office of the Indiana Department of State Revenue, 100 N. Senate Avenue, Room N248, Indianapolis, Indiana 46204 before Bruce R. Kolb, an Administrative Law Judge acting on behalf of and under the authority of the Commissioner of the Indiana Department of State Revenue.

The Petitioner was represented by Robert Dunn, Administrator. Steve Carpenter appeared on behalf of the Indiana Department of State Revenue.

A hearing was conducted pursuant to IC 4-32-8-1, evidence was submitted, and testimony given. The Department maintains a record of the proceedings. Being duly advised and having considered the entire record, the Administrative Law Judge makes the following Findings of Fact, Conclusions of Law and Departmental Order.

REASON FOR HEARING

The Petitioner's CG-1 and CG-2 (Indiana Charity Gaming Qualification Application and Indiana Department of Revenue Annual Bingo Application) were received by the Department on February 6, 2001. The Department denied Petitioner's Indiana Charity Gaming License Application in a letter dated June 25, 2001. The Petitioner protested in a timely manner. A hearing was conducted pursuant to IC § 4-32-8-1.

SUMMARY OF FACTS

1) Petitioner applied for an annual charity gaming license on August 7, 2000.
2) The Petitioner's application was denied in a letter dated November 29, 2000.
3) In the Department's letter dated November 29, 2000, the Petitioner was notified that Mr. Jerry Russo was prohibited from associating with charity gaming for a period of two (2) years pursuant to IC 4-32-13-3.
4) The Petitioner reapplied for an annual charity gaming license on February 6, 2001.
5) On April 16, 2001 the Department's investigator conducted an investigation to determine if the previous reasons for Petitioner's denial had been rectified.
6) As a result of the Department's investigation, the Petitioner's application for an annual charity gaming license was denied in a letter dated June 25, 2001.
7) In the Department's letter dated June 25, 2001 the Petitioner was informed that the Department's investigation revealed that Mr. Jerry Russo was present at the lodge when the second application was completed, and that he gave instructions on how to complete the application.
8) The Department also stated that its investigation revealed that the Petitioner does not own the building in which its gaming was to be conducted contrary to its response to question #6 on its CG-2.
9) The Department's investigator also found that some individuals listed as operators and workers are no longer members of Petitioner's organization, or are too ill to volunteer.
10) The Department also alleged that one individual listed as a bingo worker was actually a bartender, and not a member of Petitioner's organization.
11) The Petitioner protested the Department's denial in a letter dated June 29, 2001.

FINDINGS OF FACTS

1) The Department's investigator stated at hearing that the members she interviewed confirmed that Mr. Russo was present when the Petitioner was filling out its application for charity gaming, and that Mr. Russo helped in completing the application. (Record at 12).
2) The Petitioner, through its witness, testified that Mr. Russo was present while they were filling out the application, but refused to help in any way citing the fact that he was barred from associating with any charity gaming. (Record at 20).
3) Several workers and operators questioned by the Department's investigator stated that they were not members of the organization. (Record at 14-15).
4) The Petitioner's bartender who sold pull tabs was not a member of Petitioner's organization. (Record at 22).
5) An individual who is selling pull tabs must be an operator of the organization. (Record at 25).
6) The Petitioner's representative stated that several of their operators and workers were indeed unable to volunteer because of health, but that their health had deteriorated after the application had been filed with the Department. (Record at 26).
7) The Petitioner was in fact leasing the property in question. (Record at 21).
8) Petitioner also verified that Mr. Russo and several of its members have left the organization over disputes arising from gaming activities. (Record at 24).
9) Petitioner's witness also admitted that the information contained in the application in question was not accurate. (Record at 26).

STATEMENT OF LAW

1) Pursuant to IC 6-8.1-5-1, the Department's findings are prima facie evidence that the Department's claim is valid. The burden of proving that the findings are wrong rests with the person against whom the findings are made. See Portland Summer Festival v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993).
2) IC 4-32-9-28 states, "An operator must be a member in good standing of the qualified organization that is conducting an allowable event for at least one (1) year at the time of the allowable event."
3) IC 4-32-9-29 states, "A worker must be a member in good standing of a qualified organization that is conducting an allowable event for at least thirty (30) days at the time of the allowable event."

4) "Operator" means an individual who is responsible for conducting an allowable event for a qualified organization under this article in accordance with the Indiana law. See IC 4-32-6-17.

CONCLUSIONS OF LAW

1) The Petitioner at hearing failed to meet its burden of proof.
2) The lack of detailed information supporting the Petitioner's appeal was sufficient to support the denial the Petitioner's application.
3) It is clear that the Petitioner was lax in its attention to detail. These oversights may seem trivial to the Petitioner, but the information gathered on the CG-1 and CG-2 is vital in qualifying an organization to conduct gaming.
4) However, the missing information can be provided and the application resubmitted again in its completed form.

DEPARTMENTAL ORDER

Following due consideration of the entire record, the Administrative Law Judge recommends the following:
Petitioner's appeal is denied.
1) Under IC 6-8.1-5-1, the organization may request a rehearing. However, rehearings are granted only under unusual circumstances. Such circumstances are typically the existence of facts not previously known that would have caused a different result if submitted prior to issuance of the Departmental Order.
2) A request for rehearing shall be made within seventy-two (72) hours from the issue date of the Departmental Order and should be sent to the Indiana Department of Revenue, Legal Division, Appeals Protest Review Board, P.O. Box 1104, Indianapolis, Indiana 46206-1104.
3) Upon receipt of the request for rehearing, the Department will review the respective file and the rehearing request to determine if sufficient new information has been presented to warrant a rehearing.
4) The Department will then notify the organization in writing whether or not a rehearing has been granted. In the event a rehearing is granted, the organization will be contacted to set a rehearing date.
5) If the request for rehearing is denied or a request is not made, all administrative remedies will have been exhausted. The organization may then appeal the decision of the Department to the Court of proper jurisdiction.

THIS DEPARTMENTAL ORDER SHALL BECOME THE FINAL ORDER OF THE INDIANA DEPARTMENT OF STATE REVENUE UNLESS OBJECTIONS ARE FILED WITHIN SEVENTY-TWO (72) HOURS FROM THE DATE THE ORDER IS ISSUED.

Dated: _____ _____
Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #60
SALES TAX
DECEMBER 2001

(Replaces bulletin #60 dated December 2, 1987, bulletin #62 dated October 4, 1988 and bulletin #60 dated November, 2000)

Disclaimer: Informational bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules and court decisions. Any information that is not consistent with the law, regulations or court decisions is not binding on either the Department or the taxpayer. Therefore, the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: Construction Contractors

REFERENCE: IC 6-2.5-3-3, IC 6-2.5-4-9, IC 6-2.5-5-3, 45 IAC 2.2-3-7 through 45 IAC 2.2-3-12, 45 IAC 2.2-4-21 through 45 IAC 2.2-4-26

INTRODUCTION

The general rule for the application of sales or use tax is that all sales of tangible personal property are taxable, and all sales of real property are not taxable. This general rule is not changed by the conversion of tangible personal property into realty. Therefore, all construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt.

DEFINITIONS

A. "Construction Contractor" means anyone who is obligated under the terms of a contract to furnish the necessary labor or materials, or both, to convert construction material into realty, including a general or prime contractor, a subcontractor, or a specialty contractor. The term includes a person engaged in the business of: building, cement work, carpentry, plumbing, heating and cooling, electrical work, roofing, wrecking, excavating, plastering, tile work, road construction, landscaping, or installing underground sprinkler systems.

Persons selling and installing personal property such as manufacturing equipment, carpeting, appliances, water softeners, water heaters, garage door openers, telephone or intercom systems under a "lump sum purchase price" are not construction contractors. However, the sales and installation of these properties do result in the conversion of tangible personal property into realty. Therefore, these persons must collect the Indiana sales tax on the purchase price of the personal property and all incidental materials used to install the personal property.

The retail merchant must list separately on its invoices any charges for services not specifically taxable and the purchase price for tangible personal property which is taxable. If the service charges are not separately stated as required, the entire invoice amount will be taxable as a unitary transaction.

B. "Construction materials" means any tangible personal property to be used for incorporation in or improvement of a facility or structure constituting or becoming part of realty. A "facility" means any additions to the land.

C. "Lump sum contract" means a contract to incorporate construction materials into real estate with the charge for labor and materials being quoted as one price. The contractor may subsequently furnish a breakdown of the charges for labor and materials without changing the nature of the lump sum contract. For example, a typical lump sum contract provides that the contractor will build a structure for a total stated price such as $40,000. A lump sum contractor generally must pay sales tax to the vendor who sells the contractor construction materials. If the vendor is located out-of-state and is not required to collect Indiana sales tax or if the person for whom the structure is being built would be exempt from sales tax for the purchase of the construction materials, the lump sum contractor would not pay sales tax. Although the contractor may not pay sales tax when purchasing material from an out-of-state vendor, the contractor would be liable for use tax if the construction materials are stored, used or consumed in Indiana for a nonexempt purpose. Unless otherwise exempt, when a lump sum contractor purchases construction materials free of sales tax, the contractor must pay use tax on those materials when they are incorporated into real property in Indiana. To purchase construction materials exempt from sales tax, a lump sum contractor must be registered as a retail merchant.

D. "Time and materials contract" means a contract to incorporate construction materials into real estate with the charge for the labor and materials being separately stated and the final contract price being dependent on the cost of the materials and the amount of labor it actually takes to complete the contract. For example, a typical time and materials contract provides that the contractor will build a permanent structure for ten percent (10%) above the actual cost of the materials plus forty dollars ($40.00) per hour for the labor. Time and materials contractors are considered retail merchants making retail transactions with respect to the sale of construction materials and must register as retail merchants with the Department. Contractors that perform time and material contracts must separately state the charge for any construction materials and must collect Indiana sales tax on the full sales price of the construction material including overhead and profit charges. The construction materials used by a contractor in a time and materials contract should be purchased exempt by the contractor. The sales tax collected by the contractor must be separately stated on the invoice. A time and materials contractor would be entitled to the one percent (1%) collection allowance for timely remittances. Exemption certificates and direct pay permits must be retained by time and materials contractors to prove their non-liability for collecting sales tax on a sale of construction materials. If a time and materials contractor purchases construction materials exempt from sales tax and subsequently uses those materials to fulfill a lump sum contract, the contractor would be subject to use tax on those materials.

E. "Improvement to real estate" means that personal property has been incorporated into and becomes a permanent part of the real property. To accomplish this, the personal property generally takes on an immovable character. An immovable fixture is characterized by three elements:

(1) Real or constructive annexation of the article in question to the land.

(2) Adaptation of the personal property as part of the land.

(3) The intention of the party making the annexation to make the personal property a permanent part of the land so that it would pass with the land upon a sale.

