OFFICE OF THE STATE BUILDING COMMISSIONER
WRITTEN INTERPRETATION OF A BUILDING LAW

Title:	Safety Glazing
Identification Number:	OSBC-03-01
Date Originally Issued:	December 26, 2001
Effective Date:	February 1, 2003
Brief Description of Subject Matter:	Safety glazing for bathtub and shower enclosures.
Indiana Building Code(s) Affected:	Indiana Residential Code, 2001 Edition (675 IAC 14-4.2) Indiana Building Code, 1998 Edition (675 IAC 13-2.3)

The Office of the State Building Commissioner, pursuant to the authority granted under Indiana Code 22-15-2-6(5) and Indiana Code 22-13-5, has developed this written interpretation of a building law. Pursuant to Indiana Code 22-13-5-4, **this written interpretation of a building law is binding upon all counties and municipalities.**

This written interpretation will continue to bind all counties and municipalities until the earlier of the following:

(1) The general assembly enacts a statute that substantively changes the building law interpreted or voids the written interpretation.

(2) The Fire Prevention and Building Safety Commission adopts a rule under IC 4-22-2 to state a different interpretation of the building law.

(3) The written interpretation is found to be an erroneous interpretation of the building law in a judicial proceeding.

(4) The Office of the State Building Commissioner publishes a different written interpretation of the building law.

Background

Indiana Residential Code (675 IAC 14-4.2) Section R308.4(4) and Indiana Building Code (675 IAC 13-2.3) Section 2406.4(5) require safety glazing in doors and enclosures for hot tubs, whirlpools, saunas, steam rooms, bathtubs and showers where the bottom exposed edge of the glazing is less than 60 inches measured vertically above any standing or walking surface (or drain inlet). This requirement includes and also applies to glazed areas in any part of a building wall used to make up part of the enclosure.

Interpretation

The requirement for safety glazing in accordance with IRC Section R308.4(4) and IBC Section 2406.4(5) does not extend beyond an enclosure of a hot tub, whirlpool, sauna, steam room, bathtub or shower, or beyond the part of a building wall that is in contact with the perimeter of the unit.

OFFICE OF THE STATE BUILDING COMMISSIONER
WRITTEN INTERPRETATION OF A BUILDING LAW

Title:	Foundation Wall Construction
Identification Number:	OSBC-03-02
Date Originally Issued:	October 9, 2002
Effective Date:	February 1, 2003
Brief Description of Subject Matter:	Use of Header Blocks for Brick Veneer
Indiana Building Code(s) Affected:	Indiana Residential Code, 2001 Edition (675 IAC 14-4.2)

The Office of the State Building Commissioner, pursuant to the authority granted under Indiana Code 22-15-2-6(5) and Indiana Code 22-13-5, has developed this written interpretation of a building law. Pursuant to Indiana Code 22-13-5-4, **this written interpretation of a building law is binding upon all counties and municipalities.**

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(3) The written interpretation is found to be an erroneous interpretation of the building law in a judicial proceeding.

(4) The Office of the State Building Commissioner publishes a different written interpretation of the building law.

Background

The acceptance of the use of header blocks (L-blocks) for the top course of masonry foundation walls for Class 2 structures to provide a brick ledge for masonry veneer has not been uniform among authorities having jurisdiction.

Interpretation

The use of 8-inch solid or hollow concrete header blocks (L-blocks) for the top course only of plain masonry foundation walls for Class 2 structures where masonry veneer will be applied is acceptable in accordance with Indiana Residential Code (675 IAC 14-4.2) Section R404.

Using these blocks to elevate the framed wall sill above grade in accordance with Section R404.1.6 is also compliant with Section R404.1.5, and is an improvement over Figure R703.7A.

An approved alternate method of providing foundation anchorage in accordance with Section R403.1.6 may be required if solid blocks are utilized.

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #3
INCOME TAX
JANUARY, 2003
(Replaces Information Bulletin #3, dated January, 2001)

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

SUBJECT: Payment of Indiana Estimated Tax by Individuals

REFERENCES: IC 6-3-4-4.1; IC 6-3.5-1.1-18; IC 6-3.5-6-22; IC 6-3.5-7-18; IC 6-8.1-3-3

INTRODUCTION: Estimated income tax payments must be made by an individual who:

(1) receives income from which Indiana adjusted gross income tax, county adjusted gross income tax, county option income tax, or county economic development income tax, is not properly withheld; and

(2) Has an annual income tax liability described under subdivision (1), above, that is four hundred dollars ($400) or more.

Even if an individual does not meet these requirements, the individual may still make estimated payments to reduce the amount that will be due when the annual individual adjusted gross income tax return is filed.

I. ESTIMATED TAX COUPON BOOKLET

Installment payments may be made by using IT-40ES tax vouchers. The Department issues pre-printed estimated tax vouchers in coupon booklet form to those taxpayers. The coupon booklet contains vouchers for each installment period, and a change of name, address, and social security number. Pre-printed vouchers are mailed annually to any taxpayer that made estimated tax payments during the previous year. When a taxpayer makes an estimated payment for the first time, on form ES-40 (contained in the IT-40 booklet) vouchers are sent in coupon booklet form after that initial payment is received.

Taxpayers and tax preparers are encouraged to file estimated tax payments using pre-printed vouchers. If a taxpayer does not receive pre-printed vouchers before the next installment payment is due, the taxpayer may submit payment with Form ES-40. A copy of this form will be provided to the taxpayer upon request, and the form can be downloaded from the Department's Web Site: www.in.gov/dor/taxforms/.

The four installment payments are due on April 15, June 15, September 15, and January 15 following the last month of the tax year. A person filing on a fiscal year rather than calendar year basis should adjust the due dates to correspond with the appropriate voucher for the fiscal year. If the due date falls on a national or state holiday, Saturday, or Sunday, payment is timely if it is postmarked by the next business day following the holiday or Sunday.

While an installment payment cannot be changed once it has been made, future payments may be adjusted to reflect a change in the annual estimated tax due. Future installment payments are determined by subtracting the amount of the previous payments from the amount of the estimated payments not yet paid.

Any installment payment received after January 15 for the preceding tax year will be either returned to the taxpayer or credited against the taxpayer's liability for the following year.

II. CALCULATION OF THE ESTIMATED INSTALLMENT PAYMENT

The following worksheet should be used to determine the amount of estimated tax due:

A. Total Estimated Income for the Tax Year	A ____________
B. Total Exemptions × $1,000 (plus $1,500 per Qualifying Dependent for Tax Year)	B ____________
C. Amount Subject to Indiana Income Tax (Line A minus B)	C ____________
D. Amount of State Income Tax Due (Line C × .034)	D ____________
E. Amount of County Income Tax Due (Line C × County Tax Rate)	E ____________

F. Total Estimated Income Tax (Line D plus Line E) F ___________
G. Estimated State and County Income Tax Withheld Plus Total of Other Credits G ___________
H. Amount of Annual Estimated Tax Due (Line F minus Line G) H ___________
I. Each Installment Amount Due (Line H divided by 4) I ___________

III. PENALTIES

A taxpayer is subject to a penalty for underpaying estimated tax if the total state and county taxes due after credits exceeds four hundred dollars ($400). The taxpayer will not owe a penalty if each installment payment equals at least one-fourth of the required annual payment. The required annual payment is the lesser of:

(1) 90% of the tax shown on the current year return;
(2) 100% of the tax shown on the previous year's return;
(3) 112% of the tax shown on the previous year's tax return if the taxpayer is not a farmer or fisherman and the Indiana adjusted gross income shown on a joint return is more than $150,000; or
(4) 112% of the tax shown on the previous year's tax return if the taxpayer is not a farmer or fisherman and the Indiana adjusted gross income shown on the return is more than $75,000 for a taxpayer who is either single or married and filing separately.

