INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT

Title: Contained-in Policy Guidance for RCRA
Identification Number: WASTE-0052
Date Originally Effective: October 17, 2002
Dates Revised: None
Other Policies Repealed or Amended: None
Brief Description of Subject Matter: Use of RISC standards to remove contaminated environmental media from regulation as a RCRA hazardous waste or solid waste.
Citations Affected: 40 CFR 268, 329 IAC 10, 329 IAC 3.1

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

SUMMARY

The U.S. EPA "contained-in policy" states that soil and groundwater which does not contain "listed" RCRA hazardous waste, and which is not otherwise hazardous, is not subject to RCRA regulation. A determination as to whether or not "listed" waste is "contained-in" soil or groundwater may be made by authorized states based on whether constituents from listed waste are below health-based levels. It is IDEM's position that contamination levels specified in the *RISC (Risk Integrated System of Closure)* system developed by IDEM represent appropriate health-based levels for determining if soil or groundwater contain "listed" hazardous waste. This NPD is applicable to soil and groundwater which is generated and subsequently managed, and does not replace or alter requirements for closure or clean-ups found in various regulatory authorities. Residential RISC default levels must be used for material that will be managed as non-contaminated (e.g. used as fill, disposed on-site). Industrial default levels may be used for soil which will be managed off-site in a permitted disposal facility (e.g. municipal solid waste) or any unit subject to Clean Water Act regulations. This NPD is not applicable to sediment. This NPD is not applicable to soil or groundwater that will be placed in an ecologically or geologically susceptible area or a wellhead protection area. Consistent with EPA policy, a written "contained-in" determination must be obtained from IDEM. Implementation issues and background are discussed below.

DISCUSSION

This guidance is intended to clarify the application of RCRA hazardous waste regulations to environmental media (i.e. soil and groundwater). Environmental media that has become contaminated with "listed" hazardous wastes must be managed as hazardous wastes when generated (e.g. exhumed for discard during remedial activities) because--and only as long as--they contain "listed" waste(s). EPA Regions and authorized states, including Indiana, may apply the contained-in policy to determine site-specific, media-specific and contaminant-specific health-based levels, such that if the concentration of the hazardous constituents in the environmental media fall below the specified health-based levels, the environmental media may be determined to <u>no longer contain</u> hazardous waste. Such "contained-in determinations" may be made by an authorized state before or after treatment of the contaminated environmental media and may include consideration of site-specific exposure pathways (e.g., potential for human exposure, soil permeability, leaching potential to groundwater). It should be noted that any treatment of hazardous waste might require a permit. For further information on this issue, see the IDEM guidance document *Treatment of Hazardous Waste On-site By Generators* at <u>http://www.IN.gov/idem/land/pubsforms/guidance.html</u>, or contact staff of the RCRA permit or compliance programs at IDEM.

It is IDEM's position that the contaminant levels used in Table A, Default Closure Levels, of the *RISC Technical Resource Guidance Document*, represent an appropriate basis for making risk-based "contained-in determinations for soil and groundwater that will be disposed. Contaminant levels used in Table A were generated using conservative models and default assumptions concerning exposure and site conditions. Because the RISC levels are based only on human health risk, it is not appropriate to use RISC default levels for media that will be placed in ecologically susceptible areas. Karst type geological areas also fall outside RISC default assumptions, as do wellhead protection areas. If applicable, the media must also meet all Land Disposal Restriction (LDR) treatment standards (including treatment of underlying hazardous constituents as defined at 40 CFR § 268.2(i) for material that exhibits a characteristic in addition to containing a listed waste). A discussion of management conditions follows.

CONDITIONS

<u>Use of Residential Default Levels</u>

For generated soil and groundwater which would be considered a "listed" waste and are going to be deposited on-site, used as fill, or managed in any way other than off-site disposal at a permitted facility, the Residential levels in Table A must be used. Contaminated soil and groundwater are not subject to RCRA regulatory management requirements if they have been generated with, or treated to, constituent levels:

(1) below chemical of concern (COC) concentration levels in Table A, Residential Levels;
(2) below characteristic levels;
(3) meeting all LDR requirements when applicable; and
(4) will not be managed in an ecologically or geologically susceptible (e.g. wetlands or karst) area or a wellhead protection area.

Under solid waste rules found at 329 IAC 10, contaminated soil is potentially regulated as a solid waste even if it exits the RCRA hazardous waste regulations. However, using the above criteria for an exit level from hazardous waste regulations, it is also IDEM's position that soil which meets Residential levels in Table A is considered "uncontaminated" for the purposes of 329 IAC 10-3-1 (1), which is an exclusion from regulation under the provisions of the solid waste rule.

Use of Commercial/Industrial Default Levels

Depending on how soil is managed, it is also possible to use the Commercial/Industrial default levels in RISC Table A as an "exit" level from RCRA regulation. If soil is disposed at a permitted facility (Subtitle C or D), it is appropriate to use the "Direct" Commercial/Industrial default levels in Table A as the basis for a contained-in determination. Soil no longer contains hazardous waste and is not subject to RCRA regulatory management requirements if it has been disposed of in a RCRA subtitle C or D landfill cell and has been generated with, or treated to, constituent levels:
(1) below chemical of concern (COC) concentration levels in Table A, Commercial/Industrial Levels;
(2) below Characteristic levels; and
(3) meeting LDR requirements if applicable, including alternative standards established for contaminated soils (40 CFR 268.49).

It is also appropriate to use the groundwater Commercial/Industrial default levels in RISC Table A as an "exit" level for groundwater that is managed in any unit subject to Federal Clean Water Act regulations.

Written Determination Approval Required

Due to the complexity of establishing the appropriate exit level from RCRA regulations, and the need to be consistent with EPA policy, any facility that intends to demonstrate that media no longer contains a listed hazardous waste must obtain a written contained-in determination approval from IDEM. Please contact the staff of the Hazardous and Industrial Waste Compliance Program, Office of Land Quality, at 317-308-3133.

Other Options

On a case-by-case basis, facilities may develop site specific risk analyses to establish non-default exit levels.

REFERENCES

If you need additional information, or have any questions or concerns, please contact the staff of the Hazardous and Industrial Waste Compliance program, Office of Land Quality, at 317-308-3133. The IDEM toll-free telephone number (when calling within Indiana) is 1-800-451-6027. Other references:

RISC (Risk Integrated System of Closure) Technical Resource Guidance Document available at http://www.IN.gov/idem/land/pubsforms/guidance.html

Management of Remediation Waste Under RCRA, EPA Publication Number 530-F-98-026, available at http://www.epa.gov/epaoswer/hazwaste/ca/resource/guidance/remwaste/pspd_mem.pdf

NATURAL RESOURCES COMMISSION

Information Bulletin #34

RESOLUTION OF THE INDIANA NATURAL RESOURCES COMMISSION ENDORSING THE BIODIVERSITY RECOVERY PLAN FOR NORTHWEST INDIANA

WHEREAS, the Biodiversity Recovery Plan is the result of five years of assessment and planning by the Chicago Region Biodiversity Council (Northeastern Illinois, Northwestern Indiana, and Southeastern Wisconsin), also known as Chicago Wilderness; and

WHEREAS, the plan identifies the ecological communities of the region, assesses their condition, identifies the major factors affecting them and provides recommendations for actions needed to restore and preserve them into the future in a sustainable condition; and

WHEREAS, the Biodiversity Recovery Plan is a tool that provides general direction and illustrates the types of actions that can be taken to conserve biodiversity; and

WHEREAS, the Biodiversity Recovery Plan is a blueprint for action and a reference source and not a set of mandates; and

WHEREAS, the Biodiversity Recovery Plan is a representation of a regional consensus on the most important ways to further biodiversity conservation; and

WHEREAS, the Indiana Department of Natural Resources is an essential partner in the effort to protect nature; and

WHEREAS, the Commission and the Department of Natural Resources support the goal of the Biodiversity Recovery Plan, which is, "to protect the natural communities of the Chicago Region and to restore them to long-term viability, in order to enrich the quality of life of its citizens and to contribute to the preservation of global biodiversity.

NOW, THEREFORE BE IT RESOLVED, by the Indiana Natural Resources Commission that the Department of Natural Resources accept the Biodiversity Recovery Plan as a policy tool for protection of biodiversity in the region; and

BE IT FURTHER RESOLVED that the Department of Natural Resources is encouraged to work with the Chicago Region Biodiversity Council and its partner organizations to:

- Develop strategies to help protect our remaining natural heritage
- Help coordinate efforts between government agencies, organizations, and other jurisdictions
- Participate in workshops and other activities to foster the Biodiversity Recovery Plan and to help educate the public on the value of the Biodiversity Recovery Plan as a tool for regional conservation of biodiversity

Duly adopted by the Indiana Natural Resources Commission at South Bend, Indiana on September 24, 2002.

DEPARTMENT OF STATE REVENUE

03980327.LOF

LETTER OF FINDINGS NUMBER: 98-0327
Withholding Tax
For Years 1995 and 1996

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

ISSUES

I. Adjusted Gross Income Tax – Adequate Documentation

Authority: 45 IAC 15-5-4; IC § 6-8.1-5-1; IC § 6-8.1-5-4

Taxpayer protests the proposed assessments of Indiana's adjusted gross income tax.

STATEMENT OF FACTS

In the course of taxpayer's auction business operations taxpayer retained the services of a bookkeeper. A departmental audit assessed the taxpayer on adjusted gross income tax withholding (hereinafter 'withholding') that should have been withheld from the bookkeeper's wages. The taxpayer protested the audit determination stating the bookkeeper was an independent contractor; however, the taxpayer was unable to produce any documents to support this position. Taxpayer and his representative then filed a protest, claiming the documents would be made available.

I. Adjusted Gross Income Tax – Adequate Documentation

DISCUSSION

Taxpayer protests the proposed assessments of Indiana withholding, arguing that he now has available for inspection documents supporting his contention that the bookkeeper was an independent contractor. Because of taxpayer's reluctance to timely provide the proper documents to the auditor a hearing was set before one of the Legal Division's Hearing Officers. At the hearing, taxpayer's representative stated that records would be made available within a specified time period. Said records were not provided within the time period, nor has taxpayer provided any indication that said records will be produced.

This issue revolves around the burden of proof in an audit situation, which IC § 6-8.1-5-4 defines as:

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Taxpayer does not cite any statute, regulation, or case law for the proposition that the auditor was required to accept taxpayer's assertions as to the nature of the transactions without any supporting documentation. Pursuant to the above statute and the requirements of IC § 6-8.1-5-1 and 45 IAC 15-5-4, taxpayer has failed to establish a basis for reversal of this assessment.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01980331.LOF

LETTER OF FINDINGS NUMBER: 98-0331
Adjusted Gross Income Tax
For Years 1995 and 1996

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

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

ISSUES

I. Adjusted Gross Income Tax – Adequate Documentation

Authority: 45 IAC 15-5-4; IC § 6-8.1-5-1; IC § 6-8.1-5-4

Taxpayer protests the proposed assessments of Indiana's adjusted gross income tax.

STATEMENT OF FACTS

In the course of taxpayer's business operations taxpayer received income for the tax years at issued but taxpayer did not file individual returns for these years. A departmental audit assessed the taxpayer on adjusted gross income tax that should have been individually reported by taxpayer. The taxpayer filed late returns for the years in question, which resulted in a reduction in the assessment; however, the taxpayer did not produce any documents or arguments as to the remainder of this assessment. Taxpayer and his representative then filed a protest, claiming the documents and/or taxpayer's position would be presented at the hearing.

I. Adjusted Gross Income Tax – Adequate Documentation

DISCUSSION

At the hearing, taxpayer's representative stated that records would be made available within a specified time period. Said records were not provided within the time period, nor has taxpayer provided any indication that said records will be produced.

This issue revolves around the burden of proof in an audit situation, which IC § 6-8.1-5-4 defines as:

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Taxpayer does not cite any statute, regulation, or case law for the proposition that the auditor was required to accept taxpayer's assertions as to the nature of the transactions without any supporting documentation. Nor has taxpayer asserted any argument as to why the Department's assessment should be reduced or abated. Pursuant to the above statute and the requirements of IC § 6-8.1-5-1 and 45 IAC 15-5-4, taxpayer has failed to establish a basis for reversal of this assessment.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980387.LOF

LETTER OF FINDINGS NUMBER: 98-0387

For the Period: 1994 through 1996

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

ISSUES

I. Tax Administration – Payment Application

Authority: IC 6-8.1-8-1.5; 45 IAC 15-8-1

The taxpayer protests the Department's method of "allocating a taxpayer's payment to its tax liability, penalty and interest."

STATEMENT OF FACTS

Taxpayer is a general contractor that installs doors, windows, and gutters. After the taxpayer was audited, the taxpayer made a payment to the Department of Revenue. As will be elaborated below, the taxpayer's protest turns on whether the taxpayer's payment was a "full" payment or a "partial" payment.

I. Tax Administration – Payment Application

DISCUSSION

The taxpayer offers a timeline for the events and issues in the protest. In bullet point, here are the pertinent dates:

- May 1, 1998: The Department of Revenue issues the tax bill for the audit period (AR-80);
- June 25, 1998: Taxpayer files a protest with the Department of Revenue (received by the Department on June 29, 1998);
- July 13, 1998: Department sends out a letter acknowledging that it has received the taxpayer's protest. The letter from the Department contains the following paragraph: "Please be aware that interest will continue to accrue on the assessment until a final disposition of the case is made. In order to avoid the additional interest accrual, a payment in full may be made with the option of requesting a refund for any assessed items not found to be subject to the tax."
- February 4, 2000: Taxpayer sends the Department a letter dated 2/4/00 along with a check in the amount of $25,787.23. The taxpayer states in the letter accompanying the check: "Subtracting [the amount the taxpayer disputed/protested,

namely $1,260.22] from the $27,047.45 [the *principal* tax owed] results in an amount of $25,787.23. A check for that amount is enclosed for your processing which should conclude this matter."

In October of 2000, the Department did a "supplemental audit" which adjusted the taxpayer's principal amount owed from $27,047.45 to $26,169.39.

The Department contends that the payment was a partial payment since it did not cover the full amount owed (*viz.*, penalty, interest, and principal tax liability). Indiana Code 6-8.1-8-1.5 deals with partial payment of tax:

Whenever a taxpayer makes a partial payment on the taxpayer's tax liability, the department shall apply the partial payment in the following order:

(1) To any penalty owed by the taxpayer.
(2) To any interest owed by the taxpayer.
(3) To the tax liability of the taxpayer.

The taxpayer says of the above statute,

[A] **partial payment** on the taxpayer's tax liability will be applied by the department first to penalties, second to interest and third to the tax liability of the taxpayer. … When we made the $25,787.23 payment it was a FULL not a partial payment on the taxpayer's tax liability. The penalty and interest amounts were not paid at that time pending the outcome of the protest. The law itself distinguishes between the tax liability and the interest and penalties associated with a taxpayer's tax liability. (Emphasis in the original)

It is somewhat difficult to understand what the taxpayer could mean by stating "it was a full not a partial payment on the taxpayer's tax liability"—the taxpayer did not issue a check for over a 1½ years after the billing; the taxpayer on its own subtracted out what it did not think it owed from the principal liability, and the taxpayer did not pay the penalty and interest. Yet the taxpayer concludes it paid the "full" amount.

Part of the problem might be confusion over what the term "tax liability" means. The statute, uses the term twice—

Whenever a taxpayer makes a partial payment on the taxpayer's *tax liability*, the department shall apply the partial payment in the following order:

(3) To the *tax liability* of the taxpayer. (Emphasis added)

But the Indiana Administrative Code (45 IAC 15-8-1) clarifies and distinguishes the two meanings of tax liability:

(a) If a taxpayer makes a partial payment of the taxpayer's *tax liability*, the payment shall only be applied first against the penalty, second the interest and third the *principal liability* of the particular billing for a given year and tax. (Emphasis added)

Thus when IC 6-8.1-8-1.5 (3) refers to "tax liability" it means the *principal* tax liability. Taxpayer apparently realizes as much, stating in a letter that "Regulation 45 IAC 15-8-1 basically echoes the law but for the third item of payment designation uses the phrase 'principal liability for income tax.'"

The taxpayer also argues that the letter dated July 13, 1998 from the Department acknowledging receipt of the taxpayer's written protest gave it the impression that it did not have to pay the penalty and interest since the matter was under protest. Here is the paragraph at issue:

Please be aware that interest will continue to accrue on the assessment until a final disposition of the case is made. In order to avoid the additional interest accrual, a payment in full may be made with the option of requesting a refund for any assessed items not found to be subject to the tax.

The paragraph is clear—any confusion in the meaning lies with the taxpayer's desire to read "full" as meaning what it thinks it owes on the principal liability.