Indiana Property Tax regulations may be consulted as a guideline to determine whether property is real or personal, but it should not be considered determinative.

Tax Consequences

A contractor's purchase of machinery, tools, equipment and supplies that are not incorporated into the structure being built is subject to sales and/or use tax at the time of purchase. No exemption is available to the contractor because of the exempt status of the customer. Rule 45 IAC 2.2-3-12 [C], which is specifically applicable to contractors under contract for an improvement to real estate with an organization entitled to exemption from sales and use tax, states:

(1) Utilities, machinery, tools, forms, supplies, equipment, and any other items used or consumed by the contractor and which do not become part of the improvement to real estate are not exempt regardless of the exempt status of the person for whom the contract is performed.

Note:

In the construction and repair of public roads, bridges, highways and other public infrastructure for a governmental entity, a contractor may be specifically required to provide certain items of tangible personal property for the safety of the public, for traffic

control, or to enable the government to perform its responsibilities. Such items include, but are not limited to, traffic signals; signs; barrels; barricades; temporary pavement markings; materials to construct temporary traffic lanes, roads and bridges; erosion control and drainage materials; aggregates used to set grades; and field offices and communications equipment, provided such offices and equipment are exclusively for government representatives. The purchase, lease or use of such items by a contractor or its subcontractor to comply with the requirements of a government construction contract are not subject to sales or use tax, provided the item is used solely, in connection with the construction and/or repair of public roads, bridges, highways or other public infrastructures that will be paid for by a governmental entity and is not used for any other purpose.

Direct Payment Permits

A contractor holding a direct payment permit may issue it to his suppliers, but when acting as a contractor should remember that he must obtain an exemption certification—not a direct payment permit—from any exempt customer for whom he is making an improvement to real estate as a result of a lump sum contract.

A lump sum contractor does not sell tangible personal property or collect sales tax as a result of the contract and may not accept a direct payment permit. If the organization, for which the contractor is constructing the improvement, is entitled to an exemption, it must give the contractor an exemption certificate (Form ST 105) -- not a direct payment permit—certifying the exemption.

A prime contractor receiving an exemption certificate for a particular job should pass the exemption on to the subcontractor.

Asphalt Manufacturers

The manufacturing exemption will apply to an asphalt plant and paver, including repair parts and fuel for the respective equipment. Asphalt manufacturers/contractors will be granted an exemption for dump trucks used to transport "hot mix asphalt" from their asphalt plant to the job site. No exemption is available to the extent the respective dump trucks are used to haul "raw materials". Additionally, no exemption for dump trucks is available to contractors who do not produce "hot mix asphalt". Actual records must be maintained to document the exempt usage, if any. Graders, rollers, distributors, front-end loaders and other construction equipment are not exempt and will be subject to Indiana sales and use tax.

Streets and Sewer

Contractors acquiring material for incorporation as an integral part of a public street or of a public water, sewage or other utility service system are exempt from sales tax on the purchase of the construction material. The public street or public utility service system must be required under an approved subdivision plot and must be accepted by the appropriate Indiana political subdivision to be publicly maintained after its completion.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE

04970149.LOF

LETTER OF FINDINGS NUMBER: 97-0149
Withholding, Food and Beverage, Retail Sales Taxes
For the Year 1996

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

ISSUE

I. Withholding, Retail Sales, Food and Beverage Tax Assessments Made Against Taxpayer as Responsible Officer

Authority: IC 6-2.5-2-1(a, b); IC 6-2.5-6-1(a); IC 6-2.5-9-3; IC 6-3-4-8(g); IC 6-8.1-5-1(b); IC 6-9-12-7; Indiana Dept. of Revenue v. Safayan, 654 N.E.2d 270 (Ind. 1995)

Taxpayer protests the assessment of retail sales, food and beverage, and withholding taxes as a responsible corporate officer.

STATEMENT OF FACTS

Taxpayer was determined to be a responsible officer for a failed restaurant and, as a result, was assessed liability for unpaid food and beverage, retail sales, and withholding taxes in 1997. Taxpayer submitted a protest letter on March 2, 1997 requesting a hearing to challenge the assessments. The Department responded on March 6 acknowledging receipt of the protest. The taxpayer was repeatedly offered the opportunity to schedule a protest hearing and invited to submit information substantiating the basis for his protest. After taxpayer failed to respond to the initial correspondence, a hearing was scheduled for October 9, 2001 at 10:00 AM. The taxpayer was notified of that hearing by certified mail on September 7, 2001. The taxpayer declined the opportunity to attend but submitted a facsimile on October 11 indicating his inability to attend the hearing but his intention to submit information regarding his "position" by October 12. The Department responded indicating an intention to prepare a Letter of Findings determinative of the protested issues if no further information was submitted. The taxpayer submitted a second facsimile on October 12 in

which he disavowed ever having submitted the original March 1997 protest letter. Additionally, taxpayer disavowed any knowledge that the corporation owed unpaid taxes. Taxpayer did not request a hearing and did not offer to provide documentation substantiating his assertions. This Letter of Findings followed.

DISCUSSION

I. Withholding, Retail Sales, Food and Beverage Tax Assessments Made Against Taxpayer as Responsible Officer

The taxes at issue include food and beverage, retail sales, and withholding taxes as against the taxpayer individually.

Withholding taxes may be assessed against a responsible officer under the provisions of IC 6-3-4-8(g) which states that "[I]n the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

Similarly, an individual may be held personally liable for unpaid sales taxes. IC 6-2.5 et seq. describes the manner in which the retail sales tax is assessed, imposed, and collected.

> An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana. The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. *The retail merchant shall collect the tax as agent for the state*. IC 6-2.5-2-1(a, b) (Emphasis added).
>
> Each person liable for collecting the state gross retail or use tax shall file a return for each calendar month and pay the state gross retail and use taxes that the person collects during that month... IC 6-2.5-6-1(a).
>
> An individual who: (1) is an individual retail merchant or is an employee, officer, or member of a corporate or partnership retail merchant; and (2) has a duty to remit state gross retail or use taxes to the department; holds those taxes in trust for the state and *is personally liable for the payment of those taxes*, plus any penalties and interest attributable to those taxes, to the state. IC 6-2.5-9-3 (Emphasis added).

A responsible officer may also be assessed for the payment of unremitted food and beverage taxes. Under IC 6-9-12-7, "The county food and beverage tax shall be imposed, paid, and collected in the same manner that the state gross retail tax is imposed, paid, and collected under IC 6-2.5." Accordingly, assessing "responsible officers" for the payment of county food and beverage taxes is authorized under IC 6-2.5-6-1(a) by means of the mandate provided in IC 6-9-12-7.

Pursuant to Indiana Dept. of Revenue v. Safayan, 654 N.E.2d 270, 273 (Ind. 1995), three factors are relevant in determining if taxpayer is a corporate officer who had the authority and responsibility for the payment of taxes held in trust for the state. The court will look to the person's authority within the power structure of the corporation. Where that person is a high-ranking corporate officer within the corporate power structure, that officer is presumed to have had sufficient control over the company's finances to give rise to a duty to remit trust taxes. The presumption may be rebutted by a showing the officer did not in fact have that authority.

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

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

In the restaurant's business tax application dated October 28, 1990, taxpayer is listed as the corporation's president. In his position as corporate officer, taxpayer signed Indiana corporate tax returns. On those returns, taxpayer is listed as owning 50 percent of the corporation's shares. In documents filed with the bankruptcy court on February 14, 1997, the minority shareholders indicate that taxpayer was relieved of his responsibility as president on January 6, 1997 but that taxpayer thereafter retained the ability to write checks on corporate funds and to make use of corporate credit cards.

Under IC 6-8.1-5-1(b), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Other than making a bare averment of the assessment in the March 1997 protest letter and in the October 2001 facsimile, taxpayer has provided no substantive information to refute the propriety of the assessments. Other than making an assertion that persons other than himself were in control of the corporation during that latter half of 1996, taxpayer has provided nothing to justify a determination that taxpayer was not a "responsible officer" of that corporation. Under the standards for determining responsible officer status as set forth in Safayan, taxpayer occupied the position of corporate president and as such was presumed to have had control over the company's finances which gave rise to a duty to remit the trust taxes. In addition, unrefuted evidence demonstrates that taxpayer had absolute discretionary control over payments from corporate funds and that taxpayer exercised that control. Taxpayer has failed to meet his burden of demonstrating that the assessments against him for unpaid food and beverage, retail sales, and withholding taxes were incorrect.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04970394.LOF

LETTER OF FINDINGS NUMBER: 97-0394 ST
Sales and Use Tax
For Tax Periods: 1993 through 1995

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

ISSUE

Sales and Use Tax – Public Transportation Exemption

Authority: IC 6-2.5-3-2, IC 6-2.5-5-27, IC 26-1-2-319(1), National Serv-All, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), Indiana Waste Systems of Indiana, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), Panhandle Eastern Pipeline Company and Trunkline Gas Company v. Indiana Department of State Revenue, 741 N.E.2d 816 (Ind. Tax 2001)

The taxpayer protests the assessment of tax on certain trucks, gasoline, parts and accessories for those trucks.

STATEMENTS OF FACTS

The taxpayer is an Indiana corporation that has two separate business locations. It operates a stone manufacturing plant and service operations and two trucking operations. The Indiana Department of Revenue assessed additional sales and use tax, interest and penalties after a routine audit. The taxpayer timely protested the assessment. Further facts will be provided as necessary.

Sales and Use Tax – Public Transportation Exemption

DISCUSSION

IC 6-2.5-3-2 imposes the use tax on "the storage, use, or consumption of tangible personal property in Indiana,... " Certain items qualify for the public transportation exemption to the use tax pursuant to the following provisions of IC 6-2.5-5-27:

> Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

Within its corporate structure the taxpayer operates two kinds of trucking operations. The first trucking operation is for local hauling of its own property. It hauls stone from the stone quarry to the mill where the stone is cut to customers' orders. The second trucking operation is operated pursuant to an Interstate Commerce Commission permit as a for hire carrier. The auditor determined that the percentages of the taxpayer's trucking operations which are attributable to the hauling of their own products are 41.4%, 39.31% and 56.10% for 1993, 1994 and 1995 respectively. In the two years, 1993 and 1994, that the taxpayer's trucking operation pursuant to an Interstate Commerce Commission permit as a for hire carrier was the predominate trucking operation, the auditor granted the taxpayer exemption on these trucks, parts, trailers and fuel pursuant to the public transportation exemption. In 1995, the year that the taxpayer's trucking operation pursuant to an Interstate Commerce Commission permit as a for hire carrier was not the predominate trucking operation, the auditor did not grant the taxpayer exemption pursuant to the public transportation exemption. The audit agreed that the taxpayer properly paid the sales tax on property purchased for the trucking system that transported its own goods.