If the taxpayer is eligible for any of the exceptions to the penalty listed in (1), (2), (3), or (4) above, they must attach the Schedule IT-2210 to the individual income tax return showing that the exception has been met.

If a taxpayer's income is not received evenly during the year, the taxpayer can avoid penalty if the tax is paid in an amount at least equal to the annualized income installment by the due date of the installment. Schedule IT-2210A should be used to compute the annualized income installment amount. This schedule is available upon request or at the Department's Web Site (www.in.gov/dor/taxforms/). If a penalty is imposed for underpayment of estimated tax, the penalty is ten percent (.10) of the underpayment for that period.

IV. UNDERPAYMENT

The underpayment of an installment is the difference between the payment required for the installment (or the annual income statement, if applicable) and the amount paid. If a payment is made after the installment due date, the payment is considered to be made in the following installment period.

V. AVOIDING PENALTY FOR THE FOURTH INSTALLMENT

If a taxpayer files an annual individual adjusted gross income tax return and pays the entire tax due by January 31, the taxpayer will not receive a penalty for the installment payment due January 15. However, payment of the entire estimated tax liability or balance due with the fourth installment or with the filing of the return does not relieve the taxpayer from any penalty for failure to make prior estimated payments in a timely manner during the year.

VI. FARMERS AND FISHERMEN

A penalty is not imposed if:

(1) at least two-thirds of the taxpayer's annual gross income for the current year or preceding year is from farming or fishing;
(2) the taxpayer files Form IT-40 or Form IT-40PNR; and
(3) The taxpayer pays the entire tax due by March 1.

The taxpayer should attach Schedule IT-2210 to the income tax return and complete the portion of the return labeled "Farmers and Fishermen Only". If the farmer or fisherman does not file the return and pay the tax by March 1, the taxpayer should complete Schedule IT-2210 to determine if a penalty applies.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #6
INCOME TAX
JANUARY 2003
(Replaces Bulletin #6 dated April 1997)

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

SUBJECT: Civil Service Annuity Adjustment and Military Retirement or Survivor's Benefit Adjustment
REFERENCES: IC 6-3-2-3.7; IC 6-3-2-4
Civil Service Annuity Adjustment

IC 6-3-2-3.7 allows a deduction for a portion of a federal civil service annuity. In order to qualify for the civil service annuity adjustment, the taxpayer must be at least 62 years old at the close of the tax year and have received a civil service annuity includable in adjusted gross income while a resident of Indiana.

The allowable adjustment is equal to the federal civil service annuity received while an Indiana resident up to a maximum of $2,000 minus the total amount of social security and tier 1 and tier 2 railroad retirement benefits received while a resident of Indiana.

Example 1

A full-year Indiana resident who received a civil service annuity of $3,000 was 61 years old at the end of the year and received social security benefits totaling $2,300. The taxpayer received no other income during the year.

The taxpayer would not be entitled to the civil service annuity adjustment because he was not at least 62 years old.

If the taxpayer had been 62 years old, he still would not be entitled to the adjustment because the first $2,000 of civil service annuity is eliminated by the amount of social security benefits received.

Example 2

A full-year Indiana resident who received a civil service annuity of $6,000 was 66 years old and received railroad retirement benefits of $1,300. The taxpayer received no other income during the year.

The taxpayer would be entitled to a civil service annuity adjustment of $700, computed by subtracting the $1,300 railroad retirement benefits from the first $2,000 of civil service annuity received.

Example 3

A part-year Indiana resident received a civil service annuity of $5,000 and social security benefits totaling $1,800. The taxpayer became 66 years old in May of the tax year, and established residence in Indiana at that time.

During the eight months that the taxpayer was a resident of Indiana, he received a $3,000 civil service annuity and $1,200 in social security benefits. The taxpayer received no other income during the year.

The taxpayer would be entitled to a civil service annuity adjustment of $800 computed by subtracting the $1,200 social security benefits received while a resident of Indiana from the first $2,000 of civil service annuity received while a resident of Indiana.

Military Retirement or Survivor's Benefit Adjustment

IC 6-3-2-4 allows an adjustment for retirement pay or survivor's benefits received as a result of the individual's active or reserve service in the armed services.

In order to qualify for the military retirement or survivor's benefit adjustment, the taxpayer or surviving spouse must be at least 60 years of age on the last day of the tax year and have received military retirement or survivor's benefits while a resident of Indiana. The allowable adjustment is the amount of military or survivor's benefits received while a resident of Indiana and included in adjusted gross income, up to a maximum of $2,000.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #7
INCOME TAX
JANUARY 2003
(Replaces Bulletin #7 dated December 1987)

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

SUBJECT: Filing Requirements for Prior Year Individual Income Tax Returns
REFERENCES: IC 6-3; IC 6-8.1-10
INTRODUCTION

The Department has prescribed Form IT-40P for use in filing original Indiana individual income tax returns for tax years prior to January 1, 1997. Returns filed for 1997 to current should be filed on the original return for the appropriate year.

Both residents and nonresidents should use Form IT-40P. Nonresidents should complete the sections noted in the IT-40P instructions which are specifically designed for their use. Form IT-40P should not be used to file an amended (corrected) return. Form IT-40X should be used to file an amended return for any tax year.

The IT-40P booklet contains: Form IT-40P, Schedule X for Indiana deductions, Schedule Y for Indiana credits, and Schedule Z for part-year and full-year nonresidents, Schedule CT-40P (used to compute county income taxes) and instructions for the IT-40P and accompanying schedules.

The instructions needed to file Form IT-40P for tax years 1980 to 1996 are contained in the IT-40P booklet. Instructions needed to file returns for tax years 1964 through 1979 are contained in this Bulletin, which serves as a supplement to the IT-40P instructions.

Adjusted Gross Income Defined: For tax years after 1963 Adjusted Gross Income is defined under Section 62 of the Internal Revenue Code, modified by Indiana provisions for exemptions, income, and adjustments, as set forth in these instructions and/or the instructions contained in the IT-40P package.

Adjustments

Adjustments to Income: Listed in the instructions for Form IT-40P are any adjustments which are available for tax years 1964 through 1979. Listed below are four additional adjustments available during this period.

Renter's Deduction: You may deduct rent paid on property used as your principal residence, if such property was subject to Indiana property taxes. For tax year 1973, the deduction is limited to one half of the rent paid, or $500, whichever is less. For tax years 1974 and 1975 only, the deduction is limited to the amount of rent paid, or $1,000, whichever is less. No deduction for rent was available for tax years 1976, 1977 and 1978. For tax years beginning in 1979, you are allowed a deduction of the actual amount of rent paid on your principal place of residence during the tax year or $1,500, whichever is less.

National Bank Dividends: These are non-taxable for tax years prior to 1973; for tax years 1973 and thereafter these dividends are fully taxable. The dividends must first be included in the total dividends reported on your IT-40P and then taken as an adjustment to income. Attach to your IT-40P a copy of your federal Schedule B to verify this adjustment.