To summarize: the Department received a payment from the taxpayer. In line with the statute and the regulation requirements, the Department applied the payment first to the penalty, then to the interest, and lastly to principal tax liability. The taxpayer wants to "direct the application" of the payment it made to the principal liability and call it a "full payment." However the law does not allow the taxpayer to earmark the payment—instead, by statute the order is: penalty, interest, and principal liability.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02980523.LOF

LETTER OF FINDINGS NUMBER: 98-0523
Corporate Income Tax
For Tax Periods: 1993-1994

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

ISSUE

1. Adjusted Gross Income Tax – Business Income

Authority: 26 USC Sec.338(h)(10), 26 USC 338(h)(10), IC 6-3-1-20, 45 IAC 3.1-1-29, 45 IAC 3.1-1-30, The May Department Store Company v. Indiana Department of State Revenue, 749 N.E.2d 651 (Ind. Tax 2001)

The taxpayer protests the classification of certain income as business income.

STATEMENT OF FACTS

The taxpayer is an out-of-state-corporation engaged in sales of goods and services in Indiana and several other states. After an audit, the Indiana Department of Revenue, ("department"), assessed the taxpayer additional corporate income taxes. The taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Adjusted Gross Income Tax – Business Income

DISCUSSION

In 1994, Corporation A ("actual buyer"), an unrelated taxpayer, acquired the stock of Corporation B, the parent corporation of the taxpayer and a wholly owned subsidiary of Corporation C ("actual seller"). Actual buyer and actual seller entered into a joint federal income tax election under 26 USC Sec.338(h)(10) which allowed the buyer and seller to treat the sale of stock of corporation B as a sale of the assets of corporation B and its subsidiaries for income tax purposes. Under the provisions of 26 USC 338(h)(10), The taxpayer was deemed to have sold all of its assets to the "new target" on the date of acquisition and immediately distribute the proceeds from the deemed asset sale to its parent corporation in complete liquidation. The taxpayer protested the department's recharacterization of this income as business income subject to Indiana taxes.

In The May Department Store Company v. Indiana Department of State Revenue, 749 N.E.2d 651 (Ind. Tax 2001), the Indiana Tax Court determined that IC 6-3-1-20 provides for both a transactional test and a functional test in determining whether income is business or non-business in nature. Id. at 662-3.

The court looks to 45 IAC 3.1-1-29 and 30 for guidance in determining whether income is business or non-business income under the transactional test. These regulations state "... the critical element in determining whether income is 'business income' or 'non-business income' is the identification of the transactions and activity which are the elements of a particular trade or business." Id. at 664. 45 IAC 3.1-1-30 lists several factors in making this determination. These include the nature of the taxpayer's trade or business; substantiality of the income derived from activities and relationship of income derived from activities to overall activities; frequency, number or continuity of the activities and transactions; length of time income producing property was owned; and taxpayer's purpose in acquiring and holding the property producing income. In May, the Court found that the transactional test was not met when a retailer sold a retailing division to a competitor because it was an extraordinary and nonrecurring transaction for the taxpayer. Id. at 664.

The nature of this taxpayer's business included various aspects of the food service business. Almost all of the taxpayer's income derived from transactions associated with these activities. The deemed sale of assets was an extraordinary and nonrecurring transaction for the taxpayer. Therefore, it did not meet the transactional test for classification as business income.

The functional test focuses on the property being disposed of by the taxpayer. Id. at 664. Specifically the functional test requires examining the relationship of the property at issue with the business operations of the taxpayer. Id. at 664. In order to satisfy the functional test the property generating income must have been acquired, managed and disposed of by the taxpayer in a process integral to taxpayer's regular trade or business operations. Id. at 664. The Court in May defined "integral" as part or constituent component necessary or essential to complete the whole. Id. at 664-5. The Court held that the May's sale of one of its retailing division was not "necessary or essential" to May's regular trade or business because the sale was executed pursuant to a court order that benefited a competitor and not May. In essence, the Court determined that because May was forced to sell the division in order to reduce its competitive advantage, the sale could not be integral to May's business operations. Therefore, the proceeds from the sale were not business income under the functional test.

In the taxpayer's situation, the taxpayer disposed of a business selling food. At the taxpayer's election, the funds from the sale were funneled into a related corporation's business selling food. The business decision was made to acquire, manage and dispose of the income to further the corporation's function. Therefore, this sale meets the functional test for classification as business income.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02980658.LOF

LETTER OF FINDINGS NUMBER: 98-0658
Corporate Income Tax
For Tax Periods: 1993-October 1, 1995

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

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

ISSUE

1. Gross Income Tax – Gross Receipts

Authority: IC 6-2.1-2-2, IC 6-2.1-1-2(a)(10)

The taxpayer protests the disallowance of the deduction for receipts from a certain account.

2. 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, a corporation with its commercial domicile in another state, is a food and beverage company. After an audit, the Indiana Department of Revenue (department) assessed the taxpayer additional gross income tax, interest and penalty. The taxpayer protested the assessment and a hearing was held. More facts will be provided as necessary.

1. Gross Income Tax – Gross Receipts

Pursuant to IC 6-2.1-2-2, Indiana imposes a gross income tax on the gross receipts of derived from business activities in Indiana. Gross income is defined at IC 6-2.1-1-2(a)(10) as "all the gross receipts a taxpayer receives... from any other source not specifically described in this subsection." The taxpayer deducted the monies in the "Amount Due From Account" from its gross receipts to report for the gross income tax. The department disallowed this deduction in the audit.

The taxpayer protested the department's disallowance of its deduction of "Amount Due From Account" from the taxpayer's gross receipts. The taxpayer alleged that the "Amount Due From Account" is entitled to deduction because it represents cost reimbursement due from a customer based upon the difference between the taxpayer's actual profit for the period and the agreed upon profit outlined in the contract with the customer. Such a difference may arise, for example, if the customer requests that products sold at the customer's location be sold at a specific price to employees. To the extent this price results in a profit below the agreed upon profit specified in the contract, the customer must reimburse the taxpayer. The taxpayer considered this a cost reimbursement or fee for services entitled to be deducted from the gross income subject to gross income tax.

The law lists the allowable deductions from gross receipts for purposes of the gross income tax at IC 6-2.1-1-2. The taxpayer's fact situation is not one of the allowable deductions.

The monies coming to the taxpayer from the "Amount Due From Account" are additional receipts from the taxpayer's business activities in Indiana. The cost reimbursement provisions merely guarantee that the taxpayer will receive income to equal a certain profit margin. It makes no difference whether the monies are paid by the customer directly to the taxpayer or by the employer who subsidizes the customer's purchases. The end result is the taxpayer receives income not qualifying for any of the deductions allowed by the statute. These receipts are, therefore, subject to the gross income tax.

FINDING

The taxpayer's protest is denied.

DISCUSSION

2. Tax Administration – Negligence Penalty

DISCUSSION

The taxpayer also protested 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. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The taxpayer is a major corporation with an extensive tax and accounting department. Even so, it failed to report the clearly taxable income from the sales of tangible personal property. The taxpayer's failure to report this income was a failure "to use such reasonable care, caution or diligence as would be expected of an ordinary reasonable taxpayer." This breach of its duty constitutes negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980749.LOF

LETTER OF FINDINGS NUMBER: 98-0749
Sales and Use Tax
For Tax Periods: 1994-1996

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

ISSUE

Sales and Use Tax – Exemption Certificates

Authority: IC 6-2.5-2-1(a), IC 6-8.1-5-1(b), IC 6-2.5-3-7(a)

The taxpayer protests the assessment of sales tax on certain unreported sales.

STATEMENT OF FACTS

The taxpayer corporation is a retailer, installer and repairman of restaurant equipment and supplies. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," imposed additional sales and use tax, interest and penalty. The taxpayer protested a portion of the assessment and several hearings were scheduled. Since the taxpayer did not to appear for any of the scheduled hearings, the decision was based upon the documentation in the file.

Sales and Use Tax – Exemption Certificates

DISCUSSION

Indiana imposes a sales tax on the sale of tangible personal property at retail. IC 6-2.5-2-1(a). All retail transactions are presumed to be taxable and either the seller or purchaser can rebut that presumption. IC 6-2.5-3-7(a). Retail merchants need not prove nontaxability if they receive and retain a valid exemption certificate from the purchaser. IC 6-2.5-3-7(b). All department assessments are presumed to be correct and taxpayers bear the burden of proving that any assessment is incorrect. IC 6-8.1-5-1(b)

In performing the audit, the department's auditor examined the taxpayer's sales journals, purchase invoices, sales invoices and other workpapers. The auditor determined that the taxpayer collected but failed to remit sales tax for many transactions. The taxpayer argued that it initially billed but never collected sales tax in sales to exempt organizations. The taxpayer alleged that it had exemption certificates to prove that it had no responsibility to collect or remit sales tax on those transactions.

Although the taxpayer was given ample opportunity during the audit, review, and hearing procedures, it never produced any exemption certificates. The taxpayer did not sustain its burden of proving that the sales tax was improperly imposed.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990219.LOF

LETTER OF FINDINGS NUMBER: 99-0219
State Gross Retail Tax
For Years 1995, 1996, and 1997

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

ISSUES

I. State Gross Retail Tax – Adequate Documentation

Authority: 45 IAC 15-5-4; IC § 6-8.1-5-1; IC § 6-8.1-5-4

Taxpayer protests the proposed assessments of Indiana's State Gross Retail tax.

STATEMENT OF FACTS

In the course of taxpayer's auction business operations taxpayer conducted auctions both at its main location and at its customer's premises. When audited, taxpayer informed the auditor that all auctions occurred at the customer's premises, thus sales tax was not collected. The auditor determined, based on review of existing documentation- including advertising for auctions at the taxpayer's location- that 37% of taxpayer's auction business was conducted onsite and thus subject to Indiana's Gross Retail tax. The departmental audit assessed the taxpayer Gross Retail tax on 37% of its sales. The taxpayer protested the audit determination stating documentation would be provided to counter the audit's determination. Taxpayer and his representative then filed a protest, claiming the documents would be made available.

I. State Gross Retail Tax – Adequate Documentation

DISCUSSION

Taxpayer protests the proposed assessments of Indiana Gross Retail tax arguing that he now has available for inspection documents supporting his contention that the percentage of sales conducted at taxpayer's premises was not 37% as determined in the audit. Because of taxpayer's reluctance to timely provide the proper documents to the auditor a hearing was set before one of the Legal Division's Hearing Officers. At the hearing, taxpayer's representative stated that records would be made available within a specified time period. Said records were not provided within the time period, nor has taxpayer provided any indication that said records will be produced.

This issue revolves around the burden of proof in an audit situation, which IC § 6-8.1-5-4 defines as:

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

Taxpayer does not cite any statute, regulation, or case law for the proposition that the auditor was required to accept taxpayer's assertions as to the nature of the transactions without any- and in fact, contrary to- supporting documentation. Pursuant to the above statute and the requirements of IC § 6-8.1-5-1 and 45 IAC 15-5-4, taxpayer has failed to establish a basis for reversal of this assessment.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 00-0194
Financial Institutions Tax
For the 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. Combining Taxpayer's Bank Group and Financial Group Into a Single Unitary Return – Financial Institutions Tax

Authority: IC 6-5.5-1-18; IC 6-5.5-6-1; 45 IAC 17-2-1(a); 45 IAC 17-3-5(a); 45 IAC 17-3-5(c)

Taxpayer maintains that the audit erred in requiring that its bank group and financial group file a single unitary return. Taxpayer argues that the two groups operate independently of each other and are entitled to file two combined unitary returns.

II. Calculation of Taxpayer's Foreign Source Income – Exclusion of Related Expenses

Authority: IC 6-5.5-1-2(a); IC 6-5.5-1-2(a)(2)(B); IC 6-8.1-5-1(b)

Taxpayer argues that expenses related to the acquisition of its foreign source income should not be deducted from that foreign source income.

III. Calculation of Taxpayer's Receipts Factor

Authority: IC 6-5.5-2-4; 45 IAC 17-3-5(a), (c)

Taxpayer maintains that the audit erred in making adjustments to the numerator and denominator of its receipts factor. Taxpayer requests that the Department restore the separate apportionment factor calculation for its bank group and financial group and that the Department eliminate the receipts factor adjustments which result – according to taxpayer – in a double-counting of certain receipts factor items.

IV. Neighborhood Assistance Credit Carryforward

Authority: IC 6-3.1-9 et seq.; IC 6-3.1-9-6

Taxpayer argues that the Department erred when it denied permission for the taxpayer to carry forward a neighborhood assistance credit, approved in 1994, but claimed by the taxpayer in 1995.

V. Disallowance of Enterprise Zone Loan Interest Credit

Authority: IC 6-3.1-10 et seq.

According to taxpayer, the Department erred in disallowing Enterprise Zone Loan Interest Credits on the ground that the taxpayer had provided insufficient detail to substantiate that the interest was obtained from qualifying loans made within a state enterprise zone.

VI. Abatement of the Ten Percent Negligence Penalty

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

Taxpayer argues that the Department was not justified in assessing the ten percent negligence penalty. Accordingly, the taxpayer requests that the Department exercise its discretion to abate that penalty.

STATEMENT OF FACTS

Taxpayer is a diversified financial services company operating what it identifies as a "corporate group" and a "financial group." The corporate group (hereinafter "bank group") provides traditional bank services, is insured by the FDIC, and is subject to oversight by the Office of the Comptroller of the Currency. The financial group provides similar services to those consumers who may not be qualified to obtain those services from a traditional banking institution.

Taxpayer provides its subsidiaries various services including planning, asset management, investment administration, advertising, and certain personnel services. Taxpayer derives its income from investments in, and advances to, these and other subsidiaries. For federal purposes, the taxpayer filed a consolidated return which included all its subsidiaries.

For purposes of Indiana's Financial Institutions Tax, the bank group and the financial group filed two combined unitary returns. During the audit, an adjustment was made to combine both the bank group and the financial group. Taxpayer disagreed with that particular adjustment and with certain other audit adjustments. Taxpayer submitted a protest, an administrative hearing was conducted, and this Letter of Findings followed as a result.

DISCUSSION

I. Combining Taxpayer's Bank Group and Financial Group Into a Single Unitary Return – Financial Institutions Tax

Indiana imposes an excise tax known as the Financial Institutions Tax (FIT) on all entities determined to be "transacting the business of a financial institution in Indiana." 45 IAC 17-2-1(a). The taxpayer subject to the FIT must adopt the combined/unitary reporting method unless the taxpayer is not a member of a unitary group. In such an instance, a separate (single-entity) reporting method is required. For those taxpayer which are members of a unitary group, the combined return must cover "all the operations of the unitary business and including all taxpayer members of the unitary group." 45 IAC 17-3-5(a).

The audit determined that taxpayer's commonly owned bank group and financial group were required to file a single unitary return. The audit based that decision on the fact that taxpayer owned more than 50 percent of its subsidiaries' stock.

The audit's decision was predicated upon IC 6-5.5-6-1, which states that "taxpayer members of a unitary group are required to file only one (1) return covering all members of the unitary group." The resolution of taxpayer's first protest item rests on whether taxpayer's bank group and financial group were members of a unitary business.

45 IAC 17-3-5(c) states that, "A 'unitary business' means business activities or operations that are of mutual benefit, dependent upon, or contributing to one another, individually as a group, in transacting the business of a financial institution." The regulation explains that, "Unity is presumed whenever there is a unity of ownership, operation, and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting, or other controlled interaction among entities that are members of a unitary group." Id.

Taxpayer bases its protest on the regulation cited above in particular, "Unity is presumed whenever there is a unity of ownership, operation, *and* use...." 45 IAC 17-3-5(c) (*Emphasis added*) *See also* IC 6-5.5-1-18. Taxpayer readily admits that the bank group and the financial group exhibit unity of ownership because both groups are owned by the taxpayer. However, taxpayer maintains that the conjunctive "and" requires that a "three-unities" test be met in order to establish that the bank group and financial group are members of the same "unitary business." Therefore, according to taxpayer, because the Department has failed to establish that there is anything more than common ownership between the two entities, the bank group and financial group are entitled to file separate FIT returns.

To that end, taxpayer presents much evidence purportedly establishing that the bank group and the financial group are identifiably distinct and operationally independent of one another. The financial group maintains a separate out-of-state headquarters. The financial group is independent and self-supporting because it has its own corporate staff. The financial group has its own staff of attorneys to address its unique legal needs. The financial group has its own human resources group, treasury management staff, information services division, printing and shipping facilities, and its own marketing department. According to taxpayer, there is no flow of assets between the bank group and the financial group. Therefore, in the absence of operational integration, flow of value, or common management, the groups are entitled to file submit separate FIT returns.