The taxpayer paid sales tax on the trucks, parts and trailers and most of the fuel on these trucks. The taxpayer mistakenly did not pay tax on some of the fuel and has rectified this situation. The taxpayer contends that the trucks, repair parts, trailers and fuel used in the for hire trucking operation qualify for the public transportation exemption from the use tax for each year of the audit period.

The issue to be determined in this case is how the public transportation exemption from the use tax applies to a taxpayer that transports both its own property and property belonging to others pursuant to governmental regulations.

The Indiana Tax Court has addressed the issue of public transportation in several cases. The first two cases involved contract hauling of garbage. In National Serv-All, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), the Court stated that although National Serv-All "engaged in 'public transportation' when it hauled Contract garbage," nonetheless National Serv-All did not prove "that its hauling of Contract garbage was the *predominant share* of its use of the items at issue." Id. At 959. (Emphasis in the original). The Court concluded: "Although National engaged in the public transportation of property within the meaning of IC 6-2.5-5-27 when it hauled Contract garbage, it did not prove it predominantly engaged in public transportation." Id. at 960.

The Court faced a similar issue concerning the applicability of the public transportation exemption to the contract hauling of garbage in Indiana Waste Systems of Indiana, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994). In that case the Court held as follows:

> Waste Management's maximum annual revenue from public transportation was 17.7 percent of its total revenue, and therefore, the remaining 80 percent of its revenue came from non-public transportation. The predominant use of Waste Management's trucks and other items, therefore, is not exempt...
> Id. at 962.

The third case dealing with this issue in Panhandle Eastern Pipeline Company and Trunkline Gas Company v. Indiana Department of State Revenue, 741 N.E.2d 816 (Ind. Tax 2001). The petitioners were pipeline companies that transported natural gas belonging to third parties and natural gas belonging to the petitioners. In each case, the predominate use of the pipelines was to transport natural gas belonging to others. The Court, after noting the relevance of its two previous cases on public transportation, stated the following.

> If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption.
>
> Id. at 819.

The Indiana Tax Court has set out a two-pronged test to determine if a particular business qualifies for the public transportation exemption from sales and use tax. First the taxpayer must be predominately engaged in public transportation of the property of another. Secondly, the taxpayer's property must be predominately used for providing public transportation.

The first prong looks at the taxpayer itself. A determination must be made whether or not the taxpayer is engaged in public transportation. The second prong looks at the individual units to determine how they are used. Both prongs must be satisfied for the taxpayer to qualify for the public transportation exemption.

In this situation, the taxpayer is primarily engaged in the quarrying and processing of stone. It is not predominately engaged in public transportation. Therefore, having failed the first prong of the test, the taxpayer does not qualify for the public transportation exemption from the sales and use tax for any of the years of the audit.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980316.LOF

LETTER OF FINDINGS NUMBER: 98-0316
Sales and Use Tax
For Tax Periods: 1994

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

1. Sales and Use Tax – Contract for Sale of Services and Tangible Personal Property

Authority: IC 6-2.5-3-2, IC 6-2.5-2-1, IC 6-2.5-4-1, IC 6-2.5-1.1, IC 6-2.5-5-3(b), 45 IAC 2.2-1-2

Taxpayer protests the imposition of tax on a maintenance agreement.

2. Tax Administration – Penalty

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

Taxpayer protests the imposition of the penalty.

STATEMENT OF FACTS

The taxpayer of record is a partnership. After an audit, the Indiana Department of Revenue assessed additional use tax, interest and penalty on one division of the partnership. The taxpayer protested the assessment and two issues remained at the time of the hearing. Further facts will be provided as necessary.

1. Sales Tax – Contract for Sale of Services and Tangible Personal Property

DISCUSSION

Pursuant to a contract, the taxpayer provided maintenance, parts and consumables (except diesel fuel) for slab haulers that another corporation rented from a third party. The audit considered the contract a service agreement and assessed use tax on the tangible personal property that the taxpayer supplied to the other corporation while performing maintenance activities on the slab carriers pursuant to IC 6-2.5-3-2. The taxpayer protested this assessment.

Retail transactions made in Indiana are subject to sales tax. IC 6-2.5-2-1. A retail transaction is defined generally as the acquiring and subsequent selling of tangible personal property. IC 6-2.5-4-1. Except for certain enumerated services, sales of services are generally not retail transactions and are not subject to sales or use tax. IC 6-2.5-1-1.

The contract between the taxpayer and the other corporation recites the duty of the taxpayer at Paragraph 3.1 of the contract as follows:

> From and after the date on which (the other corporation) commences to use the slab carriers, (the taxpayer) shall:
>
> (a) keep the slab carriers in good condition and working order as provided in Paragraph 6.1 and perform all maintenance and repair in accordance with relevant instructions of the manufacturer (another corporation), and in accordance with the

requirements of any equipment lease which may be entered into for the slab carriers by (the other corporation) (the things to be done by (the taxpayer) pursuant to this Paragraph 3 being hereafter called the "Services");

(b) provide all labor, equipment and an adequate inventory of spare parts required for the maintenance and repair of the slab carriers and furnish all consumables required by them, including but not limited to tires, oil (other than diesel fuel), hydraulic fluids and grease; and

(c) establish and conduct a preventive maintenance program, including but not limited to routine oil analysis.

The terms of the contract make it clear that the taxpayer is providing both services and tangible personal property. The services include the routine maintenance of the slab carriers, the labor used in repairing the slab carriers and the designing and implementation of a routine maintenance program for the slab carriers. The tangible personal property provided includes tires, oil, hydraulic fluids and grease.

The gross retail taxation of service contracts is clarified at 45 IAC 2.2-4-2 as follows:

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

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

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

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

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

In the taxpayer's situation, it is clear that the taxpayer is performing services on property that the taxpayer doesn't own and transferring tangible personal property pursuant to a contract. The tangible personal property, tires, etc., appears to exceed ten per cent (10 %) of the value of the contract and the taxpayer did not pay use tax on it at the time of acquisition.

Evidence indicates that the other corporation gave the taxpayer a direct pay permit. Any corporation that applies to the Indiana Department of Revenue may be granted a direct pay permit at the Indiana Department of Revenue's discretion. Retail merchants who receive a direct pay permit from another corporation are not required to collect and remit the sales tax on tangible personal property which they sell to the grantor of the direct pay permit. IC 6-2.5-8-9. Therefore, the taxpayer was not required to collect and remit sales tax on the tangible personal property sold to the other corporation.

FINDING

The taxpayer's protest is sustained subject to audit verification that the property transferred exceeded 10% of the contract amount.

2. Tax Administration – Penalty

DISCUSSION

The taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

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

Although the taxpayer's protest was sustained, there remain other assessments that the taxpayer did not protest. These assessments included such items as office supplies, rags and a tool rest. The rules concerning the payment of use tax on such items are clear and easily accessible in Indiana Department of Revenue publications. The taxpayer's failure to self assess and remit use tax on these clearly taxable items constitutes negligence.

FINDING

The taxpayer's final point of protest is denied.

DEPARTMENT OF STATE REVENUE

04980402.LOF

LETTER OF FINDINGS NUMBER: 98-0402
Tax Administration – Penalty
For Tax Years 1992-1995

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana

Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

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

In letter withdrawing protest on the merits, taxpayer reserved the right to protest the penalty imposed.

STATEMENT OF FACTS

The Department of Revenue audited taxpayer for tax years 1992-1995. The audit resulted in a proposed assessment of gross retail and use tax, and a recommendation that the 10% negligence penalty be imposed. Taxpayer timely protested the proposed assessment, and requested a hearing. Taxpayer ultimately withdrew the protest and requested billing for the taxes due. However, the written withdrawal of taxpayer's protest also included the following: "We reserve the right to protest any penalty that may be assessed." The Department requested further information from taxpayer, solely on the penalty issue, by a certain date. Taxpayer has not provided any information. Further information will be added as necessary.

DISCUSSION

Taxpayer protested the imposition of the 10% negligence penalty in their original letter of protest. After many months of attempting to schedule a hearing, at taxpayer's convenience, on the merits, the Department set a hearing date. Taxpayer failed to appear and failed to communicate with the Department. Eventually, taxpayer left a voice mail message indicating the protest was being withdrawn and that the Department should bill taxpayer for the taxes due. The Department requested a written withdrawal of taxpayer's protest. The written withdrawal "reserved the right to protest any penalty that may be assessed." The Department requested information relevant to the penalty issue by a certain date. Taxpayer has not complied with the Department's request.

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

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

Taxpayer has failed to set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Taxpayer self assessed use tax on point of sale displays and a small amount of expense and fixed assets. The taxpayer was previously audited by the Department and was aware of the use tax applications.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990011.LOF

LETTER OF FINDINGS NUMBER: 99-0011
Sales and Use Tax
For the Period: 1995 - 1997

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

ISSUES

I. Sales and Use Tax – Pattern Shop Patterns

Authority: IC 6-2.5-5-4; Rotation Products Corp. v. Indiana Dept. of State Revenue, 690 N.E.2d 795 (Ind. Tax 1998)

The taxpayer protests the assessment of tax on pattern shop purchases.

II. Tax Administration – Penalty

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

The taxpayer protests the imposition of a negligence penalty

STATEMENT OF FACTS

Taxpayer makes molds/castings that are used to make automotive parts (e.g., brake rotors, brake drums). More facts will be provided as needed below.

I. Sales and Use Tax – Pattern Shop Patterns and Molds

DISCUSSION

At issue in the protest is the taxpayer's pattern shop. The taxpayer describes its process as follows: patterns are used to make castings/molds. The pattern shop engages in building new patterns and what the taxpayer characterizes as the "remanufacturing" of old patterns. The auditor characterized the work on the old patterns as "repair" work.

Taxpayer states that it takes patterns that have become unusable/obsolete from use in the production process and makes the old patterns the "same as new" by, for instance, "adding stock to make patterns precise and tolerant." Finally, the taxpayer concludes that the "remanufacture" of patterns "converts items with little or no market value into a marketable product." Thus, per the taxpayer, equipment used, materials consumed, in "remanufacturing patterns that were broken or otherwise unusable, or remanufactured into repair parts for other manufacturing equipment" should be exempt.

The so-called "industrial/manufacturing exemption" provided in the Indiana Code statutes are cited by the taxpayer:

IC 6-2.5-5-3:

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

And the "consumption" exemption, IC 6-2.5-5-5.1:

(b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for *direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing....* (Emphasis added)

Taxpayer, in addition to the above statutes, cites the multi-factor test set forth in Rotation Products Corp. v. Indiana Dept. of State Revenue, 690 N.E.2d 795 (Ind. Tax 1998) as being germane to an analysis of the exemption statutes. Rotation involved a company that was "engaged in the repair and remanufacture of roller bearings" owned by Rotation's customers. That is, Rotation's customers (steel and paper mills) brought their unusable roller bearings to Rotation for "remanufacturing." The Court held that,

Because RPC's [Rotation] remanufacturing of roller bearings constitutes production within the meaning of the equipment exemption and the consumption exemption, the equipment and materials used in that process are exempt from sales and use tax.