New Jobs Credit: For tax year 1977 only, a deduction is allowed from the federal taxable income by that amount of wages which could not be deducted due to the use of this credit. If the deduction is claimed, a supporting explanation must accompany the return. If the deduction is taken on the IT-20S or the IT-65, no deduction will be allowed to the individual shareholders or partners on their individual income tax returns. The deduction is taken under "Other Deductions" on the IT-40P.

Active or Reserve Military Pay: An adjustment is available for tax years 1963 through 1966, to members of reserve components of the armed forces of the United States, to the extent that such income is included in the total income. This adjustment may be applied to compensation received from active or inactive reserve components including the Army, Navy, Air Force, Coast Guard, Marine Corps, Merchant Marine, Indiana Army National Guard or Indiana Air National Guard. However, this adjustment may not be applied to compensation received from regular service or retirement pay. For tax years beginning with 1967 see the "Adjustments for Military Pay". Attach to your IT-40P a copy of your military reserve W-2 withholding statement to verify this adjustment. Enter this adjustment under "Other Deductions", or "Other Adjustments", and note on the line that the adjustment claimed is for Reserve Pay.

Exemptions

All information concerning exemptions for tax years 1964 through 1979 are contained in the IT-40P instructions. However, it bears repeating that part-year and nonresidents should not prorate their exemptions for tax years prior to 1969.

Computing Tax Rates

Income Tax: The individual income tax has been computed at the rate of two percent (.02) for tax years 1964 through 1978. In 1963 a split year tax rate was in effect and prior to that time various rates of tax were used under the 1933 Gross Income Tax Act. Therefore, if you wish to file a return for a period prior to the 1964 tax year, you should contact the Department of Revenue for additional information concerning pre-1964 tax rates.

For tax year 1979 only, the effective state tax rate is 1.7 percent (.017). For tax year 1980, 1981 and 1982 the tax rate is 1.9 percent (.019). For tax years 1983 to 1986 the tax rate is three percent (.03). For 1987 the tax rate is 3.2 percent (.032) and for 1988 the rate increases to 3.4 percent (.034).

County Tax: If, as of July 1, for tax year 1973, or January 1 for tax years after 1973, your legal residence or your principal work activity was located in an Indiana county which had adopted county tax, Schedule CT-40P must be completed. Carry the amount of county tax due from the appropriate lines of Schedule CT-40P to Form IT-40P.

Sales and Use Tax: This tax is levied on retail purchases of tangible personal property. If during the tax year for which you are filing you made purchases from out-of-state firms on which sales tax was not charged, you must report the use tax due on these purchases on Form IT-40P. The Sales and Use tax rates are: two percent (.02) from October 23, 1963 until May 1, 1973, at which time the rate increased to four percent (.04) until January 1, 1983. Effective 1983, the rate was five percent (.05). Since December 1, 2002 the rate has been six percent (.06).

Credits

All information concerning allowable credits for tax years 1964 through 1979 are contained in the IT-40P instructions. However, the following credits have additional restrictions in former tax years. Note that sales tax credits used in years 1964 through

1972; credit for refund of property taxes, used in years 1973 through 1980; and utilities tax credit or unified tax credit, beginning in 1978, are no longer available to be claimed. The statute of limitations demands that a claim for any such credit be filed within six (6) months after the close of the tax year.

College Credit: For tax years 1967 to the present a credit is allowed against your Indiana adjusted gross income tax for contributions made to institutions of higher education located within the State of Indiana, to any corporation or foundation organized and operated solely for the benefit of any such institution of higher education, and/or to the Associated Colleges of Indiana. An updated listing of qualifying institutions is included each year on Schedule CC-40. Contact the Department of Revenue for more information.

You must complete and attach Schedule CC-40 to be allowed this credit on Form IT-40P. Please note the additional limitations this credit has for the following tax years: Effective for tax years 1967 and 1968 only, the allowable credit for gifts or donations is fifty percent (50%) of the contribution, but not to exceed; a) $50 on a single return or $100 on a joint return; or b) twenty percent (20%) of the amount of state income tax due on Form IT-40P, whichever is less. Effective for tax years 1969 through 1977 the allowable credit for such gifts or donations is fifty percent (50%) of the contribution, but cannot exceed $50 on a single return or $100 on a joint return. In no case may this credit exceed the amount of state income tax due on Form IT-40P. Effective since 1978, the allowable credit is fifty percent (50%) of the gift or donation, but cannot exceed $100 on a single return or $200 on a joint return. In no case may this credit exceed the amount of state income tax due on Form IT-40P.

Retirement Income Credit or Credit For The Elderly: This credit is effective for tax years 1965 to 1979. If you qualify for this credit for federal tax purposes, and are an Indiana resident for a least a part of the tax year, you are also allowed a credit against your Indiana adjusted gross income tax liability. The Indiana credit equals 2/15 of the tentative credit from federal Schedule R, a copy of which should be attached to your IT-40P. Calculations are provided below for Full-Year Residents and Part-Year Residents. Full-Year Nonresidents may not claim this credit on their Indiana return.

Full-Year Residents of Indiana should complete lines A through C and enter the total from line C under “Other Credits” on Form IT-40P. Part-Year Residents should complete lines A through D and enter the total from line D under “Other Credits”. In no case may this credit exceed the amount of State Adjusted Gross Income Tax due on your IT-40P.

A. Enter the tentative credit from federal Schedule R/RP . . . . A ___________
B. Multiply line A by 2 . . . . B ___________
C. Divided line B by 15 . . . . C ___________
D. Multiply line C by percentage from Box 12, Form IT-40P . . . . D ___________

For tax year 1980 only, the credit is calculated by multiplying the tentative federal credit by.1267. Federal Schedule R/RP must be attached to your IT-40P to verify this credit.

County Retirement Income Credit or County Credit for the Elderly: Effective for tax years 1973 through 1980, if you qualify for the Retirement Income Credit or the Credit for the Elderly for state and federal tax purposes, you are also allowed a credit against your county adjusted gross income tax. You should compute the credit according to the table given below for tax years 1974 to 1980. (Contact the Department for the effective rates applicable to tax year 1973.) Use the county tax rate that is applicable for the filing tax year to find the state percentage of Retirement Income Credit or Credit for the Elderly allowed against the county tax. The credit may not exceed the amount of your county adjusted gross income tax.

COUNTY RATE	ALLOWABLE PERCENTAGE OF THE STATE CREDIT
1% (.01)	.50%
3/4% (.0075)	37.5%
1/2% (.005)	25%
1/4% (.0025)	12.5%

Credit for Taxes Paid to Other States: As an Indiana resident you must report all income received for the tax year, even if you are required to pay tax on a portion of this income to another state. You must also report all income received from Indiana sources while a nonresident of this state. The tax treatment depends upon the type and source of such income. You must contact the Department to verify the tax treatment of your income for tax years prior to 1980 when claiming credit for taxes paid to other states.

Computation of Credit for Taxes Paid to Other States:

The credit you may claim is the **LESSER** of:

1. The amount of tax actually paid to the other state (This does not mean the tax withheld from your wages. It means the actual tax due computed on the other state’s income tax return); or
2. The amount of Indiana adjusted gross income tax due on your Indiana return; or
3. The income taxed in both states multiplied by Indiana’s tax rate.

For tax years prior to 1979 the credit is limited to 2% (.02) of the income. For 1979, the credit is limited to 1.7% (.017) of the income. For 1980 through 1982, the credit is limited to 1.9% (.019) of the income. For 1983 to 1986, the credit is limited to 3% (.03) of the income. For 1987 the credit is limited to 3.2% (.032) of the income. For 1988 the credit is limited to 3.4% (.034) of the income.