However, taxpayer ignores the unrefuted conclusions set out in the audit report. That report stated that taxpayer provided each of its subsidiaries various services including strategic planning, asset and liability management, investment administration, portfolio planning, tax planning, new product and business development, advertising, administrative and audit services, employee services and payroll management. Taxpayer's 1996 annual report stated that taxpayer received 23 percent of its earnings from the financial group. Taxpayer's 1996 and 1997 corporate reports both emphasize that its diversified business structure – including both the bank group and financial group – enables it to meet the changing needs of its customers while simultaneously preserving the taxpayer's overall financial condition despite fluctuations in earnings amongst its different groups.

Even granting the legitimacy of taxpayer's "three-unities" test, a cursory examination of taxpayer's business operations provides sufficient indicia to establish "a unity of ownership, operation, and use." 45 IAC 17-3-5(c). Although the bank group and the financial may be distinct branches, they are nonetheless branches of the same tree. The bank group and the financial group together contribute to taxpayer's overall financial well-being and are each dependent upon and sustained by that well-being. As taxpayer succinctly puts it, "The diversity of our business enables us to rely on different streams of earnings as economic cycles and customer preferences change. Our goal is simple: earn 100 percent of every creditworthy customer's business." Taxpayer's 1997 Annual Report.

Taxpayer views the bank group and the financial group as operating in a vacuum each entirely independent of one another. However, the evidence indicates that the two entities operate to sustain and preserve the taxpayer's common economic well-being. Hence, the two entities function to "contribut[e] to one another, individually as a group, in transacting the business of a financial institution." 45 IAC 17-3-5(c).

FINDING

Taxpayer's protest is respectfully denied.

II. Calculation of Taxpayer's Foreign Source Income – Exclusion of Related Expenses

Taxpayer protests the audit's decision to reduce the taxpayer's amount of taxpayer's foreign source income exclusion.

In calculating the amount of foreign source dividends taxpayer was entitled to deduct from its federal adjusted gross income, the audit reduced the amount of foreign source dividends by 15 percent. The 15 percent deduction represented an estimate of the expenses taxpayer incurred in acquiring the foreign source dividends.

In calculating taxpayer's state FIT liability, the starting point is the taxpayer's federal adjusted gross income. IC 6-5.5-1-2(a) states that, "Except as provided in subsections (b) through (d), 'adjusted gross income' means income as defined in Section 63 of the Internal Revenue Code...."

However, the taxpayer is entitled to exclude certain income from the amount of its federal adjusted gross income. Specifically, IC 6-5.5-1-2(a)(2)(B) permits the taxpayer to subtract "Income that is derived from sources outside the United States, as defined by the Internal Revenue Code."

Therefore, the taxpayer does not have to pay the FIT on "foreign source income." However, the amount of "foreign source income" the taxpayer may subtract from its federal adjusted gross income is not unrestrained. The Department requires the taxpayer to add back to its "foreign source income" those expenses related to obtaining that "foreign source income." The Department's rationale for doing so is plain; if Indiana starts with federal taxable income – an amount arrived at by deducting all relevant business expenses – but allows a straightforward deduction of the taxpayer's foreign source income, then the taxpayer, in effect, is receiving a double deduction of the expenses related to that foreign source income.

Taxpayer challenges the audit's deduction of the expenses on two grounds: First, taxpayer argues that there is no statutory or regulatory basis on which to permit an expense adjustment in tandem with the exclusion for foreign income and that the audit's proposed adjustment goes beyond the scope of the statute; Second, taxpayer maintains that even if some expense disallowance were appropriate, the method used by the audit overstates the amount of the expenses.

The taxpayer's facial challenge to the Department's practice of deducting from its "foreign source income" those expenses related to the acquisition of that income, does not survive close scrutiny. In calculating – for purposes of the FIT – taxpayer's adjusted gross income, the taxpayer has provided no justification for allowing it to effectively "deduct" its expenses two times over. Such a proposed methodology finds no basis either in law or common sense.

Taxpayer's secondary argument must also be rejected. Taxpayer maintains that the 15 percent estimate "is not a reasonable allocation of expense deductions to the income that the expense generates [and that] it constitutes impermissible taxation of income and should be thrown out." Even if taxpayer is correct, it has offered nothing specific to refute the audit's conclusion that the 15 percent figure reasonably reflects expenses related to acquiring the foreign source income. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1(b). Taxpayer has done nothing to meet that burden.

FINDING

Taxpayer's protest is respectfully denied.

III. Calculation of Taxpayer's Receipts Factor

In reviewing taxpayer's FIT calculations, the audit adjusted the numerator of the receipts factor to include the financial group. The audit also adjusted the denominator of the receipts factor to include the financial group and to include various other adjustments.

The taxpayer has challenged these audit adjustments. Specifically, taxpayer disagreed with the decision combining the bank group and financial group receipts into a single apportionment factor.

As already determined within this Letter of Findings, it was entirely appropriate, under 45 IAC 17-3-5(a), (c), for the audit to require that the bank group and the financial group submit a single combined return. Having correctly made that determination, there is nothing to indicate that the audit erred in designating and apportioning taxpayer's receipts according to the dictates of IC 6-5.5-2-4.

However, the taxpayer also challenges the audit adjustments citing what it refers to as inadvertent "double-account[ing] for a few items." In particular, taxpayer asserts that a mortgage adjustment to the financial group's numerator double-counts receipts already accounted for in the bank group's factor.

To the extent that taxpayer maintains that the audit made computational errors, taxpayer's protest is sustained. The supplemental audit is requested to verify and, if necessary, to make the necessary corrections.

FINDING

Taxpayer's protest is denied in part and – subject to verification by the supplemental audit – is sustained in part.

IV. Neighborhood Assistance Credit Carryforward

One of taxpayer's banks was approved for a $750 Neighborhood Assistance Credit in 1994. The bank group was unable to use the $750 credit in 1994 because the bank group reported a net operating loss. In 1995, the bank was approved for an additional $5,000 in Neighborhood Assistance Credits. The taxpayer "carried over" the unused $750 credit to 1995 and claimed $5,750 in credits. The audit disallowed $750 of that credit because taxpayer had only received approval for the $5,000 1995 credit.

Taxpayer argues that it should be allowed to carry over the unused $750 credit to 1995.

There is no provision in the relevant law, IC 6-3.1-9 et seq., permitting a Neighborhood Assistance Credit grantee to carry forward the credit to a succeeding year. The taxpayer was granted permission to claim a $750 credit during 1994, but 1994 passed and the taxpayer had failed to claim the credit. For all practical purposes, the $750 credit expired on December 31, 1994. IC 6-3.1-9-6 specifically states that "[a] tax credit shall be allowable under this chapter only for the taxable year of the taxpayer in which the contribution qualifying for the credit is paid or permanently set aside in a special account for the approved program or purpose."

As set out in Information Bulletin Number 22, September 1997, "There is no provision for carry back, carry forward, or refund of the credit."

FINDING

Taxpayer's protest is respectfully denied.

V. Disallowance of Enterprise Zone Loan Interest Credit

The audit disallowed the Enterprise Zone Loan Interest Credits claimed by one of taxpayer's banks. The audit disallowed the credits on the ground that it could not verify that the loans were made to entities located within the Ft. Wayne Enterprise zone. In its protest, taxpayer disagreed with the disallowance of the credits.

Taxpayer presented a list of entities having Ft Wayne addresses. According to taxpayer, this list represents "most of the claimed enterprise zone loans."

Under the assumption that taxpayer can directly relate the claimed credits to individual enterprises located within the Ft. Wayne enterprise zone, and that the loans represent a "qualified investment" under IC 6-3.1-10 et seq., taxpayer's protest is sustained subject to the findings of the supplemental audit.

FINDING

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

VI. Abatement of the Ten Percent Negligence Penalty

Taxpayer protests the assessment of the ten percent negligence penalty on the amount of tax deficiency determined by the Department. Taxpayer maintains that any errors it made in determining its state tax liabilities was not due to willful neglect.

IC 6-8.1-10-2.1 requires that a ten percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...."

Taxpayer has presented information sufficiently adequate to support its contention that any errors it made in determining its FIT liabilities were not due to willful neglect.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 00-0467
State Use Tax – Rental of Tangible Personal Property
For Tax Years 2000-2002

NOTICE: Under Indiana 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. State Use Tax – Rental of Tangible Personal Property

Authority: IC § 6-2.5-3-1; 45 IAC 2.2-3-4; IC § 6-2.5-3-2; 45 IAC 2.2-3-18; IC § 6-2.5-3-6; 45 IAC 2.2-3-19; IC § 6-6-8.1-5-1(b); 45 IAC 2.2-4-27

Taxpayer protests proposed assessments of the state's use tax on rentals of equipment necessary to remediate contaminated groundwater, pursuant to regulations promulgated by the Indiana Department of Environmental Management.

STATEMENT OF FACTS

Taxpayer is a full service "convenience" store and gas station located in extreme southern Indiana. During the tax years at issue, the manager of taxpayer's business, Ms. D, had numerous responsibilities, including ordering, monitoring customer fill-ups, bank deposits, accounting functions, financial reports, payroll, and filing returns for federal, state, and local taxes. Ms. D was involved in all aspects of taxpayer's business operations, which included movie rentals, deli service, gasoline service, and selling many specialty items for rural farmers and hunters. Ms. D. became closely involved with the gasoline leak problem from its discovery. Although she is currently employed elsewhere, Ms. D continues to provide taxpayer with help with reports required to be sent to the Indiana Department of Environmental Management (IDEM) and the tax audit at issue in this protest.

As thoroughly documented and explained in the written materials Ms. D provided to the Department, the following sequence of events led to the eventual tax assessments at issue.

The owners of a home located directly across the street from taxpayer's store/gas station noticed a strong odor of gasoline in their basement in April of 1995. When shown a vial of contaminated water from their basement, Ms. D contacted taxpayer and the investigation began. Members of the emergency response division from IDEM were called in as well as the State Fire Marshall.

The homeowners had to vacate their home. Emergency abatement processes began. Ms. D hired an environmental services company (ESC) to find the source of the leak, determine how gasoline migrated to the homeowner's basement, and devise a plan to rehabilitate contaminated ground water once the source of the leak was identified and neutralized. IDEM supervised the abatement and remediation project and exercised control over the actions taken by the environmental services company, taxpayer, and Ms. D.

The source of the leak was identified and plugged. The ESC installed monitoring wells in IDEM-approved locations on the property, checking for levels of BTEX, MTBE, and other gasoline additives.

The next step was IDEM approval of a corrective action plan (CAP). The CAP essentially contains IDEM's expectations of what a "polluter" must do to eliminate contamination; IDEM must approve every step of every CAP proposed in the State of Indiana. IDEM did approve taxpayer's CAP, which was developed by the ESC. Because of the geological structure taxpayer's store/gas station sits on, the company suggested, and IDEM approved, using and Air Sparge Unit to remediate the contaminated groundwater. This unit was installed in the monitoring wells. The unit blows oxygen and ozone into contaminated water; bubbles form; the hydrocarbons begin breaking down; a vacuum then removes the air.

The unit is completely automatic and works off a timer set by the ESC. The unit runs for a few hours at a time at different times of the day. If the system shuts itself off, taxpayer must call the environmental services company to start it again. The company asked Ms. D several times to read a few display numbers over the telephone. The ESC checks on the system frequently and moves the unit from well to well for even remediation of the contaminated groundwater. The company also takes quarterly samples and produces the reports required to be sent to IDEM. Taxpayer does nothing to operate this system; it needs no operator because it is automated, and required for a long-term groundwater remediation project.

I. State Use Tax – Rentals of Tangible Personal Property

DISCUSSION

Under IC § 6-8.1-5-1(b), a "notice of proposed assessment is *prima facie* evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." In order to prevail in this protest, taxpayer must show that under all the relevant facts, statutes, regulations, and case law, if any, that the protest should be sustained.

IC § 6-2.5-3-1 defines "use" as "the exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-2 imposes the use tax "on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. 45 IAC 2.2-3-4 states that tangible personal property purchased in Indiana, or elsewhere, "and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax... unless the Indiana state gross retail tax has been collected at the point of purchase. Liability for the tax rests with "the person who stores, uses, or consumes such property. 45 IAC 2.2-3-18. The retail merchant collects the tax as "agent for the state of Indiana." 45 IAC 2.2-3-19. *See also*, IC § 6-2.5-3-6.

45 IAC 2.2-4-27 speaks directly to the renting and leasing of tangible personal property: "In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation only exempts from tax those transactions which would have been exempt in an equivalent sales transaction." The ESC fits squarely within the definitions contained in this regulation, and under normal circumstances, would have collected and remitted to the Department the state gross retail tax on the rental transactions between ESC and taxpayer. The ESC did not, thereby subjecting taxpayer to use tax liability.

However, the circumstances surrounding the rental of the Air Sparge Units to taxpayer certainly were not normal, nor do the transactions fit neatly into those situations covered by 45 IAC 2.2-4-27. The ESC, relying on Information Bulletin # 42, did not charge taxpayer sales tax pursuant to 45 IAC 2.2-4-27(d)(3)(B): "The rental of tangible personal property together with an operator as part of a contract to perform a specific job in a manner to be determined by the owner of the property or the operator shall be considered a service rather than a rental or lease provided the lessee cannot exercise control over such property and operator."

The ESC provides a service to taxpayer; it "performs a specific job," i.e., remediation of contaminated groundwater, "in a manner to be determined by the owner of the property," i.e., the ESC pursuant to the CAP developed in conjunction with IDEM. Taxpayer does not and "cannot exercise control" over the Sparge units. In this case, the fact that the operator is infrequently there is immaterial. The equipment is automated, and any adjustments to the equipment are performed, when necessary, by the ESC. The equipment does not require an operator to be present in order to function, but the equipment is effectively operated by the lessor, the environmental services company.

FINDING

Taxpayer's protest regarding the proposed assessment of use tax is sustained.

DEPARTMENT OF STATE REVENUE

0220010026.LOF

LETTER OF FINDINGS NUMBER: 01-0026
Corporate Adjusted Gross Income – Combined Filing
Corporate Adjusted Gross Income – Unitary Filing
Tax Administration – Penalty
For Tax Year 1998

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

ISSUES

I. Corporate Adjusted Gross Income – Combined Filing: Substantive Requirements

Authority: IC § 6-3-2-2; 45 IAC 3.1-1-38; IC § 6-3-4-14; Public Law 86-272; 15 USCS § 381

Taxpayer protests the Department's finding that taxpayer may not include a related company in its consolidated return for the tax year at issue.

II. Corporate Adjusted Gross Income – Procedural Requirements for Unitary Filing

Authority: IC § 6-3-2-2(q)

Taxpayer argues that the taxpayer's two subsidiaries meet the standards for filing a combined return.

III. Tax Administration – Penalty

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

Taxpayer protests the 10% negligence penalty added to the proposed assessment.

STATEMENT OF FACTS

Taxpayer is a holding company, incorporated in Indiana in 1998. Taxpayer's only income is from management fees from two subsidiaries, one located in Oklahoma, one in Indiana. The Oklahoma subsidiary manufactures curb and air handling units that are then attached to HVAC units. The Oklahoma subsidiary ships the units to the Indiana subsidiary, which is basically a sheet metal shop; it then manufactures parts for commercial HVAC units that are then sold to commercial distributors. Taxpayer filed a consolidated adjusted gross income tax return for all three entities. The Audit Division disallowed the combined filing based on the Oklahoma subsidiary's lack of income derived from sources within Indiana. More facts will be added as required.

I. Corporate Adjusted Gross Income – Combined Filing: Substantive Requirements

DISCUSSION

Taxpayer protests the Department's finding that taxpayer's Oklahoma subsidiary may not be part of taxpayer's consolidated filing. The applicable statute is IC § 6-3-4-14. Section (a) provides that affiliated groups of corporations "shall have the privilege of making a consolidated return" for taxes imposed by Indiana's Adjusted Gross Income Tax Act. However, there are certain statutorily required conditions that must be met before the Department grants the privilege. First, all the corporations must consent to "all of the provisions of this section including all provisions of the consolidated return regulations" of Section 1502 of the Internal Revenue Code, "and all regulations promulgated by the department implementing this section." Consent is not an issue in this protest; consequently, the relevant regulations apply. *See* discussion, *infra*.

Section (b) of IC § 6-3-4-14 defines affiliated groups in conjunction with Section 1504 of the Internal Revenue Code, with one salient exception: "the affiliated group shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana." The Audit Division determined that the Oklahoma subsidiary did not have adjusted gross income "derived from sources within Indiana." IC § 6-3-2-2(a) defines adjusted gross income derived from sources within Indiana as follows:

With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

(1) income from real or tangible personal property located in this state;
(2) income from doing business in this state;
(3) income from a trade or profession conducted in this state;
(4) compensation for labor or services rendered within this state; and
(5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

45 IAC 3.1-1-38 defines a taxpayer as doing business in a state "if it operates a business enterprise or activity in such state including, but not limited to:

(1) Maintenance of an office or other place of business in the state
(2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
(3) Sale or distribution of merchandise to customers in the state directly from company owned or operated vehicles where title to the goods passes at the time of sale or distribution
(4) Rendering services to customers in the state
(5) Ownership, rental or operation of a business or of property (real or personal) in the state
(6) Acceptance of orders in the state
(7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under Public Law 86-272 to tax its net income.