Id. at 805.

The Tax Court arrived at that holding by analyzing four factors: (1) the substantiality and complexity of the work done on the existing article and the physical changes to the existing article; (2) a comparison of the value of the article before and after the work on it; (3) the performance of the article versus that of new articles of the same kind; and (4) whether the work performed on the article is part of the normal life cycle of the existing article. Id. at 803.

Although at first glance the taxpayer's case seems to fit comfortably within cited statutes and Rotation Products, there is at least one fact that makes it dissimilar. The taxpayer does not sell the "remanufactured" patterns. The taxpayer does not "remanufacture" the patterns for a third party—that is, unlike Rotation Products, which remanufactured roller bearings for customers—the taxpayer "remanufactured" its patterns for itself. This makes it difficult to see how the taxpayer can come within the ambit of IC 6-2.5-5-3, which is an exemption for "direct use" in the "direct production" of tangible personal property. Assuming, *arguendo*, that the taxpayer is manufacturing, it does not come within the double-direct test envisioned by IC 6-2.5-5-3.

There is, however, a more relevant statute that the taxpayer does not argue (and interestingly, neither did Rotation Products in its case), namely IC 6-2.5-5-4, which states:

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

The patterns are part of the production process, they are not the end result of the production process—they are a piece of equipment. When the patterns become unusable/obsolete, the taxpayer at that point "remanufactures" the patterns, not for resale, but so that they can be used once again in the manufacturing process. Thus the taxpayer is really arguing, it would appear, that the acquisition of property at issue is for the direct use in the manufacturing of machinery, tools, or equipment (i.e., IC 6-2.5-5-4).

The question, even when framed within the correct statute, still remains, Is the taxpayer "remanufacturing" or is it simply repairing the patterns? The four-factor test outlined in Rotation Products is applicable to that question. And as the Tax Court noted in Rotation Products, the analysis of each factor will turn on a "fact sensitive inquiry." Id. at 802.

The taxpayer argues that each of the four-factors is met:

(1) Substantiality and complexity of the work done on the existing article and the physical changes to the existing article;

The taxpayer's argument with regard to this factor is the following:

"[S]ubstantial and complex work is done to transform the worn or broken pattern into a new pattern, a useful pattern, and repair part for other equipment. Indeed, the substantiality and complexity is equal to that given to making new patterns from raw

materials."

Taxpayer's argument on the first factor is almost entirely devoid of *facts*—instead it merely repeats the language of the test. In another letter to the Department by the taxpayer, the following was stated: "[Taxpayer] will build the patterns back up by adding stock to make patterns precise and tolerant...." Unfortunately this adds little to the analysis of whether the taxpayer meets the first factor or not.

The second factor:

(2) A comparison of the value of the article before and after the work on it;

Taxpayer's argument:

"[T]he worn or broken patterns have no market and only have value as scrap, whereas, the new patterns and repair parts have the same value as a new pattern made from raw materials."

Again, no facts, only an assertion is made. However, the auditor noted to the contrary, stating that a "repaired" pattern "while valuable, was not as good as a new one."

The third factor:

(3) A comparison of the performance of the remanufactured article with the performance of a newly manufactured article of its kind;

Taxpayer's argument:

"[T]he performance of the repaired and remanufactured patterns and repair parts does not differ significantly from patterns and repair parts manufactured from raw materials."

"The performance of remanufactured patterns and molds is the same as a new [one]..."

No facts are marshaled by the taxpayer to allow one to reach the conclusion that the performance is the same. The auditor reached a different conclusion, actually stating why: "the wood from which the patterns were made was subject to progressive weakening from the heat and pressure of the casting process." Further the auditor noted that "[u]nreplaced portions of a repaired pattern were not as strong or supple as virgin lumber."

The final factor:

(4) Is the work performed on the article part of the normal life cycle of the existing article?;

The taxpayer once again merely repeats, in a conclusory fashion, the language of the test (and the parenthetical language of Rotations Products):

"[T]he repair and remanufacture of worn and broken patterns is not a normal part of the patterns life cycle that is tantamount to routine maintenance because there is no expectation that these patterns can be salvaged."

"[The remanufactured patterns have] a useful life of years."

In contrast, the auditor stated:

"The repairs were expected as a normal part of the life cycle of a pattern wherein the heat of the casting process weakened and warped the wooden pattern over time."

Given the "fact sensitive" nature of the four-factor test, and the lack of facts to buttress taxpayer's arguments, taxpayer has failed to show that pattern shop expenses were exempt.

FINDING

Taxpayer's protest is denied.

II. Tax Administration – Penalty

DISCUSSION

Indiana Code 6-8.1-10-2.1 states, in part, that if "the deficiency determined by the Department was due to reasonable cause and not willful neglect, the Department shall waive the penalty." Regulation 45 IAC 15-11-2 also states,

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer."

Taxpayer argues that although it has been audited for Indiana sales and use tax "for every year since it was first incorporated," nonetheless it was not negligent with regards to the collection and self-assessment of tax. To that end, taxpayer notes that taxpayer's "first two sales and use tax audits dealt primarily with contractor issues and poor control of exemption certificates." In response to the audits, taxpayer implemented a system to self-assess "use tax on taxable purchases where the vendor had failed to collect sales tax." Taxpayer, in other words, is arguing that it has taken steps to try and rectify the shortcomings of its self-assessment system.

The implementation of a self-assessment system does evidence reasonable care on the taxpayer's part.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

02990167.LOF

LETTER OF FINDINGS NUMBER: 99-0167
Income Tax
Fiscal years June 30, 1995, June 30, 1996, June 30, 1997, and February 15, 1998

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the negligence penalty.

STATEMENT OF FACTS

The negligence penalty was assessed on an income tax assessment that resulted from a Department audit conducted for the fiscal years ending June 30, 1995, June 30, 1996, June 30, 1997, and February 15, 1998.

The taxpayer provides collection services for its customers. The taxpayer files with its parent for federal purposes. For Indiana purposes, the taxpayer files a separate return.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the negligence penalty should be waived as the taxpayer has complied with Indiana tax regulations in a good faith manner. Furthermore, the error was the result of the unintentional misinterpretation tax regulations.

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

The Department finds the taxpayer was ignorant of Indiana tax regulations. Ignorance is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

04990221.LOF

LETTER OF FINDINGS NUMBER: 99-0221 ST
Sales and Use Tax
For Tax Periods: 1994 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 – Public Transportation Exemption

Authority: IC 6-2.5-3-2, IC 6-2.5-5-27, IC 26-1-2-319(1), 45 IAC 2.2-5-61 (b), National Serv-All, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), Indiana Waste Systems of Indiana, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), Panhandle Eastern Pipeline Company and Trunkline Gas Company v. Indiana Department of State Revenue, 741 N.E.2d 816 (Ind. Tax 2001)

The taxpayer protests the assessment of tax on certain trucks, gasoline, parts and accessories for those trucks.

STATEMENTS OF FACTS

The taxpayer is an Indiana corporation that processes pork bellies and sells the end products. The Indiana Department of Revenue assessed additional sales and use tax, interest and penalties after a routine audit. The taxpayer timely protested the assessment. Further facts will be provided as necessary.

Sales and Use Tax – Public Transportation Exemption

DISCUSSION

IC 6-2.5-3-2 imposes the use tax on "the storage, use, or consumption of tangible personal property in Indiana,... " Certain items qualify for the public transportation exemption to the use tax pursuant to the following provisions of IC 6-2.5-5-27:

> Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property.

The taxpayer processes pork bellies and then sells the end products of bacon bits, cooked bacon slices, cooked round bacon slices, turkey products and oils. The taxpayer also delivers products to its customers. The auditor assessed tax on the taxpayer's trucks, gasoline and repair parts. The taxpayer contends that these items qualify for exemption from the use tax pursuant to the public transportation exemption. The taxpayer supports this contention by citing the definition of public transportation found at 45 IAC 2.2-5-61 (b) as follows:

> Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation unless it is in fact engaged in the transportation of persons or property for consideration as defined above.

The taxpayer alleges that its trucking operation meets this definition of public transportation. Product is delivered FOB the taxpayer's shipping dock. Loss of product liability goes to the customers. The delivery service is optional to the customers. Some customers actually have other trucking services deliver the product. The taxpayer only carries transportation of vehicles liability insurance. The taxpayer's trucks backhaul other products through a freight broker. Taxpayer has a motor carrier permit and is regulated by governmental agencies.

The issue to be determined in this case is how the public transportation exemption from the use tax applies to the taxpayer's delivery process.

The Indiana Tax Court has addressed the issue of public transportation in several cases. The first two cases involved contract hauling of garbage. In National Serv-All, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), the Court stated that although National Serv-All "engaged in 'public transportation' when it hauled Contract garbage," nonetheless National Serv-All did not prove "that its hauling of Contract garbage was the *predominant share* of its use of the items at issue." Id. At 959. (Emphasis in the original). The Court concluded: "Although National engaged in the public transportation of property within the meaning of IC 6-2.5-5-27 when it hauled Contract garbage, it did not prove it predominantly engaged in public transportation." Id. at 960.

The Court faced a similar issue concerning the applicability of the public transportation exemption to the contract hauling of garbage in Indiana Waste Systems of Indiana, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994). In that case the Court held as follows:

> Waste Management's maximum annual revenue from public transportation was 17.7 percent of its total revenue, and therefore, the remaining 80 percent of its revenue came from non-public transportation. The predominant use of Waste Management's trucks and other items, therefore, is not exempt...
>
> Id. at 962.

The third case dealing with this issue in Panhandle Eastern Pipeline Company and Trunkline Gas Company v. Indiana Department of State Revenue, 741 N.E.2d 816 (Ind. Tax 2001). The petitioners were pipeline companies that transported natural gas belonging to third parties and natural gas belonging to the petitioners. In each case, the predominate use of the pipelines was to transport natural gas belonging to others. The Court, after noting the relevance of its two previous cases on public transportation, stated the following.

> If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption.
>
> Id. at 819.

The Indiana Tax Court has set out a two-pronged test to determine if a particular business qualifies for the public transportation exemption from sales and use tax. First the taxpayer must be predominately engaged in public transportation of the property of another. Secondly, the taxpayer's property must be predominately used for providing public transportation.

The first prong looks at the taxpayer itself. A determination must be made whether or not the taxpayer is engaged in public transportation. The second prong looks at the individual units to determine how they are used. Both prongs must be satisfied for the taxpayer to qualify for the public transportation exemption.