A copy of the other state's tax return filed must be attached to Form IT-40P to substantiate your credit. In no case may the credit claimed for Taxes Paid to Other States exceed your Indiana adjusted gross income tax due on Form IT-40P.
NOTE: The above-mentioned credits along with any Solar and Wind Energy Credit are non-refundable; therefore, the combined totals of each of these credits may not exceed the amount of Indiana adjusted gross income tax due on Form IT-40P.

If you have any questions concerning your filing, or wish to file for a period prior to 1964, contact the Department of Revenue by calling (317) 232-2240.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #9
SALES TAX
JANUARY, 2003

DISCLAIMER: Information bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules and court decisions. Any information, which is not consistent with the law, regulations, or court decisions is not binding on either the Department or the taxpayer. Therefore, the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.
SUBJECT: Agricultural Production Exemptions
REFERENCES: IC 6-2.5-4-5, IC 6-2.5-5-1, IC 6-2.5-5-2, IC 6-2.5-5-5.1, 45 IAC 2.2-5-1, 45 IAC 2.2-5-2, 45 IAC 2.2-5-3, 45 IAC 2.2-5-4, 45 IAC 2.2-5-5, 45 IAC 2.2-5-6, 45 IAC 2.2-5-7

I. Purchases

The general rule for the application of sales or use tax is that a purchase of tangible personal property to be used in Indiana is subject to tax unless a specific exemption is available.

Indiana law provides several exemptions from sales and use tax relating to agriculture production. The exemptions are limited to purchases of animals, feed, seed, plants, fertilizer, insecticides, fungicides, and other tangible personal property; and agricultural machinery, tools, and equipment to be directly used in the direct production of food or commodities that are sold either for human consumption or for further food or commodity production.

The phrase directly used in direct production means that the property must be integral and essential to the production process. Property is integral and essential to the production of food or commodities if it is necessary to carry on production and plays a key role in the actual production of the food or commodity. Some examples of property that are directly used in direct production will be discussed later.

A. Animals, Feed, Seed and Farm Products

Purchases of animals, animal feed, seeds, fertilizer, plants, insecticides, fungicides and other similar items of tangible personal property are exempt from sales and use tax if two conditions are met. The person acquiring the property must directly use the property in the direct production of food or commodities for sale and the person must be occupationally engaged in the production of food or commodities which are sold for human or animal consumption or for further use in food or commodity production.

To be occupationally engaged in the production of food or commodities a person must be regularly engaged in the commercial production for sale of vegetables, fruits, crops, livestock, poultry and other food or agricultural products. Persons who do not intend to operate at a profit or who produce food or agricultural commodities for sale as a hobby are not occupationally engaged in the production of food or agricultural commodities.

The term feed includes salt, grains, tankage, oyster shells, mineral supplements, vitamins and other generally recognized animal feed. Fertilizer means any commodity that contains one or more substances to increase the available plant food content of the growing medium. Generally, the contents of the fertilizer must become part of the plants grown and must be used as a fertilizer.
Examples:

1. Bob Jones plants 600 acres of soybeans. He intends to sell the soybeans at a profit. He buys insecticide to spray the soybeans. The insecticide fails and his crop is eventually ruined. The purchase of the insecticide is exempt. The fact that the crop was not sold at all does not make the purchase of the insecticide taxable.
2. Same facts as in example 1, except that Bob uses the insecticide to protect his prize rhododendrons. The plants are not sold nor does Bob intend to sell them. The insecticide is taxable. In this example the insecticide is not being directly used in the direct production of agricultural products for sale.
3. Lab Animals Corporation raises animals to be used in research. The animals are not sold to be eaten by humans. The

research is to develop medicines to be used to prevent or cure human and animal diseases. Lab Animals Corporation cannot purchase animal feed exempt from tax under the agricultural exemptions.

4. Ride-A-Horse, Inc. purchases twenty horses to be used as riding animals. The horses would be taxable because the animals are not directly used in the direct production of food or agricultural commodities.

B. Agricultural Machinery, Tools and Equipment

The purchase of agricultural machinery, tools and equipment are exempt from sales and use tax if the machinery, tools and equipment are directly used in the direct production, extraction, harvesting or processing of agricultural commodities. If the machinery or equipment is not directly used in the direct production of agricultural commodities, but is designed for use in the gathering, moving or spreading of animal waste, the machinery or equipment may be exempt if the following conditions are met.

1. The person acquiring the equipment acquires it for use in conjunction with the production of food or commodities for sale.
2. The person acquiring the machinery or equipment is occupationally engaged in the production of food or commodities that are sold for human or animal consumption or are used for further food or commodity production.
3. The machinery or equipment is designed for use in gathering, moving, or spreading animal waste.

Examples:

1. Fencing used to confine livestock during breeding, gestation, farrowing, calving, nursing and finishing is exempt from tax. During these activities the fencing plays a key role in the raising of the livestock.

2. John Doe, cattle rancher, purchases needles, syringes and vaccine pumps to inoculate his herd to prevent various cattle diseases. The equipment is exempt from tax because it is essential and integral to the raising of cattle. Without vaccinations, many of John’s cattle could die.

3. Sam Johnson owns 800 acres and grows wheat to be sold to a corporate bakery. Sam purchased lumber, nails, concrete and tools to build a silo to house his grain drying operation. The lumber and other building materials are exempt from tax. The silo is exempt from tax because the grain drying operation is integral and essential to the processing of the grain. The grain can not be sold to Sam’s customer until the grain is dried, thus the silo is necessary and plays a key role in the processing of the grain. The tools used to build the silo are taxable because the tools are not used in the processing of the grain.

4. Sam Johnson buys lumber, nails and concrete to build a silo to store grain after it has dried. Sam sells the grain to his customer once the grain is dried without further processing. The materials are taxable. Once the grain has dried no further processing takes place before the grain is sold, thus the processing of the grain is complete after drying. A silo used to store dried grain may be necessary but it does not play a key role in the processing of the grain because the processing of the grain is finished. If the storage silo were used half of the time to dry grain and the other half to store dried grain, then the silo would be fifty percent exempt and fifty percent taxable. If Sam also operates a mill where the grain was ground, then the dried grain storage silo would be exempt from tax. The silo would be exempt because the silo would be a temporary storage place for work-in process. The courts have determined that the temporary storage of property between processing steps is integral and essential to an integrated production process.

5. Corporation C is engaged in the business of selling agricultural chemicals and fertilizers to farmers. Corporation C purchases an applicator that will be used to spread the chemicals and fertilizer on its customer’s fields. The purchase of the applicator is exempt from tax because the application of fertilizers and agricultural chemicals is necessary and play a key role in the raising of crops.

6. Corporation A runs a large hog farm operation where pigs are bred, raised, slaughtered and packaged to be sold to wholesale grocers. The pigs are kept in confinement buildings. The confinement buildings maintain the integrity of the product and control the animal’s growth environment to facilitate the raising process. Any property which is directly used in the process of raising the pigs, such as heat exchangers, fans, thermostats, heat pumps, roof vents and the confinement stalls or porches would be eligible for exemption. These materials are exempt because if a person occupationally engaged in producing food for human consumption chooses to raise livestock in confinement buildings these materials are both essential and integral to the production process.