The Oklahoma subsidiary manufactures custom "curbs"--the metal sheds HVAC's sit in--; the Indiana subsidiary orders the curbs exclusively from the Oklahoma subsidiary, as well as ordering standard curbs. The Oklahoma subsidiary ships its entire production of curbs by common carrier to the Indiana subsidiary. The president of the Oklahoma flies to Indiana once a year to negotiate a sales contract. The Indiana subsidiary relies on sales projections in crafting the contract. For custom curbs, employees from the Oklahoma subsidiary go to the Indiana subsidiary to learn exact specifications. All engineering and quality control occurs in Indiana; Indiana employees of the Indiana subsidiary inform "several" Oklahoma employees of the Oklahoma subsidiary, in training sessions, of the required curb specifications. The Oklahoma employees then return to Oklahoma where all manufacturing takes place.

The Oklahoma subsidiary's activities do not fall within the definitions set forth in the applicable statutes and regulations. It has no income from doing business in the state of Indiana; there are only receipts from sales of units manufactured in Oklahoma by Oklahoma employees to the Indiana subsidiary. The Oklahoma subsidiary does not maintain an office or other place of business in Indiana, nor does it maintain any inventory for sale, distribution, or manufacture. There are no consigned goods within the state. Subsection (3) above is not satisfied. The Oklahoma subsidiary renders no services to its only customer within the state, taxpayer's Indiana subsidiary. The Oklahoma subsidiary does not own, rent, or operate a business or property in Indiana. None of the Oklahoma's subsidiary's in-state activities exceed "the mere solicitation of orders" so as to give Indiana nexus with the Oklahoma subsidiary under Public Law 86-272, 15 USCS § 381. Indiana does not have the power to tax the Oklahoma subsidiary for labor conducted in Oklahoma.

FINDING

Taxpayer's protest concerning the Department's finding that taxpayer's Oklahoma subsidiary may not be part of taxpayer's consolidated filing is denied.

II. Corporate Adjusted Gross Income Tax – Procedural Requirements for Filing a Combined Return

DISCUSSION

Secondly, taxpayer argues it should be able to file a combined return. This argument rests on the contention that the Oklahoma subsidiary and the Indiana subsidiary meet the standards for a finding that they are in a unitary relationship. Taxpayer's failure to request the statutorily required permission to file a combined return was based on their mistaken belief taxpayer could file as a small business corporation. Taxpayer admitted this was a mistake, and did not protest that part of the assessment. Taxpayer is now requesting that they be allowed to file a combined return for the tax year at issue because the Oklahoma subsidiary cannot operate without the Indiana subsidiary and its cash flowing to it. Taxpayer essentially argues that both subsidiaries are really one company.

Despite taxpayer's arguments, the Department cannot grant permission for taxpayer to file unitary. Pursuant to IC § 6-3-2-2(q), taxpayer should have petitioned the Department "thirty (30) days after the end" of its taxable year "for permission to file a combined income tax return fro a taxable year." The statute is clear about the thirty-day requirement to file a petition for permission to file a combine return. Taxpayer did not meet its statutory obligation.

FINDING

Taxpayer's protest concerning the procedural requirements for filing a combined return is denied.

III. Tax Administration – Penalty

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that its failure to pay the appropriate amount of tax due was based solely on taxpayer's interpretation of the relevant statutes and regulations.

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. Although some of the questions raised by taxpayer involve technical issues of interpretation and applicability, given the totality of the circumstances, waiver of the penalty is inappropriate in this instance.

FINDING

Taxpayer's protest concerning the abatement of the 10% negligence penalty is denied.

DEPARTMENT OF STATE REVENUE

0220010076.LOF

LETTER OF FINDINGS NUMBER: 01-0076
Corporate Income Tax
For the Fiscal Years Ending March 31, 1998, 1999, and 2000

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

ISSUES

I. Gross Income Tax – Disallowance of "Special Corporation" Status

Authority: 45 IAC 1.1-2-12

The taxpayer protests the auditor's disallowance of its "special corporation" status and the imposition of the gross income tax.

II. Tax Administration – Auditor's Reliance on Auditing Technique in the Absence of Relevant Financial Records

Authority: IC 6-8.1-5-1; IC 6-8.1-4-2

The taxpayer protests the auditor's use of departmental audit experience to arrive at a standard division of income between service and sale of tangible personal property**.**

III. Tax Administration – Penalty

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

The taxpayer protests the penalty assessed.

STATEMENT OF FACTS

The taxpayer is a contractor engaged in constructing bulk materials handling facilities. The taxpayer is a wholly owned subsidiary of another regular corporation. During the years of the audit period the taxpayer considered itself to be a qualified subchapter S subsidiary (QSUB) because its parent corporation presumably met the qualifications to elect S corporation status. Based upon this belief, the taxpayer filed its Indiana income tax returns as a special corporation, i.e., one exempt from the gross income tax.

The department audited the taxpayer. The auditor disallowed the taxpayer's special corporation status and imposed the gross income tax. At the time of the examination, the taxpayer could not provide the auditor with a division of income between higher rate and lower rate receipts. Based upon departmental audit experience, the auditor assessed 60% of the taxpayer's total Indiana receipts at the higher gross income tax rate and 40% at the lower rate.

The taxpayer protested the imposition of the gross income tax and the imposition of penalty. Further, the taxpayer protested the auditor's use of a standard 60% / 40% division of gross receipts, submitting an amended return for fiscal year ending March 31, 1998 in support of its protest. This amended return presumably reflects the actual division of higher rate and lower rate receipts for this year.

In a letter dated March 6, 2002, the taxpayer conceded its liability for the gross income tax. However, the taxpayer continued to assert the accuracy of the figures contained in the amended return for fiscal year ending March 31, 1998 and continued to protest the imposition of penalty.

I. Gross Income Tax – Disallowance of "Special Corporation" Status

The taxpayer protested the auditor's disallowance of its "special corporation" status and the imposition of the gross income tax. Following review and discussion, the department and the taxpayer resolved this matter. In a letter dated March 6, 2002, the taxpayer conceded its liability for the gross income tax.

FINDING

The taxpayer has withdrawn its protest of this issue.

II. Tax Administration – Auditor's Reliance on Auditing Technique in the Absence of Relevant Financial Records

The taxpayer protests the auditor's use of departmental audit experience to arrive at a standard division of income between service income and income derived from the sale of tangible personal property. IC 6-8.1-4-2 (a) (6) states:

The division of audit may: … employ the use of such devices and techniques as may be necessary to improve audit practices.

Hence, given the absence of financial records during the audit examination, the auditor was justified in employing a standard approach to the division of income. However, in the interim, the taxpayer has submitted an amended return for fiscal year ending March 31, 1998 that purports to contain the actual division of income. The department has determined that the figures contained in it are reasonable, and, accordingly, a supplemental audit has been prepared. In a letter dated March 6, 2002 the taxpayer withdrew its protest of this issue based on the proposed supplemental audit adjustments.

FINDING

The taxpayer has withdrawn its protest of this issue.

III. Tax Administration – Penalty

Prior to being audited by the department, the taxpayer considered itself to be a QSUB for the years of the audit period. Hence, the taxpayer believed it met the qualifications for being an S corporation and filed its income tax returns as a "special corporation." The auditor determined that the taxpayer was not a QSUB for the years in question and assessed Indiana gross income tax. While the taxpayer has conceded its liability for the gross income tax, it continues to protest the imposition of the negligence penalty.

Administrative Rule 45 IAC 15-11-2 (b) states the following:

> "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.

In a letter dated February 15, 2001, the taxpayer asserted that it researched the Indiana Code, regulations, rulings, and form instructions, and found only the following statement:

> A Company is eligible to file Form IT-20SC if they would be eligible to be an S-Corporation under Federal law pursuant to IRC Section 1361 (b).

The taxpayer does not cite the source of this statement. However, the taxpayer was not eligible to be an S corporation during the years of the audit. Section 1361 (b) (1) (B) of the Internal Revenue Code (IRC) states in pertinent part:

> Small business corporation –
>
> (1) In general – For purposes of this subchapter, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not - …
>
> (B) have as a shareholder a person … who is not an individual.

The fact that the taxpayer's sole shareholder was a regular corporation makes the taxpayer ineligible for S corporation status.

Regarding the taxpayer's argument that it was a QSUB during the audit period because its parent corporation could have elected to be an S corporation, IRC § 1361 (b) (3) states in part,

> (A) In general. Except as provided in regulations prescribed by the Secretary, for purposes of this title –
>
> (i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and
>
> (ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

There is no indication that the parent corporation ever treated all assets, liabilities, etc. of the taxpayer as its own. The fact that the taxpayer filed its own income tax returns for the years of the audit clearly indicates that it was not a QSUB. The taxpayer failed to familiarize itself with those sections of the Internal Revenue Code that provide the qualifications for status as an S corporation or a QSUB. The taxpayer has not established that its failure to timely pay the full amount of tax due was due to reasonable cause and not due to negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

1820010121.LOF

LETTER OF FINDINGS NUMBER: 01-0121
Financial Institutions Tax
For the Tax Years 1994, 1995, and 1996

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

ISSUES

I. Date Upon Which Taxpayer Entered Into a Unitary Relationship with Its Out-of-State Banking Group

Authority: IC 6-5.5-1-18(a); IC 6-5.5-1-18(b); 45 IAC 17-3-5(c)

Taxpayer argues that the date upon which the audit determined that taxpayer entered into a unitary relationship with its out-of-state banking group – May 2, 1996 – was incorrect. Taxpayer maintains that the particular facts surrounding the acquisition of the out-of-state banking group establish that the unitary relationship was not established until approximately January 1, 1997.

II. Calculation of Taxpayer's Foreign Source Income – Exclusion of Related Expenses in Determining Taxpayer's Adjusted Gross Income

Authority: IC 6-5.5-1-2(a); IC 6-5.5-1-2(a)(2)(B); IC 6-8.1-5-1(b)

Taxpayer argues that expenses related to the acquisition of its foreign source income should not be deducted from that foreign source income. In the alternative, taxpayer asserts that the audit calculated the foreign source income expenses based upon incomplete information and that the correct calculation of those expenses would reduce the amount of expenses.

III. Enterprise Zone Loan Interest Credit – Credit on Interest Taxpayer Derived from Loans to Churches and Not-for-Profit Organizations

Authority: IC 6-3.1-7-1 to -6; IC 6-3.1-7-1; IC 6-3.1-7-2

Taxpayer argues that it is entitled to a credit for enterprise zone loan interest derived from loans made to churches and not-for-profit organizations located within "enterprise zones."

IV. Abatement of the Ten Percent Negligence Penalty

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

Taxpayer argues that audit's imposition of the ten percent negligence penalty against the additional assessment for calendar year 1996, was in error because any tax deficiency was not due to negligence. Alternatively, taxpayer argues that the negligence penalty should be apportioned – i.e. taxpayer was "negligent" on issue number one and not "negligent" for issue number two.

STATEMENT OF FACTS

Taxpayer is a diversified financial institution incorporated and domiciled in Indiana. Taxpayer provides financial services including commercial and retail banking, trust, investment, item processing, mortgage banking, and credit card processing. Taxpayer is subject to the state's Financial Institutions Tax (FIT). The Department conducted an audit of taxpayer's records for the calendar years 1994, 1995, and 1996. The audit determined that taxpayer owed additional taxes and assessed the ten percent negligence penalty against the taxes attributable to the calendar year 1996. The taxpayer protested certain portions of the assessment, an administrative hearing was held, and this Letter of Findings results.

DISCUSSION

I. Date Upon Which Taxpayer Entered Into a Unitary Relationship with Its Out-of-State Banking Group

For the tax years at issue, taxpayer determined that it was part of a unitary group. On May 2, 1996, taxpayer completed the purchase of an out-of-state banking group. The audit determined that the out-of-state banking group was assimilated into taxpayer's business such that the out-of-state banking group should have been included with taxpayer's unitary filing for calendar year 1996. The taxpayer included the out-of-state banking group within its federal 1996 consolidated return.

The audit came to this conclusion based, in part, on a statement included within taxpayer's 1996 Annual Report. The Annual Report statement on which the audit relied reads as follow:

> The reported numbers include the results of [out-of-state banking group].... which merged with [taxpayer] in a pooling-of-interests transaction consummated in May. As of June 1996, less than 30 days after closing, the new [out-of-state banking

group] made its debut, with all systems and procedures of the former [of-of-state banking group] converted to [taxpayer's] single operating system. While the cost saving achieved from merger integration enhance the initial return from this transaction, the real payoff is the opportunity for revenue growth – marketing [taxpayer] products and services in [out-of-state banking group's location]. It is clear that our earnings, and our growth rate, will benefit from this acquisition for years to come.

Taxpayer maintains that the audit's determination was erroneous. According to taxpayer, the assimilation of out-of-state banking group should not be based upon the date upon which the acquisition was consummated. Rather, taxpayers' assimilation of the out-of-state banking group – for purposes of determining the taxpayer's adjusted gross income – was an on-going process. Certain steps toward assimilation of the out-of-state banking group – presumably to assure continuity of services to out-of-state banking group's customers – took place before May 2. Other steps in this on-going assimilation process took place subsequent to the May 2 date.

Essentially, argues that a unitary relationship was not established with the out-of-state banking group until January 1, 1997.

The statutory definition of a "unitary business" is found at IC 6-5.5-1-18(a), (b).

"Unitary business" means business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution. The term may be applied within a single legal entity or between multiple entities and without regard to whether each entity is a corporation, a partnership, a limited liability company, or a trust, provided that each member is either a holding company, a regulated financial corporation, or a subsidiary of either, a corporation that conducts the business of a financial institution under IC 6-5.5-1-17(d)(2), or any other entity, regardless of its form, that conducts activities that would constitute the business of a financial institution under IC 6-5.5-1-17(d)(2) if the activities were conducted by a corporation. The term "unitary group" includes those entities that are engaged in a unitary business transacted wholly or partially within Indiana.

Unity is presumed whenever there is unity of ownership, operation, and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting, or other controlled interaction among entities that are members of the unitary group, as described in subsection (a). However, the absence of these centralized activities does not necessarily evidence a nonunitary business. *See also* 45 IAC 17-3-5(c).

The taxpayer asks the Department to adopt an elastic standard for marking the onset of a unitary relationship in which "ownership" is simply one factor in determining the existence of that relationship. However, there are few compelling reasons for adopting such an amorphous standard. IC 6-5.5-1-18(b) states that a unitary relationship is presumed "whenever there is unity of ownership, operation, and use...." Obviously, the precise exigencies surrounding the acquisition of a fully function banking operation will vary widely depending on the acquiring entity's specific intentions. In some circumstances, the acquiring entity will act to entirely subsume the acquired banking operation; thereafter, the acquired banking operation will lose all vestiges of individual identity and operation. In other circumstances, the acquiring entity will permit the acquired banking operation to retain its individual identity and freedom of operation; even after the formal acquisition has been full consummated, the acquiring entity will exercise only the most tenuous control over the acquired banking operation. Under either set of circumstances, the one objectively certain factor is "ownership." The remaining two factors – "use" and "operation" are less quantifiably precise but, nonetheless, inexorably follow the acquisition of the target banking operation.

Under any reasonable interpretative application of IC 6-5.5-1-18(a), (b), taxpayer entered into a unitary relationship with the out-of-state banking group on the date taxpayer acquired ownership of the group.

FINDING

Taxpayer's protest is respectfully denied.

II. Calculation of Taxpayer's Foreign Source Income – Exclusion of Related Expenses in Determining Taxpayer's Adjusted Gross Income

Taxpayer protests the audit's decision to reduce the taxpayer's amount of taxpayer's foreign source income exclusion.

In calculating the amount of foreign source dividends taxpayer was entitled to deduct from its federal adjusted gross income, the audit reduced the amount of foreign source by the amount of expenses taxpayer stated on its Federal Form 1118.

In calculating taxpayer's state FIT liability, the starting point is the taxpayer's federal adjusted gross income. IC 6-5.5-1-2(a) states that, "Except as provided in subsections (b) through (d), 'adjusted gross income' means income as defined in Section 63 of the Internal Revenue Code...."

However, the taxpayer is entitled to exclude certain income from the amount of its federal adjusted gross income. Specifically, IC 6-5.5-1-2(a)(2)(B) permits the taxpayer to subtract "Income that is derived from sources outside the United States, as defined by the Internal Revenue Code."