In this situation, the taxpayer is primarily engaged in the processing of pork bellies and sale of those products. It is not predominately engaged in public transportation. Therefore, having failed the first prong of the test, the taxpayer does not qualify for the public transportation exemption from the sales and use tax for any of the years of the audit. The Department does not need to determine whether the taxpayer's hauling of its own product is indeed public transportation.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02990422P.LOF

LETTER OF FINDINGS NUMBER: 99-0422P
Income Tax
Calendar 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.

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the negligence penalty.

STATEMENT OF FACTS

The negligence penalty was assessed on an income tax assessment that resulted from a Department audit conducted for the calendar years 1994, 1995, 1996, and 1997.

The taxpayer produces personal and business checks. The checks are sold in Indiana and outside of Indiana. The taxpayer has a manufacturing facility in Indiana. The taxpayer's domicile is out-of-state.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the negligence penalty should be waived as the error was the result of unintentional oversight. The Department points out that unintentional oversight is inattention.

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

The Department finds the taxpayer was inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

02990530.LOF

LETTER OF FINDINGS NUMBER: 99-0530
Adjusted Gross Income Tax
Calendar Years 1991, 1992, 1993, 1994, 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 – Books and Records

Authority: IC 6-8.1-5-4

Taxpayer protests the assessments that were based upon best information available.

STATEMENT OF FACTS

Taxpayer, incorporated under the laws of Indiana in 1985, is a pizza restaurant. An audit was completed on July 6, 1999 based

upon industry averages taken from Dun & Bradstreet's *Industry Norms & Key Business Ratios,* Desk-Top Edition 1998-1999. The industry averages show the net profit after tax. The adjusted gross income is not given. Adjusted gross income includes taxes. Using the data available, audit added the tax back into the net profit to arrive at the industry average adjusted gross income. The Internal Revenue Service supplied the federal tax rates via telephone. State rates were taken from the IT-20SC tax forms. Taxpayer previously filed as a regular corporation. The auditor determined, based upon criteria set forth by the Indiana Regulations for Special Corporations, that the taxpayer qualifies.

Indiana Code 6-8.1-4-2(a)(6) allows Audit to utilize projections and estimates in the absence of actual data. At this date, no additional data has been provided to the hearing officer.

At hearing, taxpayer provided photographs of his burned building and a newspaper article for verification. Taxpayer has not provided additional evidence that the proposed assessment is in error.

I. Tax Administration – Books and Records

DISCUSSION

At issue is whether the taxpayer's best information audit should be adjusted.

At hearing, taxpayer stated it had a fire in December 2000 and was not fully covered with insurance. Further, the assessment is too high. Menu prices indicate prices from $.50 to $5.95 but the Department has no show for the volume of business. Taxpayer states that he would try to get additional information. At the date of this writing, no further information has been provided.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990531.LOF

LETTER OF FINDINGS NUMBER: 99-0531
Sales and Use Taxes
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 – Books and Records

Authority: IC 6-8.1-5-4

Taxpayer protests the assessments that were based upon best information available.

STATEMENT OF FACTS

Taxpayer, incorporated under the laws of Indiana in 1985, is a pizza restaurant. An audit was completed on June 25, 1999 based upon industry averages taken from Dun & Bradstreet's *Industry Norms & Key Business Ratios,* Desk-Top Edition 1998-1999. The industry average net sales were reduced by taxable sales reported by the taxpayer on its ST-103H's. The difference was assessed as unreported taxable sales. No credit was given for exempt sales because no exemption certificates were made available.

Tangible personal property stored, used or consumed in Indiana is subject to Indiana use tax if sales tax was not paid at the point of purchase. Taxpayer did not furnish invoices for audit examination. Industry averages for eating places (SIC5812) show both a gross profit and a net profit after tax. The difference in these two figures is taxpayer's non-inventory expenses. The auditor determined to assess use tax on ten percent (10%) of the total expenses since these figures include taxes and wages as well as consumables.

Indiana Code 6-8.1-4-2(a)(6) allows Audit to utilize projections and estimates in the absence of actual data. At this date, no additional data has been provided to the hearing officer.

On June 12, 2001 a hearing was held.

At hearing, taxpayer provided photographs of his burned building and a newspaper article for verification. Taxpayer has not provided additional evidence that the proposed assessment is in error.

I. Tax Administration – Books and Records

DISCUSSION

At issue is whether the taxpayer's best information audit should be adjusted.

At hearing, taxpayer stated it had a fire in December 2000 and was not fully covered with insurance. Further, the assessment is too high. Menu prices indicate prices from $.50 to $5.95 but the Department has not been provided records for the volume of business. Taxpayer states that he would try to get additional information. At the date of this writing, no further information has been provided.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000254.LOF

LETTER OF FINDINGS NUMBER: 00-0254
Sales and Use Tax
For Tax Periods: 1997-1998

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

ISSUES

1. Sales and Use Tax – Printer Ribbons

Authority: IC 6-2.5-3-2(a), IC 6-8.1-5-1(b), IC 6-2.5-5-3(b), 45 IAC 2.2-5-8(d), Indiana Bell Telephone Co. v. Indiana Department of Revenue, 627 N.E. 2d 1386, Ind. Tax Court (1994)

The taxpayer protests the imposition of tax on printer ribbons.

2. Sales and Use Tax – Labels

Authority: IC 6-2.5-5-6

The taxpayer protests the imposition of tax on labels.

3. Sales and Use Tax – Chemical Solvents

Authority: IC 6-2.5-3-2(a)

The taxpayer protests the imposition of tax on chemical solvents.

4. Sales and Use Tax – Incinerator Replacement Parts

Authority: IC 6-2.5-5-30

The taxpayer protests the imposition of tax on incinerator replacement parts.

5. Tax Administration – Negligence Penalty

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

The taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

The taxpayer is an Indiana corporation that manufactures and sells religious items to Christian Bookstores throughout the United States. The taxpayer manufactures plaques, framed prints, decorated mirrors, jewelry, cards, stationery and novelty items. After an audit for the years 1997 and 1998, the Indiana Department of Revenue assessed additional sales and use tax, penalty and interest. The taxpayer protested this assessment. A hearing was scheduled for September 26, 2001. Since the taxpayer did not appear for the hearing, this Letter of Findings is based upon the information in the file.

1. Sales and Use Tax – Printer Ribbons

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. There are several statutory exemptions from the use tax. It is established law that all tax exemptions must be strictly construed against taxpayers. Indiana Bell Telephone Co. v. Indiana Department of Revenue, 627 N.E. 2d 1386, Ind. Tax Court (1994). Therefore the taxpayer bears the burden of showing that the subject labels meet all the tests for qualification for exemption.

Assessments by the Indiana Department of Revenue are presumed to be accurate and taxpayers bear the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The taxpayer contends that the printer ribbons qualify for exemption pursuant to IC 6-2.5-5-3 (b) as tangible personal property that is directly used in the direct production process of producing a product. 45 IAC 2.2-5-8 (d) defines the direct production process as beginning "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."

Pursuant to 45 IAC 2.2-5-10 (g), items must have a direct and immediate effect on the product being produced to qualify for this exemption. The printer ribbons are used in printers to produce a bar code label that is attached to the product for identification purposes. The bar code labels allow the taxpayer to identify the product throughout the production process. These ribbons do not have a direct and immediate effect on the production of the taxpayer's product. They do not change the product or affect the actual production process in any way. Rather, the use of these ribbons allows for inventory control. This is a taxable use.

FINDING

The taxpayer's protest is denied.

2. Sales and Use Tax – Labels

DISCUSSION

The taxpayer's second point of protest concerns the imposition of use tax on certain labels. These labels are imprinted with the taxpayer's name and "Made in the USA."

The labels are attached to and become a part of the final product. The taxpayer argues that these labels qualify for exemption

as property acquired "for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale is his business" pursuant to IC 6-2.5-5-6.

These labels actually become a part of the taxpayer's final product. Therefore they qualify for this exemption.

FINDING

The taxpayer's second point of protest is sustained.

3. Sales and Use Tax – Chemical Solvents

DISCUSSION

The audit assessed tax on chemical remover, cleaning fluid, screen wash and ink solvent that the taxpayer purchases from various vendors. The audit report indicates that these items are used to clean the equipment daily to insure that the printed matter is sharp and crisp. Materials purchased for use in routine maintenance and cleaning are subject to the use tax pursuant to IC 6-2.5-3-2 (a).

The taxpayer contends that these materials qualify for the directly used in direct production exemption pursuant to IC 6-2.5-3-2 (a). The taxpayer did not, however, offer any evidence that the materials were used in an exempt manner rather than for routine maintenance and cleaning. Therefore, the taxpayer did not sustain its burden of proof.

FINDING

The taxpayer's protest to the tax assessed on chemical solvents is denied.

4. Sales and Use Tax – Incinerator Replacement Parts

DISCUSSION

During the tax period, the taxpayer purchased an element, gasket and temperature control for the incinerator they use to destroy wiping rags used during the production process. The taxpayer contends that these items qualify for exemption from the use tax since they are used in an incinerator required by the Environmental Protection Agency.

IC 6-2.5-5-30 provides an exemption for tangible personal property that is mandated by a governmental agency regulating environmental quality. The taxpayer did not, however, offer any evidence that the Environmental Protection Agency mandated that the taxpayer destroy its wiping rags in this incinerator. Therefore, the taxpayer did not sustain its burden of proof.

FINDING

The taxpayer's protest is denied.

5. Tax Administration – Negligence Penalty

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

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

In this instance, the taxpayer failed to accrue and remit use tax on several items that were prior audit issues. This breach of its duty to properly accrue and remit sales taxes constitutes negligence.

FINDING

The taxpayer's final protest is denied.

DEPARTMENT OF STATE REVENUE

0420010135.LOF

LETTER OF FINDINGS NUMBER: 01-0135
Sales and Use Tax
For Tax Periods: 1997-1999

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

1. Sales and Use Tax – Services with Tangible Personal Property

Authority: IC 6-2.5-2-1, IC 6-2.5-3-2, IC 6-8.1-5-1(b), 45 IAC 2.2-4-2(a)

The taxpayer protests the imposition of charges for certain marketing services.

STATEMENT OF FACTS

The taxpayer is an Indiana corporation that sells automobiles. Additional use tax and interest were assessed after a routine audit. The taxpayer protested a portion of the assessment and a hearing was held by telephone. Further facts will be provided as necessary.

1. Sales and Use Tax – Services with Tangible Personal Property

DISCUSSION

Throughout the tax period the taxpayer contracted for the purchase of marketing services with tangible personal property from one firm. The Indiana Department of Revenue assessed use tax on these purchases. The taxpayer contends that these were actually purchases of services that are not subject to the use tax.