C. Utilities

Under certain circumstances Indiana law provides an exemption from sales tax for the purchase of the following utilities: electrical energy, natural and artificial gas, water, steam and steam heat. The utilities listed above are exempt from tax if they are directly used in the direct production of agricultural commodities. Thus, if a person occupationally engaged in the production of agricultural commodities purchases electricity to dry grain, the electricity would be exempt because drying grain is integral and essential to the production of grain. The purchase of electricity to run a fan to ventilate a dried grain storage silo would be taxable because the farmer purchasing the electricity is not going to subject the dried grain to further processing.

If a person, engaged in agricultural production, buys utilities from a public utility and predominantly uses the utilities directly in the direct production of agricultural commodities, then the utility is not required to collect tax on the purchase of the utilities. Each meter measuring the consumption of a utility is treated separately for purposes of determining whether a utility is predominantly used in production. Further, a utility is predominantly used in agricultural production when more than fifty percent of the utility is being directly used in direct agricultural production.

Before utilities may be purchased tax exempt from a public utility, an application for a predominant use exclusion must be filed with the Department of Revenue, form ST-200. If approved, an exemption certificate, ST-109, will be mailed to the public utility by the department. If a person is entitled to an exemption for only a percentage of their utilities, all of the tax must be paid and a refund claimed for the exempt percentage. Utilities purchased from a source other than a public utility may be purchased exempt using an exemption certificate. See section II, Exemption Certificates.

Examples:

1. Grow, Inc. has two meters for electricity and buys natural gas directly from the wellhead. One of the meters measures electricity used to dry grain. Fifty five percent of the electricity measured by the meter operates drying equipment used to dry grain. Another meter measures electricity used to heat the chicken coop and power the egg incubators. Forty-nine percent of the electricity measured by the meter is used for the incubators and fifty-one percent for general heating. The natural gas is used to heat the farmhouse and to dry grain which is harvested during periods of high humidity. Sixty percent of the natural gas dries grain.

The electricity meter for the grain silos is not taxable because the electricity is predominantly used directly in the direct processing of grain. Drying grain is integral and essential to the processing of grain. The electricity for the chicken coops is not predominantly used in direct production because only forty-nine percent of the electricity is directly used in the direct production of agricultural commodities. Therefore, Grow, Inc. is only entitled to an exemption for forty-nine percent of the cost of the electricity. The natural gas, though predominantly used in direct production, is only sixty percent exempt from tax because the gas was not purchased from a public utility.

To purchase the electricity for the silos tax exempt, an ST-200 application must be filed with and approved by the Department of Revenue. The sales tax charged for the chicken coop electricity must be paid to the utility and a claim for refund filed with the Department to recover the exempt percentage. Tax should be paid for purchase of the natural gas and a claim for refund filed to recover the tax paid for the exempt percentage. The Department of Revenue realizes that the percentage of exempt use changes from year to year. Thus, the Department may request a new application to be filed, if the Department believes the percentage of exempt consumption has changed.

II. Exemption Certificates

There are two types of exemption certificates that may be used to purchase exempt agricultural-use property. Form ST-104 allows property to be purchased exempt from tax if the property fits under one of the agricultural exemptions provided by Indiana law. The ST-104 may only be used as a single purchase exemption certificate and may not be used as a blanket exemption. The purchaser must complete the form for each purchase before the exemption will be allowed. The purchaser does not need a certificate for each item purchased but rather a certificate must be completed each time a person purchases one or more exempt items.

Form ST-106 is the Department's blanket agricultural exemption. The certificate may be issued to suppliers to be kept by the suppliers to substantiate exempt sales of the items listed on the front of the certificate. As with any other exemption certificate, the ST-106 must be completely filled out and signed before it is valid.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #11
INCOME TAX
JANUARY 2003
(Replaces Bulletin #11 dated October 1997)

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

SUBJECT: Indiana Corporate Estimated Income Tax Payments

REFERENCES: IC 6-2.3-6-1; IC 6-3-4-4.1; IC 6-5.5-6-3; IC 6-8.1-6-1; IC 6-3-4-4.1

INTRODUCTION

Form IT-6 should be used by all corporations required to file Indiana corporate adjusted gross estimated income tax returns. This return must be filed by the twentieth day of the fourth, sixth, ninth, and twelfth month of the taxpayer's taxable year.

Pre-printed IT -6 forms should be checked for accuracy. It is very important that the federal identification number, name and address are correctly printed on the form. If information is incorrect, make corrections on the Form IT-6, and complete the name and address change coupon and return it to the Department of Revenue, System Services, P.O. Box 6197, Indianapolis, IN 46206-6197. This will ensure proper crediting and quicker processing of your estimated payments.

I. Filing Requirements

Corporations must make estimated payments if the adjusted gross income tax exceeds one thousand dollars ($1,000) for the taxable year.

Taxpayers should note that refunds reflected on the annual corporate income tax return may be applied to the next taxable year's estimated liability by entering the amount to be credited on the designated line of the annual return. Overpaid estimated payments must be claimed on the annual return to obtain a refund.

One check is remitted for the remainder of a year's estimated income tax liability, no further estimated returns should be filed with the Department after the date of payment. All checks remitted to the Department should be accompanied by a return or a complete explanation for the payment. A zero liability for a quarter does not require Form IT-6 to be filed.

If a taxpayer's estimated liability exceeds ten thousand dollars ($10,000) per estimating period, the taxpayer is required to remit the tax by electronic funds transfer. If the estimated payment is made by electronic funds transfer, the taxpayer is not required to file Form IT-6 for estimated payments. Questions relating to electronic funds transfer payments should be directed to (317) 615-2695.

II. Extension Payment Using Form IT-6

The Department recognizes the Internal Revenue Service application for automatic extension of time to file. It is not necessary to request a separate Indiana extension if you have a federal extension of time. Returns received within thirty (30) days after the last date indicated on the federal extension form will be considered filed on a timely basis. A copy of the federal extension form must be attached to the Indiana annual return when filed. If a federal extension is not needed, a corporation may request a separate Indiana extension of time to file with the Department. To request an Indiana extension of time to file contact the Indiana Department of Revenue, Data Control Business Tax, Returns Processing Center, 100 N. Senate Avenue, Indianapolis, IN 46204. Ninety percent (90%) of the tax reasonably expected to be due must be prepaid prior to the original due date. Form IT-6 should be used to make an extension payment. This payment will be processed as a "fifth estimated" payment. (See Income Tax Information Bulletin #15 for more details.)

III. Adjusted Gross Income Tax

Corporations whose estimated adjusted gross income tax exceeds one thousand dollars ($1,000) for the taxable year must pay adjusted gross income tax on the estimated return. When computing the estimated adjusted gross income tax for the taxable year, the adjusted gross income tax rate is eight and five tenths percent (8.5%) of Indiana adjusted gross income after apportionment.

IV. Financial Institutions Tax & Utility Receipts Tax

Corporations subject to the financial institutions tax (IC 6-5.5) and the utility receipts tax (IC 6-2.3) are subject to the same estimated filing thresholds as corporations subject to the corporate adjusted gross income tax.

V. Penalties

Corporations required to estimate their income taxes will be subject to a ten percent (10%) underpayment penalty if they fail to file estimated tax payments or fail to remit a sufficient amount of estimated tax. The required estimate should include at least twenty percent (20%) of the total liability for the current taxable year, or twenty-five percent (25%) of the final tax liability for the prior taxable year. If either one of these conditions are met, there will be no penalty assessed for the estimated period.