Therefore, the taxpayer does not have to pay the FIT on "foreign source income." However, the amount of "foreign source income" the taxpayer may subtract from its federal adjusted gross income is not unrestrained. The Department requires the taxpayer to add back to its "foreign source income" those expenses related to obtaining that "foreign source income." The Department's rationale for doing so is plain; if Indiana starts with federal taxable income – an amount arrived at by deducting all relevant business expenses – but allows a straightforward deduction of the taxpayer's foreign source income, then the taxpayer, in effect, is receiving a double deduction of the expenses related to that foreign source income.

Taxpayer challenges the audit's deduction of the expenses on two grounds: First, taxpayer argues that there is no statutory or regulatory basis on which to permit an expense adjustment in tandem with the exclusion for foreign income and that the audit's proposed adjustment goes beyond the scope of the statute; Second, taxpayer maintains that even if some expense disallowance were appropriate, the method used by the audit to determine the amount of expenses overstates the actual amount of expenses.

The taxpayer's facial challenge to the Department's practice of deducting from its "foreign source income" those expenses related to the acquisition of that income, does not survive close scrutiny. In calculating – for purposes of the FIT – taxpayer's adjusted gross income, the taxpayer has provided no justification for allowing it to effectively "deduct" its expenses two times over. Such a proposed methodology finds no basis either in law or common sense.

The audit referenced taxpayer's Federal Form 1118 to determine the amount of expenses related to the acquisition of its foreign source income. However, according to taxpayer, "Use of the Form 1118 as the basis for the adjustments results in the disallowance of expenses which insufficiently related to the [foreign source income] to justify the adjustment." Taxpayer argues that Federal Form 1118 is a blunt instrument which substantially overstates the actual amount of foreign source income expenses. Taxpayer maintains that the federal system of calculating foreign source income expenses, arbitrarily allocates a raw percentage of its *total* expenses as expenses related to the foreign source income whether or not that allocation to foreign source income is based in financial reality. For example, taxpayer offers the hypothetical example of a Singapore treasury bond purchase. Taxpayer's actual expenses related to this essentially passive investment are insubstantial yet – according to taxpayer – the Federal Form 1118 arbitrarily attributes a certain percentage of its total expenses toward the maintenance of this investment.

Taxpayer's secondary argument must also be rejected. Even if taxpayer is entirely correct in asserting that the Federal Form 1118 is an inexact instrument for calculating its foreign income expenses, the alternative information it has provided is insufficient to overcome the presumption of correctness which attaches to the audit's original calculation. As set out in 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." There is no basis for substituting the equally imprecise supplementary information for the audit's original calculation based upon the taxpayer's own Federal Form 1118. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Id.

FINDING

Taxpayer's protest is respectfully denied.

III. Enterprise Zone Loan Interest Credit – Credit on Interest Taxpayer Derived from Loans to Churches and Not-for-Profit Organizations

The audit determined that taxpayer was not entitled to a credit for interest received on certain loans made within an "Enterprise Zone." Specifically, the audit disallowed the credit for loans made to churches and not-for-profit organizations. The audit reasoned that the churches and not-for-profit organizations lacked a qualifying business purpose.

The statutory scheme, IC 6-3.1-7-1 to -6, permits taxpayer to claim a credit against its state FIT liability if it receives interest on a "qualifying loan" made to an organization located within an enterprise zone.

IC 6-3.1-7-1 states in part as follows:

"Qualified loan" means a loan made to an entity that uses the loan proceeds for: (1) a purpose that is directly related to a business located in an enterprise zone; (2) an improvement that increases the assessed value of real property located in an enterprise zone; or (3) rehabilitation, repair, or improvement of a residence.

The credit which taxpayer seeks to obtain is defined in IC 6-3.1-7-2 which reads:

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

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

The audit was correct in concluding that a church or not-for-profit organization is not a "business" in the conventional sense of that word. After all, a church or not-for-profit organization does not manufacture widgets, sell groceries, provide dry-cleaning services, or perform any of the activities that one would readily associate with having a "business purpose." However, the language found within IC 6-3.1-7-1 does not impose such a restraint on a "qualifying loan." The statute plainly allows the taxpayer to claim the interest credit for loans made to an enterprise zone "entity" which uses the loan proceeds for "an improvement that increases the value of real property in an enterprise zone." IC 6-3.1-7-1.

FINDING

Taxpayer's protest is sustained.

IV. Abatement of the Ten Percent Negligence Penalty

Of the three years considered by the audit, the ten percent negligence penalty was assessed against the additional assessment for 1996. The additional assessment is attributed largely to taxpayer's failure to include the out-of-state banking group within its unitary return. Taxpayer asks the Department to exercise its discretion to abate the ten percent negligence penalty. Taxpayer argues that its positions concerning the state's Financial Institutions Tax were based upon good faith interpretations of the relevant statutes, Indiana case law, and Department policy; were not due to negligence or intentional disregard of the law; and that the original determination of its tax liability had a reasonable basis.

In the alternative, taxpayer argues that assessment of the ten percent negligence paints with too broad a brush. Taxpayer argues that the Department should wend its way through the additional assessments, determine which of those additional assessments can be attributed to a particular "negligent" act, and then assess the penalty against only those portions of the additional assessments directly attributable to the particular negligent act.

IC 6-8.1-10-2.1 requires that a ten percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...."

Taxpayer was assessed the ten percent negligence penalty primarily based on its failure to include the newly acquired out-of-state banking entity in its 1996 Indiana FIT return while simultaneously including the entity in its federal consolidated return for that same year. Taxpayer has provided sufficient indicia to establish the failure to include the entity in FIT was due to "reasonable cause."

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420010352.LOF

LETTER OF FINDINGS NUMBER: 01-0352
State Gross Retail Tax
For Tax Years 1998-2000

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

I. State Gross Retail Tax – Public Transportation Exemption

Authority: IC 6-2.5-5-27; 45 IAC 2.2-5-61(b), (g)

Taxpayer protests the assessment of tax on various purchases of equipment and supplies that taxpayer believes were used to administer the business of public transportation.

II. Tax Administration – Abatement of Penalty

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

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

STATEMENT OF FACTS

Taxpayer is in the business of rendering public transportation and warehousing perishable food products by means of its "cold" transportation equipment and facilities. Taxpayer uses refrigerated trucks that are owned by taxpayer to transport the frozen food products from a location designated by taxpayer to its cold storage facilities. At a later date, upon receipt of further shipping instructions, taxpayer transports the goods from its storage facilities to the location designated by the customer. The customer pays an arranged fee for the transportation services.

Taxpayer's cold storage facilities are used to warehouse the customer's goods. Just as the perishable goods must be carried in temperature-controlled refrigerated trucks, so too must the goods be maintained in temperature controlled facilities at taxpayer's cold storage facilities during the storage, handling, and transfer phase of the transportation journey. Warehousing of specific goods is usually for no longer than one to two weeks; however, some contracts with customers provide that taxpayer will warehouse certain seasonal goods for a few months. A special warehousing fee is charged to storage customers who contract for the warehousing of seasonal goods. From time-to-time, a transportation customer may incur an additional separately stated storage surcharge if its goods remain within taxpayer's cold storage facility for longer than the normal period of transfer and handling time.

The Department agreed that taxpayer is engaged in public transportation. However, the Department assessed tax on items used by taxpayer in its cold storage facility because the Department found that the cold storage area is used for warehousing goods and not for the temporary storage of goods in public transportation. These items included utilities, forklift trucks and various repair parts for the forklift trucks, handheld computers that verify the receipt of shipments and keep inventory, and various office supplies. Taxpayer argues that whereas it does provide storage service to certain storage customers, the storage service is temporary in nature.

I. State Gross Retail Tax – Public Transportation Exemption

DISCUSSION

The definition of public transportation is 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.

If a person acquiring tangible personal property or services directly uses or consumes the property or services in providing public transportation for persons or property, the transactions involving the tangible personal property and services are exempt from the state gross retail tax. *See* IC 6-2.5-5-27. "Property directly used for temporarily storing persons or property being transported is exempt from tax because temporary storage is considered to be an integral part of rendering transportation." 45 IAC 2.2-5-61(g).

Here, taxpayer is a public transportation company that transports frozen foods for customers. Taxpayer picks up the goods at the customer's location and delivers them to taxpayer's cold storage facilities. Taxpayer imposes a separately stated "storage surcharge" in addition to the transportation/cartage charges if, for any reason, the customer's goods are held at taxpayer's cold storage facility for longer than the normal period of transfer and handling time. Upon receipt of further shipping instructions from the customer, the goods are delivered by the taxpayer to the customer's designated final destination. Based upon the facts of the instant case, the question before us becomes whether or not taxpayer's storage (*i.e.*, warehousing) activities constitute the temporary storage of property in transit such that the equipment and supplies consumed in maintaining the storage facility are exempt from sales tax because they are an integral part of taxpayer's public transportation service.

45 IAC 2.2-5-61(g) gives several examples of temporary storage facilities which would qualify for exemption from the gross retail tax. Some of these examples include facilities to store airline passengers' luggage until it can be loaded on a plane, and a carrier temporarily storing property until it can be loaded for further shipment.

The Department defines "temporary storage of persons or property in transit" as that storage required by the public transportation company to facilitate the routine transfer of persons or property between public transportation carriers or equipment or as required by unanticipated delays. The Department does not consider storage that is requested by the person for whom public transportation is performed (*i.e.*, taxpayer's customers) to be temporary storage of persons or property in transit. Such storage is a service performed for the customer after public transportation has ceased. Subsequent shipment begins the public transportation activity anew.

In the instant case, the storage provided by taxpayer is requested by taxpayer's customers for the customers' own convenience. As such, the storage service performed by taxpayer is not "temporary storage of persons or property in transit", but instead constitutes storage unrelated to the public transportation business. Therefore, the cold storage facility including the equipment and supplies consumed in maintaining it are subject to sales or use tax.

FINDING

Taxpayer's protest is denied.

II. Tax Administration – Abatement of Penalty

DISCUSSION

The Department determined that a ten percent (10%) negligence penalty should be imposed upon taxpayer. Taxpayer disagrees with the imposition of said penalty.

Under IC 6-8.1-10-2.1(d), the Department is empowered to waive the ten-percent negligence penalty if the taxpayer can establish that its failure to pay the tax deficiency was due to reasonable cause and not due to willful neglect. Under 45 IAC 15-11-2(c), in order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. Ignorance of the listed tax laws, rules, and/or regulations is treated as negligence. Factors which may be considered to determine reasonable cause include the nature of the tax involved, judicial precedents set by Indiana courts, judicial precedents established by jurisdictions outside Indiana, published Department instructions, information bulletins, letters of findings, rulings, and letters of advice. 45 IAC 15-11-2(c).

Taxpayer was the subject of a prior audit by the Department in 1997 that addressed whether or not taxpayer was entitled to the public transportation exemption. Following taxpayer's protest of the issues of the prior audit, and a subsequent hearing, a letter of findings was issued stating that taxpayer was not entitled to the public transportation exemption. Thereafter, taxpayer chose to discount the Department's determination and continued to make purchases for its cold storage facility in adherence with its previous interpretation of the tax laws and regulations (*i.e.*, no sales or use tax was paid on the purchases). Although taxpayer chose not to appeal the Department's finding, it undoubtedly realized that something was amiss. However deeply felt its position may have been, taxpayer's decision to ignore the results of the prior audit takes that decision out of the "ordinary business care" standard necessary for the Department to grant the taxpayer's request to waive the penalty.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220020019.LOF
0220020122.LOF

LETTER OF FINDINGS NUMBER: 02-0019 and 02-0122
Adjusted Gross Income Tax
For Tax Year 1997

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

ISSUE

I. Adjusted Gross Income Tax – Unitary (Combined) Filing Status

Authority: *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corp. V. Franchise Tax Board*, 463 U.S. 159, 103 S.Ct. 2933; 35 ILCS 5/1501(a)(27) and Tenn.Code Ann. § 67-4-2004(25)(B)

Taxpayers protest the auditor's determination that because the parent corporation's ownership of its subsidiary was less than 80%, the subsidiary should not have been included in the combined tax returns with the parent corporation.

II. Adjusted Gross Income Tax – Throwback Sales

Authority: IC 6-3-2-2; 45 IAC 3.1-1-64; Indiana Dept. of State Revenue Information Bulletin #12

Taxpayers protest the inclusion of sales to Illinois in the Indiana apportionment sales factor.

STATEMENT OF FACTS

The taxpayers in the instant case are a parent corporation and its subsidiary. The two entities chose to file a joint-protest. Within this Letter of Findings, the entities will be addressed separately as "Parent" and "Subsidiary" and together as "taxpayers".

Subsidiary

Subsidiary is a manufacturer and marketer of specialty engineered products used primarily in the automotive after-market industry. Subsidiary is an out-of-state company but conducts virtually all of its business operations from its Indiana location. At the time of the audit, Subsidiary filed combined tax returns with its parent corporation (hereinafter referred to as "Subsidiary's parent"), Parent, and other affiliates. At the time of the audit, Subsidiary's parent owned (55%) of Subsidiary.

Pursuant to the audit, the auditor determined that because Subsidiary's parent's ownership of Subsidiary was less than 80%, Subsidiary should not have been included in the combined tax returns with Parent. Based upon this finding, the auditor recomputed Subsidiary's taxable gross income on a separate basis.

Parent

Parent is a global manufacturer of energy absorption and power transmission products as well as custom engineered components. At the time of the audit, the Parent's business group was comprised of Parent and seven wholly-owned subsidiaries (an eighth was added in tax year ending December 31, 1997). Parent operates primarily as a strategic management company for its subsidiaries.

Since 1987, Parent has filed on a consolidated basis for gross income tax purposes, and on a combined basis for adjusted gross income tax purposes. All of the companies included in the returns were 100% owned, either directly or indirectly, by Parent, with the exception of Subsidiary. During the audit period, Subsidiary was 55% owned by Subsidiary's parent. (Subsidiary's parent is a subsidiary of Parent.)

Based upon the auditor's belief that there must be 80% ownership for an entity to be included in a combined filing, the auditor excluded Subsidiary from the combined filing for adjusted gross income tax purposes. For the same reason, the auditor also excluded Subsidiary from the consolidated filing, for gross income tax purposes.

I. Adjusted Gross Income Tax – Unitary (Combined) Filing Status

DISCUSSION

Taxpayers protest the auditor's determination that Subsidiary should be excluded from the combined filing returns with Parent because Subsidiary was only 55% owned by Subsidiary's parent. The determination was made based upon the auditor's belief that there must be 80% ownership for an entity to be included in a combined filing.

The Supreme Court over the years has developed a three-part test in determining whether a unitary relationship exists: common ownership, common management, and common use or operation. *See*, *e.g.*, *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992). The first item to be considered under this three-part test is common ownership. As a general rule, *at least* fifty percent (50%) of a corporation's stock must be commonly owned (either directly or indirectly) in order for a corporation to be considered part of a unitary business. *See*, *i.e.*, 35 ILCS 5/1501(a)(27) and Tenn.Code Ann. § 67-4-2004(25)(B).

The information and documentation available shows that during the audit period Parent (*i.e.*, Parent through Subsidiary's parent) owned fifty-five percent (55%) of the stock of Subsidiary. The evidence of file is sufficient to establish common ownership.

There is also sufficient evidence to find common management and common use or operation. Common management is shown when the parent corporation provides a management role that is grounded in the parent's own operation expertise and overall operational strategy. *See*, *e.g.*, *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983). Evidence of a common operation exists where certain functions are performed for the group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which independent companies would perform for themselves.

The evidence on file shows that Parent operated as a management company for its subsidiaries and exercised control and influence over them. Officers and directors of Parent held officer positions and directorships within the subsidiaries (*e.g.*, Parent's president also served as the director of Subsidiary). Parent was responsible for the strategic management of the subsidiaries, including the overall approval of the subsidiaries' budgets, and final authority over funding and financing decisions. Furthermore, many of the administrative, management, and financing functions for the subsidiaries were centralized. For example, income tax filing services, legal support, human resources and insurance coverage for each of the subsidiaries was centralized at the level of Parent. Parent also secured third party financing, and provided pension plans, post-retirement, self-insured health care and life insurance benefits for the active and retired employees of the subsidiaries.

On the basis of the facts, it appears that Parent and Subsidiary enjoyed a unitary relationship. Subsidiary should not have been excluded from the combined filing returns with Parent.

FINDING

Taxpayers' protest is sustained.

II. Adjusted Gross Income Tax – Throwback Sales

DISCUSSION

Subsidiary argues that the auditor erred in including its sales to Illinois in the combined filing Indiana sales factor. According to Subsidiary, because it is subject to income tax in Illinois and was included in a combined Illinois income tax return with Parent, Subsidiary's Illinois sales should have been excluded from the numerator of the Indiana sales factor.