Indiana imposes a gross retail tax on the sales of tangible personal property by retail merchants in Indiana. IC 6-2.5-2-1. Indiana imposes a complementary tax on the use of tangible personal property purchased in a retail transaction. IC 6-2.5-3-2. There is no statutory provision imposing a gross retail tax on services. The tax implications of a sale that includes both services and the sale of tangible personal property are clarified at 45 IAC 2.2-4-2 (a) as follows:

> Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:
>
> (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property:
>
> (2) The tangible personal property purchased is used or consumed as a necessary incident to the service:
>
> (3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and
>
> (4) The serviceman pays gross retail or use tax upon the tangible personal property at the time of acquisition.

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The taxpayer contracts to purchase direct marketing promotions from the vendor. The invoices represent the total cost of the services and tangible personal property transferred in the performance of the service. Based on their market research, the vendor targets a specific demographic and conducts a sale on the taxpayer's premises. One of the vendor's representatives is responsible to plan the sale, attend the sale, register guests, monitor the progress of the sale, determine if a prize has been won and follow up with all the people who attended the sale. During the process of the contest, the vendor mails printed forms to the persons in the targeted demographic. These forms include papers that resemble 1099s, checks, patriotic documents and Internal Revenue Service refund checks and constitute the tangible personal property transferred with the performance of the service.

The vendor considers the transaction the sale of a service and pays use tax on the tangible personal property used in the provision of the service.

The vendor provided the following cost breakdown of the direct marketing promotions.

	1999	1998	1997
Postage	1700	1700	1350
Printing	100	100	100
Prize Insurance	350	350	350
Gifts	200	200	200
Coordinator	200	100	0
Labor	400	400	400
List & Data Research	950	950	950
Total Promotion Cost	3900	3800	3350

The only tangible personal property transferred in each transaction was the category of gifts and printed materials. These gifts were the mock checks and other documents mailed to the target demographic to promote the sale. In each transaction, the cost of the tangible personal property transferred was significantly below ten per cent (10%) of the total cost of the transaction. The remainder of the costs was clearly related to the provision of the vendor's personal services to the taxpayer.

In each of these transactions, the vendor transfers tangible personal property for a consideration along with the provision of a service. Pursuant to the previously cited Regulation, this would transform the provision of the service into a taxable sale by a retail merchant unless four conditions are met. First, the vendor in this situation is in an occupation that primarily furnishes services, direct marketing productions. The tangible personal property, the gifts, is used as a necessary incident to the service. Thirdly, the price charged for the gifts is inconsequential, less than ten per cent (10%) of the total cost. Finally, the vendor pays tax on the tangible personal property that is transferred with the provision of the service. In this situation, each of the four conditions is met. Therefore the taxpayer's purchase of direct marketing promotions is a non-taxable purchase of a service.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420010228P.LOF

LETTER OF FINDINGS NUMBER: 01-0228P
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 protests the penalty assessed on an audit completed on July 25, 2001.

Taxpayer maintains its headquarters out of state and has a manufacturing facility in Indiana. Taxpayer failed to self-assess use tax on clearly taxable fixed asset and general expense purchases such as computers, printers, lighting, racks, sprinklers, tables, an electric welder used in maintenance, forklifts, limestone materials, fans, storage units, a telephone system, office supplies, and other miscellaneous items.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit revealed that it failed to self assess use tax for a majority of its general expenses and fixed assets purchases.

Taxpayer requests a waiver of penalties because it makes every attempt to file its returns timely and accurately. Taxpayer has made changes to assure that it is in compliance in the future and maintains that it has substantially complied with the Indiana Statutes and Rules.

Taxpayer failed to self assess use tax on clearly taxable fixed asset and general expense purchases. Taxpayer failed to remit ninety-five percent (95%), ninety-four percent (94%), and ninety-nine percent (99%) of its use tax in calendar years 1997, 1998, and 1999, respectively. The issues addressed are clearly outlined in the Indiana Code and Regulations.

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

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010229P.LOF

LETTER OF FINDINGS NUMBER: 01-0229P
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 March 21, 2001.

Taxpayer maintains its headquarters out of state and has several business locations in Indiana. Taxpayer failed to self-assess use tax on clearly taxable fixed asset purchases in calendar year 1999.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to self assess use tax for its fixed assets purchases.

Taxpayer requests a waiver of penalties because it makes every attempt to file its returns timely and accurately.

Taxpayer failed to self assess use tax on clearly taxable fixed asset purchases in calendar year 1999. For the three-year audit period, the assessment was more than ninety percent (90%) of the use tax due.

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

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120010231P.LOF

LETTER OF FINDINGS NUMBER: 01-0231P
Individual Income Tax
For the Calendar Year 2000

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

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); IC 6-8.10-5; 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer, in a letter dated August 30, 2001, protested the penalty assessed. Taxpayer states he made an error on the amount he thought he had paid in estimated income tax throughout the year and his tax preparer also made a math error in computing his tax liability. The amount owed is a large financial burden and consideration for the penalty waiver is appreciated.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer requests the penalty be abated because the addition of estimated tax and the penalty is an extremely large burden.

Both the taxpayer and his tax preparer made mistakes in computing the tax liability which is clearly negligent.

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

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010255P.LOF

LETTER OF FINDINGS NUMBER: 01-0255P
Sales 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 May 9, 2001.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that the taxpayer failed to remit sales tax on all of its soft goods. Audit indicates that the total soft goods for 1997 were $589,401, while the taxpayer reported $198,055. Taxpayer reported one third of the total due. Auditor

determined that the percent of error for 1997 based upon this information and the total lease amount was 13.74%. The percent of error was also applied to the total leases in 1998 and 1999.

Taxpayer merely makes a request for the penalty waiver based upon its past filing history, audit cooperation, and willingness to comply with all state imposed regulations. Taxpayer further states that the audit location recently moved from California to Kentucky and has experienced the trickle effects of employee turnover. Taxpayer further assures the Department that it has exercised ordinary business care and prudence in complying with the law and did not willfully disobey any set tax laws, rules and or regulations.

Taxpayer, however, was aware that sales tax was due and should have remitted the tax. Taxpayer's sales tax report noted the sales tax collected but failed to remit the total due. Failure to do so constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990046.SLOF

SUPPLEMENTAL LETTER OF FINDINGS: 99-0046 SLOF
Sales and Use Tax
For the 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.

ISSUES

I. Applicability of the State's Gross Retail Tax on the Transfer of Catalogs from Taxpayer to Parent Corporation

Authority: IC 6-2.5-2-1; IC 6-2.5-3-1(b); IC 6-2.5-3-2(a); IC 6-2.5-4-1(b); IC 6-2.5-4-1(c); Cowden & Sons Trucking, Inc. v. Indiana Dept. of Revenue, 575 N.E.2d 718 (Ind. Tax Ct. 1991); Miles Inc. V. Indiana Dept. of Revenue, 659 N.E.2d 1158 (Ind. Tax Ct. 1995)

Taxpayer takes the position that the business arrangement between itself and its parent company is solely for the provision of services, that no transfer of tangible personal property between the taxpayer and the parent company occurs as a result of that arrangement, and that the provision of catalogs to the parent company's customers does not constitute a transfer of tangible personal property subjecting the taxpayer to the state's gross retail tax.

II. Abatement of the Ten Percent Negligence Penalty

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

Taxpayer argues that it is entitled to abatement of the ten percent negligence penalty and that the Department of Revenue (Department) should exercise its discretion to do so.

STATEMENT OF FACTS

Taxpayer prepares, prints, and distributes catalogs on behalf of the parent company and is located outside the state. Parent company is in the catalog retailing business. A sales tax audit for 1995, 1996, and 1997 was conducted resulting in modifications to the taxpayer's sales tax liability for all years under the audit. The audit determined that the transactions between taxpayer and parent company, evidenced by the transfer of catalogs, constituted retail transactions and were subject to sales tax.

The taxpayer disagreed with the audit's determination on the ground that the activities performed in acquiring and distributing the catalogs were exclusively those of a service provider. Taxpayer was granted a hearing to discuss the issues and a Letter of Findings was issued subsequent to the hearing. The Letter of Findings found that the taxpayer was engaged in retail transactions and was subject to sales tax on payments received for those catalogs which were mailed to parent company's potential customers located in Indiana or delivered to taxpayer's distribution center before being shipped to recipients located both within and outside of Indiana. In addition, the Letter of Findings found that the taxpayer was subject to the ten percent negligence penalty.

Taxpayer argues that the determinations contained within the Letter of Findings were wholly without merit and requested the opportunity for a rehearing on the identical issues. That request was granted, a rehearing was conducted, and this Supplemental Letter of Findings revisits the issues.

DISCUSSION

I. Applicability of the State's Gross Retail Tax on the Transfer of Catalogs from Taxpayer to Parent Corporation

Indiana's gross retail (sales tax) is imposed on "retail transactions" conducted within the state. IC 6-2.5-2-1. Retail transactions are defined as "selling at retail." Id. IC 6-2.5-4-1(b, c) defines "selling at retail," stating that:

> A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he: (1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration. (c) For purposes of determining what constitutes selling at retail, it does not matter whether; (1) the property is transferred in the same form as when it was acquired; (2) the property is transferred alone or in conjunction with other property or services; or (3) the property is transferred conditionally or otherwise.

The taxpayer has entered into an arrangement with parent company whereby taxpayer is responsible for the production and delivery of the parent company's retail catalogs. By the terms of their agreement, taxpayer is made responsible for the selection and supervision of the advertising companies and printers necessary to produce the catalogs. Taxpayer is also made responsible for the distribution of the catalogs to bulk mailing centers or the parent company's distribution center. Under the terms of the agreement, taxpayer is required to "take title" to the catalogs at the time they are delivered and does not transfer title to the parent company.

By the terms of their agreement, the parties agreed that the title to the catalogs would always remain with taxpayer and that the agreement was exclusively one for the provision of the services rendered in the production of the catalog. Specially, the agreement states that, "Except as expressly provided in this Agreement, neither [parent company] nor [taxpayer] authorizes the transfer, use, consumption, control or right of use of the title or possession, whether actual or constructive, of tangible personal property in any manner or form pursuant to this Agreement. Tangible personal property owned or controlled by [parent company] or [taxpayer] shall, at all times, remain in the sole control and possession of respectively, [parent company] or [taxpayer]. *This agreement provides the provision of services only, except as expressly provided herein.* (Emphasis added).

In effect, the parties' agreement explicitly sets forth terms in which taxpayer produces catalogs intended for the use of parent company's customers, provides for the distribution of the catalogs to the parent company's existing and potential customers, but provides that ownership of the catalog remains with taxpayer until the catalogs were actually delivered to the ultimate recipients.