If you have any questions concerning the filing of the estimated return, or if you need to obtain an IT-6 booklet, please do not hesitate to contact the Indiana Department of Revenue.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #17
INCOME TAX
JANUARY 2003
(Replaces Information Bulletin #17 dated June 1992)

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SUBJECT: Taxation and Filing Requirements of Not-For-Profit Organizations
REFERENCES: IC 6-3-2-2.8, IC 6-3-2-3.1
INTRODUCTION

All organizations are subject to the adjusted gross income tax unless the income is specifically exempted from taxation under the provisions of the Adjusted Gross Income Tax Act (Indiana Code 6-3-2-2.8 and 6-3-2-3.1). All not-for-profit organizations will be subject to tax on income derived from unrelated trade or business as defined in Section 513 of the Internal Revenue Code.

I. Recognition of Not-For-Profit Organizations

An organization will not be considered exempt from tax until it applies to and is approved by the Indiana Department of Revenue to file as a not-for-profit organization. Application should be made on Form NFP20A, Application to File as a Not-For-Profit Organization, and must be made within one hundred twenty (120) days after the organization's formation. If federal not-for-profit status has been granted by the Internal Revenue Service, a copy of the determination letter should accompany the NFP20A.

For Indiana adjusted gross income tax purposes, the Department will accept the exempt status determination by the Internal Revenue Service.

Unlike the Internal Revenue Service, the Indiana Department of Revenue will not approve an application for group exemption for affiliated groups. Each affiliate must apply separately for exemption. International, national, state or similar governing bodies may submit one set of Articles of Incorporation, Constitution, By-laws, and similar information requested by the Department on behalf of affiliated groups within the state. However, each affiliate is required to file a separate application and submit a copy of its Constitution, By-laws, etc., if different from the information submitted by its governing body.

After considering the application and information submitted, the Department will notify each organization whether it should file as an exempt organization. If an organization's application to file as a not-for-profit organization is denied, a formal protest may be filed with the Department. If a protest is filed, an administrative hearing shall be scheduled in order to allow the organization to present additional evidence relevant to its application.

II. Unrelated Business Income

All not-for-profit organizations are subject to Adjusted Gross Income Tax on their unrelated business income.

The term "unrelated business income" as defined in IRC Section 513 means income from a trade or business regularly carried on by the organization which is not substantially related to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption. A trade or business activity is regularly carried on when it manifests a frequency and continuity and is pursued in a manner generally similar to comparable commercial activities of nonexempt organizations. The trade or business is not substantially related to an organization's exempt purpose when it does not contribute importantly to the achievement of that purpose other than by the mere production of income.

An exempt organization receiving unrelated business income will compute its taxable income in the same manner as that of any other taxpayer receiving business income, except that business deductions may be taken only in so far as they are directly related to the production of taxable income.

For more information on "unrelated business income," and the computation of unrelated business taxable income, please refer to Internal Revenue Service Publication 598.

III. Filing Requirements

In addition to filing an Application to File as a Not-For-Profit Organization, Form NFP20A, the organization must file an annual report, Form NFP20, with the Department on or before the fifteenth day of the fifth month following the close of the taxable year. If the organization fails to file the annual report, the Department will notify the organization of such failure. If, within sixty days after receiving such notice the organization does not file the annual report, the organization's exempt status will be canceled. The Department may reinstate the organization's exempt status if the organization shows by petition that the failure was due to excusable neglect. Extensions of time to file are available and must be filed with the return if it is filed after the due date.

Forms relating to not-for-profit organizations and their due dates are as follows:

	FORM	FILING DATES
IT-6	Indiana Corporation Estimated Quarterly Income Tax Return – Required if the not-for-profit organization's income tax liability in any quarter exceeds $250	Due on the 20th day of the 4th, 6th, 9th and 12th month of the taxable year.
IT-20NP	Not-For-Profit Organizations Return – Tax return for organizations reporting unrelated business income	Due the 15th day of the 5th month following the close of the tax year (accounting year of the not-for-profit organization)
NFP20A	Application to File as a Not-For-Profit Organization	Within 120 days after the not-for-profit organization is formed
NFP20	Annual Report of Not-For-Profit Organization- Required by all not - for-profit organizations	Due 15th day of the 5th month following the close of the tax year (accounting year of the not-for-profit organization)
NFP1	Not-For-Profit Tax Registration Certificate	Issued by the Department upon approval of application

The Department will allow not-for-profit organizations to attach copies of their annual federal reports and returns to the Indiana annual report, Form NFP20. Form NFP20 will serve as a cover document and must be signed by an authorized person. Completed federal forms 990, 990PF, 4720, or 5500-C can serve as attachments.

IV. Other Taxes

Registration of a not-for-profit organization does not relieve the organization from liability for other taxes or from other reporting requirements.

Special provisions apply to not-for-profit organizations with respect to sales tax. Certain purchases made by not-for-profit organizations are exempt from sales tax. Sales tax must be collected and remitted to the Department on sales made by not-for-profit organizations unless certain limitations are met. For further information please refer to sales tax Information Bulletin Number 10.

Miscellaneous Information

Other Income Tax Information Bulletins available from the Compliance Division which apply to Not-For-Profit Organizations are:

Information Bulletin #	Subject
11	Indiana Corporation Quarterly Income Tax Return (Form IT-6) Filing Requirements
50	Requirements for Certain Information Returns for Income Tax Purposes
84	Not-For-Profit Sponsored Gambling Activities

Sales Tax Information Bulletins available from the Compliance Division which apply to Not-For-Profit Organizations are:

Information Bulletin #	Subject
7	Application of Sales Tax to Meals and Banquets
10	Application of Sales Tax to Not-For-Profit Organizations
20	Casual Sales: Auctions; Garage Sales; Rummage Sales; and Similar Sales
41	Sales Tax Application to Furnishing of Accommodations

V. Public Inspection

In accordance with Commissioner's Directive #6, the Department shall keep all applications for exemption and annual reports, available for public inspection during the Department's working hours. An advance request to inspect such records is recommended.

Questions concerning the taxation of not-for-profit organizations should be addressed to: Indiana Department of Revenue, Compliance Division, Not-For-Profit Section, Indiana Government Center North, 100 North Senate Avenue, Indianapolis, Indiana 46204-2253. The phone contact number is 317-232-2188. Forms are available on the Department's web site at (www.in.gov/dor/).

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #37
SALES TAX
JANUARY 2003
(Replaces Bulletin #37 dated May 1988)

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SUBJECT: Sales by Out-of-State Merchants

REFERENCES: IC 6-2.5-4-1; IC 6-2.5-3; IC 6-2.5-8-1

I. Definition of Indiana Retail Merchant

A person is an Indiana Retail Merchant and must be registered with the Department to collect Indiana Use Tax if the retail merchant is engaged in selling at retail for use, storage, or consumption in Indiana and is:

1. Maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary or agent, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business in Indiana unless the property is subsequently shipped to another state.
2. Having any representative, agent, salesman, canvasser, or solicitor operating in Indiana under the authority of the retail merchant or its subsidiary for the purpose of selling, delivering, or taking orders for the sale of any tangible personal property for use, storage or consumption in Indiana.