Sales made by Indiana corporations to out-of-state purchasers must be apportioned, as income, to Indiana, if the state in which the purchaser resides is without legal authority to claim such income as its own. *See* IC 6-3-2-2(e) and 45 IAC 3.1-1-64. Specifically, if interstate sales are "taxable in another state" - *i.e.*, the state of the purchaser - the sales are not includible in the numerator of the Indiana sales factor. Such sales are defined as throwback sales.

According to IC 6-3-2-2(n):

For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if:

(1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or

(2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part: "A corporation is 'taxable in another state' under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax."

It is well-settled that the basic premise in filing a combined return is that all activities carried on by separate entities are part of a single unitary business (*i.e.*, one taxpayer). *See Indiana Dept. of State Revenue Information Bulletin #12*, page 11. Under the "Finnigan" concept (set forth in *Appeal of Finnigan Corporation*, Cal. St. Board of Equal., Jan. 24, 1990 (88-SBE-022A) and adopted by the Department in *Indiana Dept. of State Revenue Information Bulletin #12*), a "taxpayer" for combined filing purposes is defined to mean all corporations (*i.e.*, members) of a unitary group. *See Indiana Dept. of State Revenue Information Bulletin #12*, page 11.

In the instant case, the evidence of file establishes that Subsidiary is part of a unitary group that filed a combined Illinois corporation income tax return for the tax year in question. A review of the Illinois tax return evinces that Subsidiary was not the only entity within the unitary group with activities in Illinois. Another member of the unitary group reported property, payroll, and sales from activities within Illinois. Because this entity was clearly taxable in Illinois, and because Subsidiary and the entity were both members of the Indiana and Illinois unitary groups, and because for purposes of determining throwback or a sales factor calculation the meaning of the term "taxpayer" includes all members of the unitary group, the throwback of Subsidiary's Illinois sales was improper.

FINDING

Taxpayers' protest is sustained.

DEPARTMENT OF STATE REVENUE

2820020081.LOF

LETTER OF FINDINGS NUMBER: 02-0081 CSET
Controlled Substance Excise Tax
For Tax Period: 2001

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

ISSUE

Controlled Substance Excise Tax – Imposition

Authority: IC 6-7-3-19(2), IC 6-8.1-3-1, IC 6-7-3-5, IC 6-7-3-13, Fifth Amendment to the United States Constitution, Bryant v. State, 660 N.E. 2d 290 (Ind. 1995)

The taxpayer protests the imposition of the controlled substance excise tax.

STATEMENT OF FACTS

On August 17, 2001, the taxpayer picked up a box of controlled substances at the post office. The taxpayer's county prosecutor sent the Indiana Department of Revenue, hereinafter the "department", a letter requesting that the department institute a controlled substance excise tax investigation. The Indiana Department of Revenue issued a Record of Jeopardy Finding, Jeopardy Assessment, Notice and Demand on January 7, 2002 in a base tax amount of $170,236.00. The taxpayer protested the assessment. At the request of the taxpayer's representative, the Letter of Findings was based upon the documentation in the file. Further facts will be provided as necessary.

Controlled Substance Excise Tax – Imposition

DISCUSSION

The department can only commence an investigation into and collection of controlled substance excise tax after it is notified pursuant to the terms of IC 6-7-3-19(2) as follows:

> ... in writing by the prosecuting attorney of the jurisdiction where the offense occurred that the prosecuting attorney does not intend to pursue criminal charges of delivery, possession, or manufacture of the controlled substance that may be subject to the tax required by this chapter.

In this case, the department received this notification in writing from the taxpayer's county prosecutor in the following words:

> This letter is a request for you to continue the investigation of the above entitled cases for the Indiana State Department of Revenue. Both of our cases have been closed. Attached, you will find a copy of the plea agreement in these cases.

Pursuant to IC 6-8.1-3-1, the department's receipt of the prosecutor's request for an investigation transferred to the department the "primary responsibility for the administration, collection, and enforcement of the listed taxes."

After receipt of the prosecutor's letter, the department investigated the taxpayer's case. As a result of the investigation, the department imposed controlled substance excise tax on the taxpayer's possession of anabolic steroids in Indiana pursuant to IC 6-7-3-5. The assessment was issued as a jeopardy assessment as required at IC 6-7-3-13.

The department later received a second letter from the county prosecutor requesting that the department discontinue the collection of the controlled substance excise tax from the taxpayer. The department considered the prosecutor's request and determined to proceed with the collection of the tax.

The prosecutor and the taxpayer negotiated another plea agreement after the issuance of the jeopardy assessment. Pursuant to the new plea agreement, the defendant pled guilty on April 26, 2002 to each of the counts of possession of anabolic steroids. That agreement reads in part as follows, "no further jeopardy shall attach to the defendant in this case, under counts 1,2,3,4,5 and 6. Including but not limited to the tax typically applied in these cases."

The taxpayer argues that the department's continued efforts to collect the controlled substance excise tax violates the taxpayer's constitutional protection against double jeopardy guaranteed in the Fifth Amendment to the United States Constitution.

The Indiana Supreme Court considered this double jeopardy issue in Bryant v. State, 660 N.E. 2d 290 (Ind. 1995). In that case, the police searched Bryant's home and found a marijuana growing operation. The department issued a jeopardy assessment of the controlled substance excise tax in August 1992. Bryant was convicted of growing, cultivating and possession of marijuana in criminal court in April 1993. This conviction placed Bryant in criminal jeopardy based upon the same possession of the marijuana as the jeopardy assessment.

The Fifth Amendment to the United States Constitution prohibits the placing of any person in jeopardy twice for the same offense. The issue the Court had to decide was which jeopardy would be effective and which jeopardy would be vacated. The Court decreed that it must be determined based on a calendar determination of which jeopardy came first. In the Bryant case, the controlled substance excise tax jeopardy was previous in time to the criminal jeopardy. Therefore the criminal court incorrectly convicted Bryant and the criminal conviction was vacated.

This is identical to the taxpayer's situation. The controlled substance excise tax jeopardy assessment was issued prior in time to the plea bargain wherein the taxpayer pled guilty and was placed in jeopardy for the criminal actions. The first jeopardy, the controlled substance excise tax jeopardy, was the constitutionally allowed jeopardy. The criminal jeopardy, the April 26, 2002 plea agreement, was barred by the Fifth Amendment to the United States Constitution because it placed the taxpayer in jeopardy a second time for the same offense.

The prosecutor and judge had no further authority over the matter after the department issued the jeopardy assessment.

The taxpayer clearly possessed the box of anabolic steroids when he picked it up at the post office. Therefore, the controlled substance excise tax was properly imposed.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

2820020089.LOF

LETTER OF FINDINGS NUMBER: 02-0089 CSET
Controlled Substance Excise Tax
For Tax Periods: 2001

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

ISSUE

Controlled Substance Excise Tax – Imposition

Authority: IC 6-7-3-19 (2), IC 6-8.1-3-1, IC 6-7-3-5, IC 6-7-3-13, IC 6-8.1-5-1 (b), Hurst v. Department of Revenue, 720 N.E.2d 370 (Ind. Tax. 1999), Hall v. Department of Revenue, 720 N.E.2d 1287 (Ind. Tax 1999)

The taxpayer protests the imposition of the controlled substance excise tax.

STATEMENT OF FACTS

On August 17, 2001, controlled substances were found in the home of the taxpayer. The taxpayer's county prosecutor sent the Indiana Department of Revenue, hereinafter the "department," a letter requesting that the department institute a controlled substance excise tax investigation. The Indiana Department of Revenue issued a Record of Jeopardy Finding, Jeopardy Assessment, Notice and Demand on January 7, 2002 in a base tax amount of $191,872.00. The taxpayer protested the assessment. At the request of the taxpayer's representative, the Letter of Findings was based upon the documentation in the file. Further facts will be provided as necessary.

Controlled Substance Excise Tax – Imposition

DISCUSSION

The department can only commence an investigation into and collection of controlled substance excise tax after it is notified pursuant to the terms of IC 6-7-3-19 (2) as follows:

> ... in writing by the prosecuting attorney of the jurisdiction where the offense occurred that the prosecuting attorney does not intend to pursue criminal charges of delivery, possession, or manufacture of the controlled substance that may be subject to the tax required by this chapter.

In this case, the department received this notification by letter from the taxpayer's county prosecutor in the following words:

> This letter is a request for you to continue the investigation of the above entitled cases for the Indiana State Department of Revenue. Both of our cases have been closed. Attached, you will find a copy of the plea agreement in these cases.

Pursuant to IC 6-8.1-3-1, the department's receipt of the prosecutor's request for an investigation transferred to the department the "primary responsibility for the administration, collection, and enforcement of the listed taxes."

After receipt of the prosecutor's letter, the department investigated the taxpayer's case and imposed the controlled substance excise tax on the taxpayer's possession of anabolic steroids in Indiana pursuant to IC 6-7-3-5. The assessment was issued as a jeopardy assessment as required at IC 6-7-3-13.

The department later received a second letter from the county prosecutor requesting that the department discontinue the collection of the controlled substance excise tax from the taxpayer. The department considered the prosecutor's request and determined to proceed with the collection of the tax.

Department assessments are presumed to be correct and the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1 (b).

Possession of the controlled substances can be either actual or constructive. Hurst v. Department of Revenue, 720 N.E.2d 370 (Ind. Tax. 1999), Hall v. Department of Revenue, 720 N.E.2d 1287 (Ind. Tax 1999). Although both direct and circumstantial evidence may prove constructive possession, proof of presence in the vicinity of controlled substances, presence on property where controlled substances are located, or mere association with the possessor is not sufficient. Hurst at 374-375. To prove constructive possession, there must be a showing that the taxpayer had not only the requisite intent but also the capability to maintain dominion and control over the substance. Hurst at 374.

In the Hall case, the department assessed controlled substance excise tax against a husband and wife. The couple owned and lived together in a residence. The wife testified that she had no knowledge of the presence of a controlled substance in the house. Marijuana, a controlled substance, was grown in a basement room with a locked door. Only the husband had a key to the room. The Court found that the wife did not have the capability to maintain dominion and control over the marijuana since she had no capability of entering the locked room containing the marijuana to exert any control over the growing operation. Therefore she did not constructively possess the marijuana and the controlled substance excise tax was improperly imposed against the wife.

There are significant differences between the Hall case and the taxpayer's situation. The taxpayer is assessed tax on the anabolic steroids found in an unlocked closet in her bedroom. At the time of the arrest, the taxpayer told the police that she knew of the shipments of anabolic steroids received by her husband, knew of the controlled substances stored in her residence and used some of the controlled substances herself. Those self-incriminating statements made at the time of her arrest are more credible than the contradicting statements in taxpayer's May 2, 2002 affidavit or her husband's May 2, 2002 affidavit. The facts of this situation indicate that the taxpayer did intend to possess the anabolic steroids. The taxpayer had access to the anabolic steroids and the capability to maintain dominion and control over them. Thus, the taxpayer had constructive possession of the controlled substances found in her residence. The taxpayer failed to sustain her burden of proof that the controlled substance excise tax was improperly imposed.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120020199.LOF

LETTER OF FINDINGS NUMBER: 02-0199 AGI
Adjusted Gross Income Tax
For Tax Period: 2000

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

ISSUES

1. Adjusted Gross Income Tax – Human Services Tax Deduction

Authority: IC 6-3-2-1, IC 6-3-1-3.5 (a) (14), Income Tax Information Bulletin #80, April 1997

The taxpayer protests the disallowance of the human services tax deduction.

2. 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 filed a 2000 Indiana Income tax return, form IT-40EZ. The taxpayer, a quadriplegic, lived in a nursing home paid for by medicaid and was gainfully employed by an Indiana business during the tax period. The taxpayer had taxable wages in 2000 and had a total tax liability per his original return of $1,285.00. The taxpayer had total credits, from withholding of state and local tax by his employer in the amount of $1,329.00. The taxpayer requested and received a $44.00 refund.

The taxpayer later filed an amended return for 2000 claiming all income was exempt under the human service deduction. The taxpayer was issued a refund of all taxes paid. Later, the Indiana Department of Revenue, hereinafter referred to as the "department," adjusted the return to disallow the human service deduction and billed the taxpayer for the refund issued in error, interest, and penalty. The taxpayer protested the assessment and a hearing was held.

1. Adjusted Gross Income Tax – Human Services Tax Deduction

DISCUSSION

Pursuant to IC 6-3-2-1, an adjusted gross income tax is imposed upon all Indiana residents. After determining the Indiana adjusted gross income, taxpayers may take certain statutory deductions. One of these deductions is the human services tax deduction that is stated at IC 6-3-1-3.5 (a) (14) as follows:

In the case of an individual who is a recipient of assistance under IC 12-10-6-1, IC 12-10-6-2, IC 12-15-2-2, or IC 12-15-7, subtract an amount equal to that portion of the individual's gross income with respect to which the individual is not allowed under federal law to retain an amount to pay state and local income taxes.

Income Tax Information Bulletin #80, April 1997, discusses the application of the deduction. The purpose of the deduction is explained as follows:

There are instances in which persons who are receiving Medicaid may have a source of taxable income such as a pension or annuity or be entitled to a monthly personal allowance. The receipt of this income gives rise to state and local income tax liabilities. However, an individual on Medicaid is allowed to retain an amount equal to the individual's state and local income tax liabilities.

Under the terms of Income Tax Information Bulletin #80, April, 1997, a taxpayer is eligible to receive the deduction if:

1. The person receives medical assistance payments (known as Medicaid.),
2. The person does not live at home,
3. The person receives care at a hospital, a skilled nursing facility or an intermediate facility.

The department and the taxpayer agree that the taxpayer received Medicaid, did not live at home, and lived in a skilled nursing facility. Therefore, the only issue to be determined is the proper computation of the deduction.

Directions for computation of the human services deduction are found in Income Tax Information Bulletin #80, April, 1997, as follows:

Step #1

Complete the IT-40 without using the human services tax deduction. If the total Indiana Credits on Line 26 is greater than the Total Tax on Line 19, you are not eligible to claim the deduction. However, if the Total Tax on Line 19 is greater than the Total Indiana Credits on Line 26, go to Step #2.

Step #2

Complete a second IT-40 using the human services tax deduction as computed in this step. Take Line 11, Indiana adjusted gross income figure computed in Step#1 and place the sum of Line 9 of the IT-40. This sum is the amount of the human services tax deduction to which you are entitled. This figure should also be entered on Schedule 1, Line F of the IT-40 and labeled Human Services Tax Deduction.

Since the tax form line references referred to the 1996 IT-40 tax return, the references did not correspond correctly with the 2000 IT-40 EZ tax return. The taxpayer was required, therefore, to interpret the meaning of the various lines. The taxpayer classified the taxes withheld as an Indiana credit and compared it to his total tax. The withholding was greater than his tax liability, so the taxpayer interpreted this as indicating that he qualified for the Human Services Tax Deduction and requested the refund of his total taxes paid.

The taxpayer erred in this computation. The withholding was deducted from earned income as opposed to annuity or pension income as the written purpose of the Human Services Deduction indicated was the target income. Further, the term "Indiana Credit" referred to such credits as the gifts to Indiana colleges. The taxpayer did not have any of these credits available to him. Therefore, the taxpayer's Indiana Credits did not exceed his tax liability on non earned income. The taxpayer did not qualify for the Human Services Tax Deduction.

FINDING

The taxpayer's protest is denied.

2. Tax Administration – Negligence Penalty

DISCUSSION

The department assessed the 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. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

In this case, the taxpayer attempted to follow a seldom used and poorly understood deduction from the adjusted gross income tax. The taxpayer obtained and tried to follow the directions in the department's publication concerning operation of the deduction. Unfortunately, the directions referred to specific tax lines on a form for a previous tax return form and were difficult to apply to the taxpayer's 2000 form. The taxpayer used reasonable care in attempting to properly apply the deduction to his situation. Therefore, although the taxpayer erred in his application, the negligence penalty does not apply in this case.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0120020300.LOF

LETTER OF FINDINGS NUMBER: 02-0300
Indiana Individual Income Tax
For the Tax 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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Imposition of the State's Individual Income Tax By Reference to Taxpayer's Federal Adjusted Gross Income

Authority: IC 6-3-1-3.5; United States v. Kimball, 896 F.2d 1218 (9th Cir. 1990); United States v. Moore, 627 F.2d 839 (7th Cir. 1980); United States v. Long, 618 F.2d 74 (9th Cir. 1980); Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); 45 IAC 3.1-1-1

Taxpayer maintains that because he reported "0" income on his Federal income tax return for year 2000, he was compelled to put "0" on his state return for that same year.