The taxpayer argues that the decision reached by the tax court in Cowden & Sons Trucking, Inc. v. Indiana Dept. of Revenue, 575 N.E.2d 718 (Ind. Tax Ct. 1991) is supportive of its contention that it never intended to transfer ownership of the catalogs to the parent company and that, as a result, it was not responsible for collecting sales tax. In Cowden a trucking company, having engaged in certain transactions in which it transported stone, was assessed sales tax on the value of the transportation services. The Department argued that the service costs were taxable because Cowden had entered into a unitary transaction which included hauling services and the sale of stone. The court disagreed, finding that the sale of the stone was not inextricable and indivisible from the transportation services. The court stated that the issue should be resolved by discerning Cowden's intent and that evidence supported Cowden's "assertion that the acquisition of stone was for the convenience and accommodation of its customers, incidental to its hauling services and not for the purposes of resale." Id. at 721. The court found that the sale of the stone was one transaction and the provision of the services was a second, severable transaction and that the second transaction was not subject to the sales tax. Id. at 722. The court found relevant the fact Cowden did not maintain an inventory of stone to sell to its customers, did not advertise the sale of stone, did not hold itself out as a stone merchant, and that 95 percent of the taxpayer's customers engaged Cowden exclusively for its hauling services. Id. at 721. In addition, Cowden – because it merely charged its customers for the cost of the stone – had no profit motive in selling stone to its customers and that transfer of stone was entirely incidental to Cowden's provision of transportation services. Id. at 721-22.

Taxpayer sets out a second argument based upon the tax court's decision in Miles Inc. V. Indiana Dept. of Revenue, 659 N.E.2d 1158 (Ind. Tax Ct. 1995). In that case, Miles was assessed use tax on certain promotional materials temporarily stored at an Indiana location. The court held that Miles was not subject to the use tax finding that the storage of the promotional materials at Miles' Indiana warehouse facility and the withdrawal of those materials for subsequent shipment outside of Indiana did not constitute a taxable "use" but fell under the storage exception contained in IC 6-2.5-3-1(b). Id. at 1164 Taxpayer's argues that it was not required to assess sales tax because the catalogs were temporarily stored in Indiana for shipment to the ultimate out-of-state recipients of the catalogs. Taxpayer maintains that its position is reinforced by the Department's own published rulings.

Finally, taxpayer makes a more general equitable argument on the ground that the Department is unreasonably attempting to increase the taxpayer's sales tax liability over and above the liability it would have incurred had the taxpayer not restructured its business relationship with the parent company. According to the taxpayer, if the Department had not assessed the additional sales tax, it would have paid use taxes – based on the tangible personal property used to produce the catalogs – equal to the amount it would have owed previous to the restructuring. Therefore, according to taxpayer, the assessment of sales tax is inherently inequitable.

The taxpayer asks the Department to agree that taxpayer is in the business of providing services, agree that the parent company is merely a disinterested purchaser of those services, and agree that taxpayer is in the "business" of providing catalogs to the parent company's customers. The taxpayer asks too much of the Department. The relevant statutory language is clear and straightforward. Sales tax is assessed on the transfer of tangible personal property in the course of the taxpayer's regularly conducted trade or business when that property is transferred for consideration. IC 6-2.5-4-1(b). For the purpose of determining that applicability of the sales tax, it is irrelevant whether the property is transferred alone or in conjunction with other services. IC 6-2.5-4-1(c). Taxpayer is in the business of preparing and printing catalogs. Parent company is in the business of selling items which are available in those catalogs. Parent company is interested in having the catalogs in the hands of its potential customers. Parent company and taxpayer entered into a relationship in which taxpayer would exercise its specific abilities, prepare the catalogs, and then arrange to have the catalogs delivered. Parent company agreed to pay taxpayer for the cost of the catalogs together with a "mark-up" of five percent not to exceed $250,000. The finer points of the parties' agreement to the contrary, taxpayer is transferring tangible personal property for a consideration and is responsible for collecting sales tax on the transaction. The parties' attempt to circumscribe their agreement as one for the "provision of services only" is illusionary because the centrality of the agreement was for the provision of catalogs. Parent company wanted catalogs, taxpayer printed catalogs, parent company paid taxpayer, taxpayer owes sales tax.

Taxpayer relies on Cowden to support the proposition that services may be provided to a customer in which the transfer of tangible personal property is entirely incidental to the provision of the services. Taxpayer is correct. The court found that Cowden was in the business of providing transportation services. Cowden owned equipment for the provision of those services and did not maintain an inventory of stone. Cowden did not advertise for the sale of stone and did not hold itself out as a stone merchant. Ninety-five percent of Cowden's customers sought out Cowden for its hauling services. On occasion, Cowden purchased stone on behalf of its customers "merely for the convenience of its... customers." Cowden at 721. In taxpayer's case, it is clearly and exclusively in the business of producing catalogs destined to be placed in the hands of the parent company's customers. The provision of the catalogs is not ancillary or incidental to the taxpayers' business and is not made for the occasional convenience of the parent company. The singular objective of the parties' agreement is that catalogs – by themselves useless to the taxpayer – are placed in the hands of the parent company's customers for the benefit of the parent company.

Taxpayer's reliance on Miles is equally unavailing. In that case, the tax court determined that the taxpayer was not required to pay use tax on promotional materials that were stored in Indiana for subsequent use outside the state. Under the relevant statute, the use tax is imposed on the "storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction..." IC 6-2.5-3-2(a). An exception is provided for that property which is stored in Indiana but which is subsequently used solely outside of Indiana. IC 6-2.5-3-1(b). Taxpayer claims that the catalogs it ships to parent company's Indiana distribution center for eventual delivery to out-of-state customers should be exempted from the *sales tax* based on the *use tax* temporary storage exception found in IC 6-2.5-3-1(b). Even viewed most generously, taxpayer presents a strained argument. There is simply no temporary storage sales tax exemption. If and when the parent company is assessed use tax liability, the parent company would conceivably be entitled to claim the temporary storage use tax exemption. Until that day arrives, the Department must decline taxpayer's invitation to infer a temporary storage sales tax exemption.

Taxpayer's final argument is based on general equitable principles. Taxpayer maintains that the intervening restructuring of its business relationship with the parent company should not be seized upon by the Department as an opportunity to increase taxpayer's sales tax liability. According to taxpayer, had the Department not assessed sales tax, it would have been liable for use tax in an amount equal to the use tax liability it bore previous to the restructuring. Taxpayer is a sophisticated business entity free to enter into any business arrangement which it deems appropriate. Similarly, taxpayer is fully capable of comprehending the nature of that business arrangement and understanding the tax consequences which may result. The taxpayer would quite justifiably have protested a determination of its tax liabilities based on the taxpayer's previous business arrangement when that determination would have increased the tax liability over and above what the taxpayer would incurred under its existing business arrangement. The Department is not – nor should it be – placed in a position of enforcing the state's tax laws based on what business arrangement the taxpayer might have, could have, or should have entered into.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten Percent Negligence Penalty

Taxpayer has requested that the ten percent negligence penalty, imposed under authority of IC 6-8.1-10-2.1(a), be abated. The penalty was assessed against taxpayer's cumulative gross retail tax liabilities determined for the tax years 1995 through 1997.

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

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

Regardless of the Department's determination that taxpayer was responsible for paying sales tax on the transfer of catalogs to its parent company, taxpayer has established that its initial failure to collect the sales tax was due to "reasonable cause and not due to willful negligence...." 45 IAC 15-11-2(c). However attenuated its statutory interpretation may have been, it cannot be said that the taxpayer failed to exercise a degree of "ordinary business care." 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is sustained.

INDIANA DEPARTMENT OF STATE REVENUE
Revenue Ruling #2000-04 IT
December 19, 2001

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

ISSUES

Adjusted Gross Income Tax, Supplemental Net Income Tax and Gross Income Tax – Income Tax Consequences of Proposed Reorganization

Authority: IC 6-3-1-11, IC 6-3-8-2, Rule 45 IAC 1.1-6-8, IC 6-2.1-3-25, IC 6-3-1-19, Rule 45 IAC 1.1-2-13

The taxpayer requests the Department to rule, should the taxpayer conclude to reorganize as described herein, whether or not:

1. The mergers that will take place as part of that reorganization shall be nontaxable events for Indiana income tax purposes; and

2. The surviving Delaware limited liability partnership is a recognized partnership and shall be an exempt partnership for Indiana gross income tax purposes.

STATEMENT OF FACTS

The taxpayer is a cooperative corporation formed under Ohio law. It is headquartered in Indiana and markets various products. The taxpayer currently has approximately 100 voting member-shareholders that are themselves cooperatives. In addition to the taxpayer's 100 voting member-shareholders, the taxpayer currently has approximately 6,500 shareholders holding various classes of non-voting stock, which is non-transferable without the consent of the taxpayer and which is not entitled to share in the profits of the taxpayer.

The taxpayer is currently considering reorganizing as a Delaware limited liability partnership. In order to effect this reorganization, the taxpayer will form an Ohio corporation (the "Ohio Corporation") as a wholly-owned subsidiary of the taxpayer and the Ohio Corporation will form a wholly-owned Delaware limited liability company (the "LLC"). The Ohio Corporation and the LLC will then organize a Delaware limited liability partnership (the "LLP"), which will be owned 99% by the Ohio Corporation and 1% by the LLC.

Because Ohio cooperative law does not allow the merger of a cooperative directly into a limited liability partnership, the Ohio Corporation will also organize a wholly-owned Delaware corporation (the "Delaware Corporation"). The taxpayer will merge with and into the Delaware Corporation, which in turn will immediately merge with and into the LLP, with the LLP being the surviving entity.

The Internal Revenue Service will treat the merger of the taxpayer into the Delaware Corporation and the merger of the Delaware Corporation into the LLP as a tax-free reorganization under Internal Revenue Code Section 368(a).

Following this restructuring, all of the business, property and rights of the taxpayer will be acquired, owned and operated by the LLP. The shareholders of the taxpayer will receive, at the effective time of the merger of the taxpayer into the Delaware Corporation, shares in the Ohio Corporation identical in number and class to the shares held in the taxpayer, and the shareholders of the taxpayer will become shareholders of the Ohio Corporation.

For federal income tax purposes, neither the LLC nor the LLP will elect to be treated as associations taxable as corporations. As a result, both the LLC and LLP will be disregarded entities for federal income tax purposes and the Ohio Corporation will be considered to be a "corporation operating on a cooperative basis" for purposes of Subchapter T (Section 1381) of the Internal Revenue Code. The LLP, also, will be disregarded for federal income tax purposes because the LLC will be disregarded leaving only one partner in the partnership.

DISCUSSION

For Indiana adjusted gross income taxation and supplemental net income taxation, pursuant to IC 6-3-1-11 and IC 6-3-8-2, the merger of the taxpayer into the Delaware Corporation and the subsequent merger of the Delaware Corporation into the LLP will follow the federal code, i.e., both transactions will be treated as tax-free reorganizations resulting in no Indiana adjusted gross income tax or supplemental net income tax liability for the taxpayer, the Delaware Corporation, the Ohio Corporation, the LLP or their respective members, shareholders, or partners.