II. Engaged in Business in Indiana

An out-of-state vendor is engaged in business in Indiana and must be registered as an Indiana Retail Merchant and charge Indiana Use Tax on tangible personal property delivered in Indiana if the out-of-state vendor's only Indiana activity is within "I (1)" or "I(2)" above. This activity includes:

a. maintaining an administrative office;
b. maintaining a research facility;
c. displaying merchandise at local trade fairs and exhibitions;
d. maintaining a factory or warehouse; or
e. delivering goods into Indiana by the seller's truck where title and possession transfer in Indiana.

III. Not Engaged in Business in Indiana

An out-of-state vendor is not engaged in business in Indiana and therefore is not required to register as an Indiana Retail Merchant and charge Indiana Use Tax on tangible personal property delivered in Indiana where the out-of-state vendor's ONLY Indiana activity is one of the following:

1. owning Indiana realty for investment;
2. being "qualified" to do business in Indiana;
3. purchasing goods in Indiana;
4. conducting credit investigations;
5. installing or assembling products;
6. servicing or repairing products;
7. advertising in a publication originated, mailed or retailed inside or outside Indiana;
8. advertising by radio or television broadcast from a transmitting location inside or outside Indiana;
9. advertising on billboards' or
10. delivering goods by common carrier or parcel post regardless of F.O.B. point.

IV. Consigned Goods

An out-of-state seller who consigns tangible personal property to an Indiana resident "on approval" is deemed to be engaged in business in Indiana, and must register as an Indiana Retail Merchant to collect Indiana Use Tax on such transactions.

An out-of-state seller whose only business activity in Indiana is the consignment of tangible personal property to an Indiana resident on a "sale or return" basis is deemed not to be engaged in business in Indiana and is not required to register to collect Indiana Use Tax.

V. Registration Procedures, Requirements and Privileges

An Indiana Registered Retail Merchant's Certificate will provide the registrant authority to collect Indiana Sales or Use Tax. In addition, the registrant is entitled to privileges of exemption from the tax on purchases of items to be used for an exempt purpose. The Indiana Registered Retail Merchant's Certificate is permanent. The registration fee is $25.00.

VI. Purchaser's Use Tax Liability

If an out-of-state vendor is not required or permitted to collect Indiana Sales Tax, the Indiana purchaser is liable for the Indiana Use Tax on such purchases if the property is to be used, stored, or consumed in Indiana.

VII. Out-Of-State Tax Collection Permit

An out-of-state merchant not required to become registered as an Indiana Retail Merchant may qualify for an Out-of-State Use Tax Collection and Remittance Permit. Holders of such permits must collect and remit Indiana Use Tax to the Department on sales of tangible personal property subject to the tax. The holders of these permits are also entitled to issue valid certificates of exemption on purchases of items to be used for an exempt purpose.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #43
SALES TAX
JANUARY 2003
(Replaces Bulletin #43 dated April 18, 1983)

DISCLAIMER: Information Bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules, and court decisions. Any information that is inconsistent with the law, regulations, or court decisions is not binding on the Department or the taxpayer. Therefore, information provided in this Bulletin should only serve as a foundation for further investigation and study of the current law and procedures related to its subject matter.

SUBJECT: Nursing Homes

REFERENCES: IC 6-2.5-5-18; IC 6-2.5-4; IC 6-2.5-5-19

For purposes of this bulletin, the term "nursing home" shall mean those facilities which qualify as "health care facilities" under IC 16-10-2-2.

I. Nursing Homes Not Required to Register as Indiana Retail Merchants

A nursing home located in Indiana is not required to register as an Indiana Retail Merchant and collect sales tax in regard to providing health care services to its resident patients for a fixed sum.

Meals, linens, or other tangible personal property normally furnished to the patient as a part of fixed fee charges to the patient are considered to be an incidental part of the service and as such are not subject to the collection of sales tax from the patient.

All purchases by the nursing homes of supplies, medicines, equipment furnishings, or other tangible personal property or taxable services to be used or consumed in the operation of the nursing home are subject to sales tax at the time of purchase by the nursing home. The purchase of grocery type food which is exempted by statute is not subject to sales tax.

Nursing homes as such, providing health care services for a fixed sum are not authorized to issue exemption certificates for any of its purchases.

Sales of nonlegend drugs as defined in IC 16-18-2-101(a) are exempt from the sales tax if the nonlegend drug is dispensed upon an original prescription or a drug order, and the user of the drug is a person confined to a nursing home.

II. Nursing Homes Required to Register as Indiana Retail Merchants

If the nursing home conducts the sale or leasing of tangible personal property to employees or persons other than their patients of the nursing home (such as the sale of meals to visitors and guests), or sells or leases property (such as medicine, clothing, supplies, television sets, etc.) to its patients which is separately billed or charged, the nursing home must register as an Indiana Retail Merchant and must collect and remit Indiana Sales Tax on such transactions.

Tangible personal property which is purchased by the nursing home for rental purposes as outlined in the preceding paragraph is not subject to sales tax at the time of purchase, and the nursing home registered as an Indiana Retail Merchant, may issue exemption certificates at such time for such purposes.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #47
SALES TAX
JANUARY 2003
(Replaces Bulletin #47 dated November 1985)

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SUBJECT: Auto Rental Excise Tax and Marion County Supplemental Auto Rental Excise Tax

REFERENCES: IC 6-6-9; IC 6-6-9.7

I. Auto Rental Excise Tax

An excise tax known as the auto rental excise tax, is imposed on rentals of passenger motor vehicles and trucks for periods of less than 30 days. The rental of a trailer is not subject to this tax. The tax is equal to 4% of the gross retail income received by the retail merchant. The person renting the vehicle is liable for the tax. The retail merchant is required to collect the tax and remit it to the Department of Revenue. The tax must be a separate added amount to the consideration paid for the rental. Trucks which have a declared gross weight of over 11,000 pounds are exempt. The rental of a passenger motor vehicle or truck by a funeral director is exempt from the auto rental excise tax if the rental is part of the services provided by the director for a funeral.

Example: Mr. X rents a passenger motor vehicle (auto) for 10 days in August and returns the auto; then rents the same auto or another auto for 20 days in September. Both transactions are separate and each is taxable. The rental must be for 30 consecutive days, not 30 total days, in order to be exempt.

A separate return must be filed for each business location. Consolidated reporting is not allowed as each location's tax collections are to be credited to the location's taxing district. A monthly return must be filed even though no tax is due.

II. Marion County Supplemental Auto Rental Excise Tax

Marion County is authorized to impose a supplemental auto rental excise tax on the rental of passenger motor vehicles and trucks in the county for periods of less than thirty (30) days. The tax is imposed at two percent (2%) of the gross retail income derived from the rental.

Trucks exceeding a gross weight of eleven thousand (11,000) pounds are exempt from the tax. The rental of a passenger motor vehicle or truck by a funeral director is exempt from tax if the rental is part of the services provided by the director for a funeral. The temporary rental of a passenger vehicle or truck is exempt if the rental is made or reimbursed under a contract for mechanical breakdown insurance, automobile collision insurance, or provided while repair work is completed.

The supplemental auto rental excise tax expires on December 31, 2027. All revenue collected from the tax shall be distributed monthly to the capital improvement board of managers operating in Indianapolis.