II. Definition of "Income" for Purposes of Imposing the State's Individual Income Tax

Authority. U.S. Const. amend. XVI; Ind. Const. art X, § 8; IC 6-3-1-3.5 et seq.; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; I.R.C. § 61; I.R.C. § 62; New York v. Graves, 300 U.S. 308 (1937); Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921); Eisner v. Macomber, 252 U.S. 189 (1920); Doyle v. Mitchell, 247 U.S. 179 (1918); Stratton's Independence v. Hobert, 231 U.S. 399 (1913); United States v. Connor, 898 F.2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F.2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F.2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F.2d 1328 (7th Cir. 1984); United States v. Romero, 640 F.2d 1014 (9th Cir. 1981); United States v. Ballard, 535 F.2d 400 (8th Cir. 1976); Conner v. United States, 303 F.Supp. 1187 (S.D. Tex. 1969); Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994)

Taxpayer maintains that the term "income" is not defined in the Internal Revenue Code. According to taxpayer, under the law and Supreme Court precedent, only corporations are competent to receive taxable income and that the normal income – such as wages and retirement benefits – received by ordinary citizens is not subject to Federal or state income tax.

STATEMENT OF FACTS

Taxpayer filed an Indiana individual income tax return for 2000. On that return, the taxpayer reported that his Federal adjusted gross income was "0." Taxpayer attached a letter to the Indiana return stating he had decided that he would no longer volunteer to pay the state's individual income tax because, he had received no "income" during 2000. The Indiana Department of Revenue (Department) chose to disagree with taxpayer and – given every indication that taxpayer had received income in the form of retirement benefits during the year – sent the taxpayer a notice of "Proposed Assessment." Taxpayer submitted a protest of the Proposed Assessment, an administrative hearing was held, and this Letter of Findings results.

DISCUSSION

I. Imposition of the State's Individual Income Tax By Reference to Taxpayer's Federal Adjusted Gross Income

Taxpayer presents numerous arguments in support of his assertion that he is not liable for Indiana income tax. His first argument is based on the undisputed fact that he reported "0" income on his corresponding Federal return. According to taxpayer, he was thereafter – under penalty of law – obliged to report that same amount on his state return. In support of his argument, taxpayer presented a copy of his 2000 Federal return and, indeed, it is apparent that taxpayer had reported "0" on the Federal return. Taxpayer has also submitted a copy of the check which the Federal government obligingly issued to taxpayer and which refunded the total amount of federal taxes previously withheld.

It is also not disputed that the Indiana tax return for the tax year 2000 employs Federal adjusted gross income as the starting point for determining the taxpayer's state individual income tax liability. Line one of the IT-40 state form requires the taxpayer to "Enter your Federal adjusted gross income from your Federal return (see page 9)."

IC 6-3-1-3.5 states as follows: "When used in IC 6-3, the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code)...." Thereafter, the statute specifies addbacks and deductions, peculiar to Indiana, which modify the Federal adjusted gross income amount. The Department's regulation concisely restates the same formulary principal. 45 IAC 3.1-1-1 defines individual adjusted gross income as follows:

> Adjusted Gross Income for Individuals Defined. For individuals, "Adjusted Gross Income" is "Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:
> (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
> (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
> (3) Make all modifications required by IC 6-3-1-3.5(a).

Both the statute, IC 6-3-1-3.5, and the accompanying regulation, 45 IAC 3.1-1-1, require that an Indiana taxpayer employ the Federal adjusted gross income calculation, as determined under I.R.C. § 62, as the starting point for determining the taxpayer's Indiana adjusted gross income.

Taxpayer's contention – that he was compelled by force of law to declare "0" as Indiana adjusted gross income because he declared "0" on his Federal return – is totally meritless. The statute is unambiguous. Indiana adjusted gross income begins with Federal taxable income as defined by I.R.C. § 62, not as reported by the taxpayer. *See* Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209, 1213 (Ind. Tax Ct. 1996). The directions contained within the Indiana income tax form provide the individual taxpayer with abbreviated directions for completing the form. The form does not purport to state what Indiana tax law is or is not; the directions themselves are not the means for determining the taxpayer's adjusted gross income. The Indiana tax form simply instructs a taxpayer to put which number inside of which box. Those directions notwithstanding, taxpayer is nonetheless required to actually perform the calculations necessary to determine his Indiana adjusted gross income tax liability.

Taxpayer has cited to a number of cases in support of the proposition that he is in full compliance with the tax laws simply by placing a "0" on his tax return. For example taxpayer cites to United States v. Kimball, 896 F.2d 1218 (9th Cir. 1990); United States v. Moore, 627 F.2d 839 (7th Cir. 1980); United States v. Long, 618 F.2d 74 (9th Cir. 1980). However, none of these cases support the fanciful notion that a taxpayer has fulfilled his obligations by merely placing a "0" on the form. Rather, in each of the cited cases, the defendant was being criminally prosecuted for failing to file an income tax return. *See* 26 U.S.C.S. § 7203. In each of those cases, the court merely found that "A return containing false of misleading figures is still a return." Long, 618 F.2d at 76. The cases cited by the taxpayer are entirely irrelevant to taxpayer's basic argument that he does not have to pay income tax. Taxpayer is not being criminally prosecuted for failure to file a return, because it is clear that taxpayer *did* file an Indiana tax return for 2000. Rather, the issue is whether the taxpayer owes adjusted gross income tax for that year.

FINDING

Taxpayer's protest is denied.

II. Definition of "Income" for Purposes of Imposing the State's Individual Income Tax

Taxpayer argues that he did not receive "income" during the year 2000. Liberally construed, taxpayer's argument is that – for purposes of determining income tax liability – "income" can only be derivative of corporate activity. Therefore, as an individual Indiana resident who by definition did not receive "corporate" income, taxpayer is not subject to the adjusted gross income tax because the ordinary income received by individuals is not "taxable income."

Taxpayer has provided a number of Supreme Court cases which purportedly support taxpayer's basic contention. Taxpayer cites to Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921) for the proposition that income tax can only be levied against corporate gains. In that case, the Court held that the when a provision in a will created a trust, the increase of the value of the trust resulted in taxable "income" under the provisions of the U.S. Const. amend. XVI. Id. In arriving at that decision, the Court stated that "the word [income] must be given the same meaning and content in the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of [the] court." Id. 519.

Taxpayer also cites to Eisner v. Macomber, 252 U.S. 189 (1920), a case in which the Court addressed the issue of whether the U.S. Const. amend. XVI permitted the government to tax a taxpayer's stock dividends resulting from a corporation's accumulated profits. The Court held that the stock dividend did not involve the realization of a taxable gain but that the corporation's accumulated profits were simply capitalized or retained as surplus. Id. at 211. In effect, the taxpayer in Eisner had not yet realized a gain severed from and independent of the corporations' assets. Id. at 211-12. In reaching that decision, the Court stated that income is the "gain derived from capital, from labor, or from both combined." Id. at 201.

Taxpayer reads Merchant's Loan and Eisner together with certain other cases – Doyle v. Mitchell, 247 U.S. 179 (1918);

Stratton's Independence v. Hobert, 231 U.S. 406 (1913) United States v. Ballard, 535 F.2d 400 (8th Cir. 1976) – as supporting his contention that the individual income tax can only be assessed against corporate gain. Taxpayer predicates this conclusion on selected case citations which, when taken together, purportedly limits the definition of "taxable income" to the definition originally established under the Civil War Income Tax Act of 1867. However, setting aside the question of the validity of taxpayer's legal analysis, taxpayer's conclusion concerning the definition of corporate income tax is totally irrelevant.

Taxpayer's legal analysis stands for nothing more than, when read in isolation and selectively divorced from the factual setting under which the decisions were reached, a legal argument can be proposed which will support any legal conclusion no matter how unjustified that conclusion is ultimately found. Taxpayer cites cases in which the Court was asked to determine what constituted *corporate income* under the corporate income and excise taxes in effect at the time the Court reached its conclusion. To apply Supreme Court decisions limited to determining the efficacy and application of corporate income taxes to issues related to individual income tax may yield a certain desired result but the entire process is not legally, intellectually, or logically sound.

Taxpayer cites to numerous other cases each of which will not be addressed here. It is sufficient to say that the cases simply do not get the taxpayer where he wants to go. For example, taxpayer cites to Conner v. United States, 303 F. Supp. 1187 (S.D. Tex. 1969) in which the court held that the plaintiff taxpayers' receipt of fire insurance proceeds did not constitute taxable income. Id. at 1191. Nowhere in that case or in any of the other cited cases, did the court find that individuals were not responsible for reporting their income and paying tax on that income.

The United States Supreme has clearly stated that the wages of individual citizens may be subjected to an adjusted gross income tax. In New York v. Graves, 300 U.S. 308 (1937), Justice Stone stated "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized." Id. at 312.

Since that 1937 decision, the Federal courts have consistently, repeatedly, and without exception, determined that individual wages are income. United States v. Connor, 898 F.2d 942. 943 (3rd Cir. 1990) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income"); Wilcox v. Commissioner of Internal Revenue, 848 F.2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); Coleman v. Commissioner of Internal Revenue, 791 F.2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); United States v. Koliboski, 732 F.2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable") (Emphasis in original); United States v. Romero, 640 F.2d 1014, 1016 (9th Cir. 1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable.... [Taxpayer] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves.").

In addressing the identical issue, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United Sates Supreme Court and Federal circuit courts, and this Court's opinion... all support the conclusion that wages are income for purposes of Indiana's adjusted gross income tax." Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). *See also* Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

As set out in the Indiana Constitution, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art X, § 8. The Indiana General Assembly exercised its constitutional prerogative by imposing an adjusted gross income tax on individuals and corporations. IC 6-3-1-3.5 et seq. In doing so, the General Assembly defined an individual subject to the adjusted gross income tax as a "natural born person, whether married or unmarried, adult or minor." IC 6-3-1-9.

Taxpayer further argues that nowhere in the Internal Revenue Code is there a definition of "income." Taxpayer errs. I.R.C. § 61(a) states as follows:

> Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
> (2) Gross income derived from business;
> (3) Gains derived from dealings in property;
> (4) Interest;
> (5) Rents;
> (6) Royalties;
> (7) Dividends;
> (8) Alimony and separate maintenance payments;
> (9) Annuities;
> (10) Income from life insurance and endowment contracts;
> (11) *Pensions*.... (*Emphasis added*).

Under I.R.C. § 62, taxpayer begins calculating his adjusted gross income by starting with "gross income" as defined under I.R.C. § 61. Taxpayer received pension payments during 2000. Therefore, taxpayer must include those pension payments as part of his reported "gross income." Taxpayer is then entitled to takes whatever adjustments and deductions are available to him in determining the amount of adjusted gross income. Thereafter, the taxpayer is required to report the Federal adjusted gross income on his Indiana return and begin the process of calculating his Indiana tax liability.

Taxpayer is of the opinion that, with the just the right alchemistic combination of semantic technicalities, he can render himself immune from Federal and state tax liability. There is not one single Federal or state court case which supports such a notion. Wishful thinking aside, given that taxpayer received gross income (I.R.C. § 61) in 2000, is an "individual" under IC 6-3-1-9, was a resident of Indiana for the year 2000 (IC 6-3-1-12), and is a "taxpayer" as defined within (IC 6-3-1-15), the statutes imposing the Indiana individual income tax apply with full force to taxpayer's pension payments.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120020301.LOF

LETTER OF FINDINGS NUMBER: 02-0301
Indiana Individual Income Tax
For the Tax Years 1998, 1999, and 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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Taxpayer's Administrative Remedies

Authority: U.S. Const. amends. V, XIV; IC 6-8.1-5-1; IC 6-8.1-5-1(a); IC 6-8.1-5-1(c); IC 6-8.1-5-1(g); Goldberg v. Kelly, 397 U.S. 254 (1970); Sniadach v. Family Finance Corp., 395 U.S. 337 (1969)

Taxpayer objects to being invited to participate in an administrative hearing and challenges – on due process grounds – the authority of the Department of Revenue to adjudicate his individual income tax liability.

II. Applicability of the State's Individual Income Tax

Authority: Ind. Const. art. X, § 8; IC 6-2.1-1-16; IC 6-2.1-2-2; IC 6-3-1-3.5 et seq.; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; 45 IAC 1.1-1-22; 45 IAC 1.1-1-22(b); 45 IAC 1.1-1-22(b)(1); Edwards v. Keith, 231 F. 110 (2nd Cir. 1916); I.R.C. § 61

Taxpayer argues that he is not subject to the state's individual income tax.

STATEMENT OF FACTS

Taxpayer received notices of proposed assessments for the 1998, 1999, and 2000 tax years. Thereafter, taxpayer submitted a protest to the Department of Revenue (Department) in which the he "refuse[d] these proposed assessments, for cause, based upon errors in fact and law."

The Department acknowledged receipt of the protest and assigned the file to a hearing officer. Thereafter, taxpayer was advised of his right to explain the basis for the protest during an administrative hearing. Taxpayer declined the opportunity either to schedule a hearing at his convenience or, alternatively, to attend a hearing which had been scheduled on his behalf. In declining to participate in the administrative hearing process, the taxpayer stated that "The undersigned is informed and believes that the DOR is operating under a SECRET JURISDICTION and, as such, is operating unlawfully." (*Emphasis in original*).

Faced with taxpayer's decision to submit a protest but refusal to participate in the available administrative hearing process, this Letter of Findings was prepared based upon taxpayer's original protest letter and on correspondence received after the protest was first submitted.

DISCUSSION

I. Taxpayer's Administrative Remedies

Taxpayer challenges the Department's administrative procedures made available to him. Taxpayer maintains that the procedures deny him his due process rights and that he wishes "only to be brought before a judge of competent jurisdiction empowered under federal/state constitutions." Taxpayer maintains that the Department is "operating unlawfully."

IC 6-8.1-5-1(a) provides the Department with certain authority when it concludes that a taxpayer has failed to pay the taxes for which he is otherwise responsible. "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department." After the Department has made such a proposed assessment, it is then obligated to "send the person a notice of the proposed assessment through the United States mail." Id.

The Department apparently concluded, on the basis of W-2 forms issued to the taxpayer, that taxpayer failed to pay the taxes due on income received during 1998, 1999, and 2000. Taxpayer has not challenged the accuracy of the information contained within the W-2 forms. Taxpayer has not challenged the method by which the Department calculated the amount of taxes due.

Having received a notice of "proposed assessment," the taxpayer is entitled to challenge the Department's conclusions. Furthermore, the Department is required to notify the taxpayer of his *right* to challenge the "proposed assessment." IC 6-8.1-5-1(c) provides that, "The notice [of proposed assessment] shall state that the person has sixty (60) days from the date the notice is mailed to pay the assessment or to file a written protest."

The taxpayer does not dispute the fact that he received the notices of proposed assessment. Taxpayer does not maintain the Department failed to advise him of his right to challenge the assessment. To the contrary, taxpayer – in a letter dated May 19, 2002, and received by the Department on June 7, 2002 – acknowledged receiving the notices of proposed assessment and submitted a protest of those assessments. Thereafter, on June 14, 2002, the Department formally acknowledged receipt of the taxpayer's protest.

Having received a taxpayer's protest, the Department is then required to provide the taxpayer an opportunity to fully explain the basis for that protest during an administrative hearing. IC 6-8.1-5-1(c) provides as follows: "If the person files a protest and requires a hearing on the protest, the department *shall*: (1) set the hearing at the department's earliest convenient time; and (2) notify the person by United States mail of the time, date, and location of the hearing." (*Emphasis added*).

On June 14, 2002, the Department notified taxpayer of his opportunity to appear at a hearing, was advised of his right to have a representative appear on his behalf, and was advised of the informal procedures employed during the administrative hearing. In addition, taxpayer was invited to suggest a convenient date on which the hearing could be scheduled. The taxpayer declined to respond to the June 14 correspondence, and the Department sent additional correspondence on July 8, 2002, again reminding him of his opportunity to explain the basis for his protest at an administrative hearing.

Taxpayer responded by means of correspondence dated July 15, 2002, and received by the Department on July 19, 2002. In that letter, taxpayer challenged the Department's authority to enforce the state's tax laws on "citizens that they [did] not apply to." In addition, the taxpayer suggested the Department was "acting without authority of law and 'under color of law' and created the legal presumption or conclusion that you and/or Indiana DOR are engaged in an extortion scheme against [taxpayer].

Following receipt of taxpayer's July 15 correspondence, the Department sent a letter dated July 19, 2002. The Department again advised the taxpayer of his right to an administrative hearing, explained the hearing procedures, and advised the taxpayer that the Department had scheduled a hearing for August 9, 2002, at 2:00 PM. In addition, the taxpayer was advised that "[i]f this time is not convenient for you... [the Department] would reschedule the hearing at a date and time of your choice."

Taxpayer responded on August 1, 2002, stating that he "[did] not wish to succumb to an administrative hearing before an administrative officer, posing as a judge, possibly assume a judicial role and force me to act accordingly."