Similarly, for Indiana gross income taxation purposes the treatment afforded a reorganization by the Internal Revenue Service determines its taxability. Rule 45 IAC 1.1-6-8 provides that the Department will generally look to the treatment by the Internal Revenue Service in determining whether or not a reorganization is valid and, therefore, qualifying for the exclusion from gross income taxation that is provided by this regulation.

Such is the case here, with the merger of the taxpayer into the Delaware Corporation and the subsequent merger of the Delaware Corporation into the LLP not giving rise to gross income tax liability to the taxpayer, the Delaware Corporation, the Ohio Corporation, the LLP or their respective members, shareholders or partners.

As indicated in the "Statement Of Facts", the LLP formed by the Delaware Corporation and the LLC will be disregarded for federal income tax purposes because the LLC is disregarded leaving only one partner.

Because the Internal Revenue Code is not incorporated by reference into the Indiana Gross Income Tax Act, the Department's regulations and rulings govern the treatment of the LLP. The Department has ruled (Revenue Ruling #2001-09IT) that if a partnership is disregarded for federal income tax purposes the Department is not precluded from treating the partnership as a validly existing partnership for gross income tax purposes.

The LLP will be formed pursuant to Delaware partnership statutes, validly existing laws which share similarities to Indiana partnership statutes, therefore, based on Revenue Ruling #2001-09IT, the LLP will be recognized as a validly existing partnership for Indiana gross income tax purposes.

The LLP is a partnership and IC 6-2.1-3-25 provides that a partnership, as defined by IC 6-3-1-19, is exempt from gross income tax, provided it is not a publicly-traded partnership treated as a corporation under IRC Section 7704. In the instant case, the LLP will not be a publicly-traded partnership that is treated as a corporation under IRC Section 7704, hence, the LLP will not be subject to gross income tax.

As provided by Rule 45 IAC 1.1-2-13, the Ohio Corporation will be taxable on its "net distributable income" from the LLP (as calculated pursuant to Section 704 of the Internal Revenue Code and its prescribed regulations) that is derived from Indiana sources.

RULING

The Department rules that for adjusted gross income taxation and supplemental net income taxation purposes:

1. No gain or loss will be recognized by the taxpayer, the Delaware Corporation, the Ohio Corporation or the LLP as a result of the taxpayer's merger into the Delaware Corporation and the subsequent merger of the Delaware Corporation into the LLP; and
2. No gain or loss will be recognized by the members or shareholders of the taxpayer, the members or shareholders of the Delaware Corporation, the members or shareholders of the Ohio Corporation, or the partners of the LLP as a result of the taxpayer's merger into the Delaware Corporation and the subsequent merger of the Delaware Corporation into the LLP.

The Department rules that for gross income taxation purposes:

1. The taxpayer, the Delaware Corporation, the Ohio Corporation and the LLP will incur no taxable gross receipts as a result of the taxpayer's merger into the Delaware Corporation and the subsequent merger of the Delaware Corporation into the LLP;
2. The members or shareholders of the taxpayer, the members or shareholders of the Delaware Corporation, the members or shareholders of the Ohio Corporation and the partners of the LLP will incur no taxable gross receipts as a result of the taxpayer's merger into the Delaware Corporation and the subsequent merger of the Delaware Corporation into the LLP; and
3. The LLP is a recognized partnership and will be exempt from gross income tax. The Ohio Corporation will be taxable on the net distributive income from the LLP that is derived from Indiana sources.

CAVEAT

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

INDIANA DEPARTMENT OF STATE REVENUE
RULING #2001-12 IT
November 13, 2001

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

ISSUES

Gross Income Tax – Consolidated Gross Income Tax Return

Authority: IC 6-2.1-1-16, IC 6-2.1-5-5, IC 6-2.1-4-6

The taxpayer requests the Department to rule on the following issues:

1. Whether or not the taxpayer and two of its solely owned limited liability companies may file consolidated gross income tax returns;
2. Whether or not the taxpayer may deduct receipts received from the two solely owned limited liability companies on those returns; and

3. Whether or not the solely owned limited liability companies may deduct receipts received from the taxpayer or from each other on those returns.

STATEMENT OF FACTS

The taxpayer is engaged in the business of manufacturing and is headquartered outside Indiana. The taxpayer is a Delaware corporation authorized to do business in Indiana. The taxpayer currently files an Indiana gross income tax return on a consolidated basis with two affiliates.

On November 1, 2000, the taxpayer formed two single member limited liability companies, hereinafter "SMLLC#1 and SMLLC#2". The taxpayer transferred to SMLLC#1 and SMLLC#2 certain intangible properties. The taxpayer is the sole owner and sole member of both SMLLCs. The SMLLCs each "checked the box" to be taxed as a corporation for federal tax purposes. SMLLC#1 and SMLLC#2 will each obtain a certificate of authority to transact business in Indiana if this ruling dictates same.

SMLLC#1 and SMLLC#2, while each meeting the definition of a taxpayer under IC 6-2.1-1-16 for gross income tax purposes, are not expected to have any receipts derived from Indiana sources.

DISCUSSION

Pursuant to IC 6-2.1-1-16(27), SMLLC#1 and SMLLC#2 are "taxpayers" for gross income tax purposes, because they are not disregarded entities, but instead are taxable as corporations for federal income tax purposes. As such, they will be treated and taxed for gross income tax purposes in the same manner as corporations are treated and taxed. For Indiana income tax purposes, limited liability companies are classified the same as they are for federal income tax purposes. (Tax Policy Directive #2)

IC 6-2.1-5-5 allows Indiana corporations or corporations that are authorized to do business in Indiana and that are members of an affiliated group to file a consolidated gross income tax return. As noted above, the taxpayer is already authorized to do business in Indiana and SMLLC #1 and SMLC#2 intend to obtain a certificate of authority to do business in Indiana. Furthermore, the taxpayer, SMLLC#1 and SMLLC#2 are clearly affiliated in that the taxpayer owns 100% of SMLLC #1 and 100% of SMLLC#2. SMLLC#1 and SMLLC#2 are also affiliated because "every corporation affiliated with another corporation is affiliated with every corporation that is affiliated with such other corporation [and] all corporations so affiliated constitute an affiliated group." IC 6-2.1-5-5(a).

Accordingly, assuming for purposes of this ruling request that the taxpayer, SMLLC#1 and SMLLC#2 are authorized to do business in Indiana, they will meet the requirements to file a consolidated gross income tax return.

IC 6-2.1-4-6 provides that a group of affiliates filing a consolidated return is entitled to deduct from its gross income inter-affiliate receipts. Therefore, on the consolidated gross income tax return, the taxpayer will be permitted to deduct receipts from SMLLC#1 and SMLLC#2. SMLLC#1 and SMLLC#2, even though they are not expected to have any income derived from Indiana sources, will be entitled to deduct on that return receipts they might receive from the taxpayer and from each other.

RULINGS

The Department rules that to the extent SMLLC#1 and SMLLC#2 are authorized to do business in Indiana:

1. The taxpayer, SMLLC#1 and SMLLC#2 may file consolidated gross income tax returns;
2. The taxpayer may deduct receipts received from SMLLC#1 and SMLLC#2 on those returns; and
3. SMLLC#1 and SMLLC#2 may deduct receipts received from the taxpayer or from each other on those returns.

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 STATE REVENUE
Revenue Ruling #2001-13 IT
December 5, 2001

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

ISSUE

Gross Income Tax – Inventory In State

Authority: Rule 45 IAC 1.1-1-3, IC 6-2.1-2-2, 45 IAC 1.1-3-3

The taxpayer requests the Department to rule whether or not the taxpayer is subject to Indiana gross income tax as a result of owning inventory in Indiana.

STATEMENT OF FACTS

The taxpayer, a New York corporation is selling goods to an unrelated U. S. corporation. According to the sales agreement, the taxpayer is required to store the goods imported from China at a warehouse in Indiana, as designated by the buyer, until the goods are taken by the buyer. The warehouse is a distribution center owned and managed by a third party who is unrelated to either the taxpayer or the buyer. The buyer has contracted directly with the third party for the operation and management of the distribution center. At all times, the merchandise remains intact in its original packaging. The taxpayer never removes the goods from their sealed boxes. Title of the goods is transferred to the buyer at the earlier of approximately 30 days after the goods arrive at the warehouse, or when the buyer directs the third party to ship the goods. The goods that are transferred because of the thirty-day rule are segregated at the warehouse by the third party by simply moving the sealed boxes to another side of the warehouse floor. Approximately 95% of the goods are shipped outside of Indiana to the buyer's customers or to the buyer's other locations outside of Indiana. The buyer reimburses the taxpayer for all transportation, carrying and insurance charges and pays the warehouse expenses directly to the third party.

The taxpayer does not have an office or employees in Indiana, nor does it have salespeople conducting business activities in Indiana. The taxpayer does not rent facilities, is not listed in phone directories and does not have a business address listing in Indiana. Furthermore, the taxpayer is a nonresident seller whose sales contracts are initiated, negotiated and serviced by out-of-state personnel and the goods are shipped into Indiana from out-of-state to be temporarily stored in a warehouse owned, operated and managed by a third party.

DISCUSSION

Rule 45 IAC 1.1-1-3(b)(3) provides that the maintenance of an inventory or stocks of goods for sale, distribution or manufacture in Indiana creates a "business situs" in Indiana for the owner of the goods. Generally, having a business situs in Indiana establishes nexus for a taxpayer and subjects the taxpayer's taxable gross income to Indiana gross income tax pursuant to IC 6-2.1-2-2.

Rule 45 IAC 1.1-3-3(d)(6) states that a sale to an Indiana buyer by a nonresident seller after the goods are transported into Indiana is considered to be a sale completed in Indiana, hence, subject to gross income tax.

Rule 45 IAC 1.1-3-3(c)(5), however, provides that a sale to an Indiana buyer by a nonresident with an in-state business situs or activities but the situs or activities are not significantly associated with the sale because it was initiated, negotiated and serviced by out-of-state personnel, and the goods are shipped from out-of state is not considered to be a sale completed in Indiana, therefore, not subject to gross income tax.

Here, although the sale by the taxpayer is initiated, negotiated and serviced by out-of-state personnel, the goods are warehoused in Indiana subsequent to the transportation of the goods into Indiana establishing a business situs in Indiana for the taxpayer with the sale completed in Indiana. This being the case, the taxpayer's sale of goods warehoused in Indiana to an Indiana buyer is subject to Indiana gross income tax.

RULING

The Department rules that the sale of goods from the Indiana warehouse to the Indiana buyer by the taxpayer is subject to Indiana gross income tax.

CAVEAT

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