There is nothing in the record to indicate the Department acted inappropriately in issuing taxpayer the notices of "Proposed Assessment" as authorized under IC 6-8.1-5-1(a). There is nothing in the record which disputes the accuracy of the amount of taxes set out in those notices.

In addition, there is nothing in the record which indicates that the Department failed to advise taxpayer of his right to an administrative hearing or that the Department acted in any way to deny taxpayer of his *right* to fully, fairly, and completely explain the basis for his protest.

Taxpayer's procedural due process claim is totally without merit. The essential guarantee of the Due Process Clause (U.S. Const. amends. V, XIV) is that of fairness. Any procedure must be fundamentally fair to the individual in the resolution of the factual and legal basis for government actions which will potentially deprive the citizen of life, liberty, or property. *See* Goldberg v. Kelly, 397 U.S. 254 (1970); Sniadach v. Family Finance Corp., 395 U.S. 337 (1969). Taxpayer has provided no basis upon which to substantiate his argument that the administrative procedures authorized under IC 6-8.1-5-1 are inherently unfair. Taxpayer has provided no support for his argument that the Department has, in any way denied the taxpayer a fair opportunity to explain the basis for his protest of the proposed assessment of additional individual income taxes.

Having declined to participate in the administrative review process, taxpayer's remaining option is to present his arguments to the Indiana Tax Court pursuant to IC 6-8.1-5-1(g). However, taxpayer is cautioned that "the tax court does not have jurisdiction to hear an appeal that is filed more than one hundred eighty (180) days after the date on which the letter of findings is issued by the department." Id.

FINDING

Taxpayer's protest is denied.

II. Applicability of the State's Individual Income Tax

Having declined to actively participate in the administrative review process available to him, the Department is left with the task of discerning the basis for taxpayer's protest based upon the information contained within taxpayer's correspondence.

Taxpayer's first argument is that he is not a "statutory taxpayer" as defined under IC 6-2.1-1-16 and 45 IAC 1.1-1-22(b).

IC 6-2.1-1-16 reads, in its entirety as follows:

"Taxpayer" means any: (1) assignee; (2) receiver; (3) commissioner; (4) fiduciary; (5) trustee; (6) institution; (7) national bank;

(8) bank; (9) consignee; (10) firm; (11) partnership; (12) joint venture; (13) pool; (14) syndicate; (15) bureau; (16) association; (17) cooperative association; (18) society; (19) club; (20) fraternity; (21) sorority; (22) lodge; (23) corporation; (24) municipal corporation; (25) political subdivision of the state of Indiana or the state of Indiana, to the extent engaged in private or proprietary activities or business; (26) trust; (27) limited liability company (other than a limited liability company that has a single member and is disregarded as an entity for federal income tax purposes); or (28) other group or combination acting as a unit.

45 IAC 1.1-1-22 reads, in its entirety as follows:

"Taxpayer" includes the following:

(1) A regular C corporation.
(2) A regular C corporation that is a partner of a partnership.
(3) A not-for-profit organization on nonexempt income.
(4) A business trust as defined in IC 23-5-1-2.
(5) Indiana or a political subdivision of Indiana to the extent engaged in private or proprietary activities.
(6) A political organization as defined in Section 527 of the Internal Revenue Code.
(7) A publicly traded partnership that is treated as a corporation under Section 7704 of the Internal Revenue Code.
(8) A receiver, trustee, or conservator of a taxpayer subject to IC 6-2.1.
(9) An individual or entity required to withhold gross income taxes pursuant to IC 6-2.1-6.
(10) A fund, account, or trust treated as a corporation under Section 468B of the Internal Revenue Code or its accompanying regulations.
(11) A limited liability company, except when it is composed of a single member and is disregarded as an entity for federal income tax purposes.

(b) Except as provided in subsection (a), the term does not include the following:

(1) An individual.
(2) A partnership.
(3) A trust.
(4) An estate.
(5) An S corporation exempt under IC 6-2.1-3-24.
(6) A small business corporation as defined in IC 6-2.1-3-24.5.
(7) An organization wholly exempt from the gross income tax under IC 6-2.1-3.

At first reading, it would appear that taxpayer's argument has merit. Taxpayer is indeed not a "national bank," "cooperative," "sorority" or any of the enumerated classes of statutory taxpayers defined under IC 6-2.1-1-16. The accompanying regulation seems to confirm taxpayer's assertion; indeed, the language of 45 IAC 1.1-1-22(b)(1) specifically states that "An individual" is not subject to the state's gross income tax. However, taxpayer's argument is nonsensical because taxpayer has not been assessed gross income taxes. Indeed no individual is *ever* subject to gross income tax. The state's gross income tax is imposed exclusively on certain business entities which are either residents or domiciliarys of Indiana or on non-resident business entities which nonetheless derive income from doing business within the state. IC 6-2.1-2-2. In taxpayer's case, the notices of "Proposed Assessment" advised taxpayer that he was being assessed individual adjusted gross income taxes. *See* IC 6-3-1-3.5 et seq.

Taxpayer's next argument is that an individual cannot be assessed income tax against income received for the provision of services. To that end, taxpayer cites to Edwards v. Keith, 231 F. 110 (2nd Cir. 1916) in which the court stated that, "[O]ne does not 'derive' income' by rendering services and charging for them." Id. at 113. However, taxpayer neglects to describe the substance of that case in which the plaintiff taxpayer, in his role as an insurance agent, argued that he could not be assessed income taxes on insurance commissions which were due him but which the agent had not yet actually received. The Second Circuit Court of Appeals agreed with the plaintiff taxpayer stating that taxes could not be levied against commission income earned, but not yet received because "there [was] no certainty that the sum conditionally promised for an ensuing year will be paid or will accrue or come due." Id. at 112. The court also pointed out that "the obligation does not arise until [the insured] actually pays his renewal premium in tax." Id. In taxpayer's case, there is no contention that the Department has assessed individual income tax against income which the taxpayer has not yet received.

Taxpayer has postulated numerous alternative theories purportedly forming a basis for his assertion that he is not subject to the state's individual adjusted gross income tax. However, the Department will not expend its resources in addressing the remaining arguments which are as equally ill-conceived as those previously here considered. Suffice it to say that the Indiana Constitution specifically provides that, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art X, § 8. Pursuant to that constitutional provision, the Indiana General Assembly exercised its prerogative by imposing an adjusted gross income tax on individuals and corporations. IC 6-3-1-3.5 et seq. In doing so, the General Assembly defined an individual subject to the adjusted gross income tax as a "natural born person, whether married or unmarried, adult or minor." IC 6-3-1-9.

Taxpayer is of the opinion that, with the just the right semi-mystical combination of semantic technicalities and invocations to irrelevant court cases, he can render himself immune from state income tax liability; such a supposition defies ordinary common sense. There is not one single Federal or state court case which supports such a fanciful notion. Wishful thinking aside, given that taxpayer received gross income (I.R.C. § 61) in 1998 through 2000, is an "individual" under IC 6-3-1-9, was a resident of Indiana for during those years (IC 6-3-1-12), and is a "taxpayer" as defined within (IC 6-3-1-15), the statutes imposing the Indiana individual income tax apply with full force to taxpayer's individual income.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02980675.SLOF

SUPPLEMENTAL LETTER OF FINDINGS: 98-0675 SLOF
Indiana Gross Income Tax
For the Tax Years 1993 and 1994

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

ISSUE

I. Gross Income Tax – Telecommunications Services

Authority: U.S. Const. art. I, § 8; IC 6-2.1-1-13; IC 6-2.1-2-2; IC 6-2.1-3-3; 45 IAC 1-1-124(b); Monarch Steel Co. v. State Bd. Of Tax Comm'r, 699 N.E.2d 809 (Ind. Tax Ct. 1998); Indianapolis Public Transp. Corp. v. Indiana Dept. of State Revenue, 512 N.E.2d 906 (Ind. Tax Ct. 1987)

Taxpayer argues that it is a carrier of interstate telecommunications and that the income it received from the interstate communication of telecommunications was not subject to the state's gross income tax.

STATEMENT OF FACTS

Taxpayer is in the business of providing private line telecommunication transmission services to long distance carriers. Using the jargon of the telecommunications industry, taxpayer is a "facilities-based interexchange carrier" of voice and data information. As that term is used in the industry, taxpayer is a carrier which owns most of its equipment and transmission lines and provides long distance telephone service between LATA's (Local Access and Transport Areas). In order to provide its services, taxpayer operates a microwave transmission network on a regional basis. That network consists of microwave transmitters, receivers, towers, antennae, auxiliary power equipment, and equipment shelters.

When taxpayer computed its Indiana gross income, taxpayer included only the receipts from transporting "intrastate" communications and excluded that income attributable to "interstate communications. Taxpayer reported only that gross income derived from transporting communications over transmission segments that originated and terminated within Indiana.

Audit disagreed with taxpayer's reporting method. The audit determined that taxpayer was not a "communications carrier" but was a mere service provider and, consequently, could not adopt the definition of "intrastate" applicable to "communications carriers." Audit concluded that taxpayer operated to provide ancillary communication services to the actual "communications carriers." The ancillary nature of taxpayer's activities required that taxpayer report, as gross income, all receipts attributable to its Indiana activities. As a result, audit proposed additional assessments of gross income tax. Taxpayer protested both the audit's conclusions and the additional assessments. A hearing was held and a Letter of Findings was prepared and issued by the Department. The Letter of Findings agreed with the audit's conclusions finding that taxpayer was not "carrying communications" but was providing an intermediate service to long distance carriers. The taxpayer requested a rehearing on the issues, an administrative hearing was held, and this Supplemental Letter of Findings followed.

DISCUSSION

I. Gross Income Tax – Telecommunications Services

Under IC 6-2.1-2-2, Indiana imposes "[a]n income tax, known as the gross income tax... upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." A taxpayer's gross income includes all gross income not specifically exempted. IC 6-2.1-1-13.

The Department's regulation provides such an exemption which is central to the taxpayer's protest. 45 IAC 1-1-124(b) provides as follows:

Income from wire communications, including telephone and telegraph lines is taxable if derived from carrying communications between two (2) points in Indiana. It is not taxable if derived from carrying communications between a point outside Indiana and a point in Indiana, or from a point outside Indiana into and across the state to a point outside Indiana. *(Note: 45 IAC 1 was repealed effective January 1, 1999, and replaced by 45 IAC 1.1).*

In addition to the specific exemptions allowed within the gross income tax scheme, IC 6-2.1-3-3 codifies the constitutional prohibition placed upon the individual states by the Interstate Commerce Clause. U.S. Const. art. I, § 8. Specifically, IC 6-2.1-3-3 provides that "Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution." It would seem apparent that 45 IAC 1-1-124(b) is an attempt to meet the constitutional requirement codified at IC 6-2.1-3-3.

Taxpayer provides its services to primary long distance carriers. That service is provided to fill in the gaps in the primary carrier's own transmission system or to provide additional capability when the primary carrier's system lacks available capacity to carry the amount of potential traffic. Once the taxpayer's customers route their communications signal into the taxpayer's system, it is the taxpayer who has the responsibility for carrying that signal between the designated points. Taxpayer's system is essentially a "fill in the gap" service. These "gaps" may be between two different points within Indiana (Indianapolis to Bloomington) between a point within Indiana and a point outside Indiana (Indianapolis to Chicago); or a gap which traverses Indiana (Chicago to Cleveland).

It is not disputed that the money taxpayer received from carrying communications between two points located within the state (Indianapolis to Bloomington) is subject to the gross income tax. However, taxpayer argues that the money it received for carrying communications between a point within Indiana to a point outside Indiana and the money it received for carrying communications across the state is, under 45 1-1-124(b), exempt from the gross income tax.

When discussing tax exemptions, such as 45 IAC 1-1-124(b), the courts have held that the exemptions are strictly construed against the taxpayer and in favor of taxation. Monarch Steel Co. v. State Bd. Of Tax Comm'r, 699 N.E.2d 809, 811 (Ind. Tax Ct. 1998). Trinity Episcopal Church v. State Bd. Of Tax Comm'r, 694 N.E.2d 816, 818 (Ind. Tax. Ct. 1998).

Nonetheless, however stringently 45 IAC 1-1-124(b) is construed or however finely the language of 45 IAC 1-1-124(b) is parsed, taxpayer is entitled to the regulatory exemption.

The plain words of 45 IAC 1-1-124(b) state that a carrier is entitled to the exemption when it carries telecommunications information from a point within Indiana to a point outside the state or if the information is carried across the state. The audit and the original Letter of Findings found that the taxpayer was not "carrying communications" but was merely an intermediate service provider. In addition, the Letter of Findings determined that an exemption claimant could only succeed if the claimant, on a "transactional basis," could determine the interstate or intrastate nature of each individual phone message. Because – according to the original Letter of Findings – taxpayer was not billing its customers on a per call basis but was carrying bulk, undifferentiated phone communications, the taxpayer was not entitled to the exemption.

Taxpayer is indeed providing bulk communication services to "primary" long distance carriers. It may be even fair to describe taxpayer as an intermediate telecommunications carrier. However, that does not alter the act that the taxpayer is – by any means used to define that term – "carrying" communications from one geographic point to another geographic point. That the originator of those telecommunications is a primary long distance carrier rather than a single, identifiable customer, is a distinction nowhere to be found – either explicitly or implicitly – within 45 IAC 1-1-124(b). That the taxpayer is an "intermediate" carrier of bulk communications, does not alter the fact that taxpayer can readily distinguish income it receives from carrying intrastate (Indianapolis to Bloomington) communications from that income derived from carrying interstate (Indianapolis to Chicago or Cleveland to Chicago) communications.

Under the plain words of the regulation, there is no requirement that a telecommunications carrier deal directly with the originator of each phone call and with each and every recipient of that same phone call. To impose such a requirement would add an additional mandate found nowhere within 45 IAC 1-1-124(b) and would ignore the technological and structural changes which have transformed the telecommunications industry. The days when the individual telephone customer would contract with a single phone carrier to install the customer's equipment, receive every phone message the customer originated, and carry – in toto – the consumer's phone calls to each and every one of the ultimate recipients, are long past.

The audit and the original Letter of Findings found that taxpayer was merely an intermediate "service provider," removed from the actual business of "carrying communications." A reasonable argument can be made that certain vendors – though peripherally involved in the telecommunications business – are simply "service" providers not involved in "carrying communications" and, as such, certainly not entitled to the regulatory exemption. Such vendors might include those who originally built and installed taxpayer's microwave equipment, vendors who provide taxpayer with billing or accounting services, or independent contractors which maintain and repair taxpayer's equipment. Clearly, taxpayer is not simply peripherally involved in "carrying communications." Taxpayer constructed its microwave system and exists to "carry communications" between two distinct geographic points. If taxpayer would be removed from the network infrastructure, the communications which travel through taxpayer's system would – until an alternative was provided – not be "carried" and the originators' messages would not be received at the their intended destinations.

The original Letter of Findings determined that taxpayer was not entitled to exemption because it could not compute its gross income on a “transactional basis.” Because taxpayer could not determine the exact point of origin and terminus of each individual phone message, taxpayer could not claim the 45 IAC 1-1-124(b) exemption. However, the requirement that taxpayer be able to calculate its gross income on a transactional basis adds a level of complexity and specificity nowhere to be found in the plain words of 45 IAC 1-1-124(b). Although tax exemptions are to be strictly construed against the taxpayer, it is also true that such exemptions are not to be interpreted so narrowly as to obscure the legislative purpose of the exemption. Indianapolis Public Transp. Corp. v. Indiana Dept. of State Revenue, 512 N.E.2d 906, 908 (Ind. Tax Ct. 1987). Although it is true that taxpayer cannot peer into its microwave transmissions and determine that origin and terminus of each individual phone call, it is also true that the taxpayer can precisely delineate the income received from the interstate transmission of communications from that income received from the intrastate transmission of communications. Taxpayer enters into contracts with primary carriers (LATA’s) to provide service along specific geographic segments of its microwave system. The primary carriers pay taxpayer to use an interstate segment such as Indianapolis to Chicago. Another primary carrier will pay taxpayer to use an intrastate segment such as the segment between Indianapolis and Bloomington. There is no ambiguity in determining what portion of taxpayer’s income is “derived from carrying communications between two (2) points in Indiana.” 45 IAC 1-1-124(b). There is no ambiguity in determining what portion of taxpayer’s income is “derived from carrying communications between a point outside Indiana and a point in Indiana, or from a point outside Indiana into and across the State to a point outside Indiana.” Id.

Accordingly, to the extent that taxpayer can specifically differentiate between the income it received for carrying intrastate communications linking two points within the state (e.g. Indianapolis to Bloomington) from the income it received for carrying interstate communications (e.g. Indianapolis to Chicago), taxpayer is entitled to claim the exemption available under 45 IAC 1-1-124(b).

FINDING

Taxpayer’s protest is sustained.