The return filed by the retail merchant must separate the amount of taxes collected at each location.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #51T
SALES TAX
JANUARY 2003
(Replaces Bulletin 51T dated May 23, 1994)

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

SUBJECT: Telecommunication Services

REFERENCES: IC 6-2.5-4-6; IC 6-2.5-4-13; IC 6-2.5-5-13; IC 6-8.1-15

Telecommunication Services

IC 6-2.5-4-6 subjects a wide range of intrastate telecommunication services to sales tax. The statute states that a person is a retail merchant making a retail transaction when the person provides intrastate telecommunication service. Telecommunication service is defined as the transmission of messages or information by or using wire, cable, fiber-optics, laser, microwave, radio, satellite, or similar facilities. It is not required that the person furnishing such service be a public utility for the service to be subject to sales tax.

A person is a retail merchant making a retail transaction when the person sells a prepaid telephone calling card at retail, a prepaid telephone authorization number at retail, or reauthorizes either of the above. Effective August 1, 2002 there was a standardized method for taxes, charges, and fees levied on wireless telephone service. The method is that all fees are charged and taxed based on the customer's place of primary use.

Example 1

Company A provides cellular phone service. Company A is not a public utility. Company A is required to collect and remit sales tax on its cellular service. The statute imposes sales tax on the transmission of messages or information by microwave, radio, satellite, or similar facilities. Cellular communications are covered by the statute and the statute does not require that a person be a public utility.

Example 2

Company X transmits a satellite television service. Customers are charged a fee by Company X for the privilege of receiving television signals on their satellite dishes. Company X is providing a telecommunication service and its charges are subject to sales tax. (Cable television charges are similarly subject to sales tax.)

Value Added Services

Value added services in which computer processing applications are used to act on the form, content, code, or protocol of the information for purposes other than transmission are not telecommunication services and are therefore not subject to sales tax.

Example 3

Company B is a local telephone service provider. Company B provides several additional services and service enhancements to its customers. These include: call waiting, caller ID, call forward, distinct ringing, and voice mail. Company B's local phone service is subject to sales tax. However, not all of the additional services will be subject to sales tax if separately stated on the customer's monthly bill. Call waiting, caller ID, call forwarding, distinct ringing, and similar service enhancements are acting upon the transmission itself and do not affect the information contained in the transmission. These services or enhancements are therefore subject to sales tax. Voice mail and similar services are value added services which utilize computer processing applications to act upon the information for purposes other than transmission. The main distinction between voice mail and the other services is that the other services enhance the telecommunication service itself rather than provide a distinct non-telecommunication service. Therefore, voice mail and similar services are not telecommunication services under the statute and not subject to sales tax if separately stated on the customer's monthly bill. These charges must be separately stated or they will be subject to tax as part of a taxable unitary transaction.

The voice mail service should not be confused with the transmission of voice mail messages. Company B must pay sales or use tax on the intrastate transmission of the messages unless Company B's purchase of telecommunication services is exempt from sales tax. (See Example 7.)

Example 4

Company C is a local convenience store that offers to fax customer's documents for a fee. This charge is not subject to sales tax. Company C is not providing telecommunication services, rather, Company C is providing a service whereby it digitizes a document and sends it to its intended destination using a telecommunication service. Company C is the end user of the telecommunication service and must pay sales tax on any intrastate transmissions.

Example 5

Company Z provides access to a computer database. Customers of Company Z access the database over telephone lines using a modem. Company Z charges its customers for the amount of time they are connected to the database. Company Z is not required to collect sales tax on its charges. Company Z is providing a value added service that is not subject to sales tax. The use of the telephone line to provide the service is subject to sales tax.

Public Utilities

The sale of telecommunication services to public utilities or any provider of telecommunication services are not subject to sales or use tax.

Example 6

Company D provides local telephone service to Company W. Company W is a public utility providing water service to the community. The sale of local telephone service to Company W is not subject to sales tax because Company W is a public utility.

Example 7

Company E provides cellular phone service to Company D. Company D provides local telephone service to Company E. Neither transaction is subject to sales tax because each is selling a telecommunication service to another provider of a telecommunication service.

Example 8

Company B is a local telephone service provider. Company B offers voice mail service to its customers. This service is not taxable. (See Example 3.) However, the fact that the voice mail service is not subject to tax does not exempt the use of telecommunication service in furtherance of that service. In this case, Company B is a telecommunication service provider and therefore its purchase or use of telecommunication service is exempt even when used in furtherance of a non-taxable service. If Company B was not a telecommunication service provider or a public utility, it would be required to pay sales or use tax on its purchase of telecommunication service in furtherance of its voice mail service.

Tangible Personal Property

A telecommunication service provider is not making a retail transaction subject to sales or use tax when it provides, installs, constructs, services, or removes tangible personal property which is used in connection with the furnishing of the telecommunication service.

Example 9

Company F is a paging services provider. Company F is not a public utility. The paging service is a telecommunication service and subject to sales tax. Company F provides its customers with a pager as part of the service. If there is a single charge for the service, then only that portion attributable to air time is subject to sales tax. The portion attributable to the providing of the pager itself is exempt. If Company F charges separately for air time and rents the pager, then both charges will be subject to sales tax. The difference being that providing only tangible personal property is exempt. In the latter case, the pager is rented not provided. (**Note**: Public utilities are not retail merchants making retail transactions when they lease or rent tangible personal property to another. Therefore, this analysis does not apply to public utilities. If the telecommunication service provider is a public utility, the charge for tangible personal property will be exempt unless the tangible personal property is being sold to the customer.)

The way that Company F contracts with its customers will determine whether Company F will pay sales or use tax when it purchases the pagers. If Company F charges separately for the pagers, it may purchase them exempt for resale or rental. However, if Company B provides the pagers as part of the service and does not charge separately for the pagers, it must pay sales or use tax on the purchase price of the pagers. (For additional information on purchases by telecommunication service providers see Example 11.)

Miscellaneous Charges

Charges for installing or servicing tangible personal property related to telecommunication service are not subject to sales tax.

Example 10

Company B is a local telephone service provider. Company B charges customers for initial hook-up and an additional charge if any labor is needed to physically connect the customer. The hook-up charge is subject to sales tax because it is a charge for telecommunication service. The charge for labor necessary to physically connect the customer is not taxable since it is not taxable since it is not a charge for telecommunication service.

Company B also offers a service whereby it will maintain the phone lines within the customers house for a fixed monthly fee. This charge is not for telecommunication service and is therefore not subject to sales tax.

Any parts used in providing these services are not subject to sales tax if provided by Company B. (See Example 9.)

Purchases by Telecommunication Service Providers

Transactions involving acquisition of tangible personal property by telecommunication service providers are exempt from sales tax if the property is classified as central office equipment, station equipment or apparatus, station connection, wiring, or large private branch exchanges according to the uniform system of accounts which was adopted and prescribed for the utility by the Indiana Utility Regulatory Commission. Mobile telecommunications switching office equipment and radio or microwave transmitting equipment, including, towers and antennae are also exempt. If the provider is not subject to the control of the Indiana Utility Regulatory Commission, then the exemption applies to any property similar to that mentioned above.

Example 11

Company B is a local telephone service provider. Company B is subject to the authority of the Indiana Utility Regulatory Commission. Company B will look to the uniform system of accounts for local telephone companies to determine whether property it leases or purchases is subject to sales or use tax.

Example 12

Company F is a paging services provider. Company F rents space on a local tower for its antenna. The rental charges are not subject to sales tax. The purchase or rental of the antenna is also exempt from sales tax.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #65
SALES TAX
DECEMBER 2002
(Replaces Bulletin #65 dated March 1993)

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

SUBJECT: Manufactured Homes (Mobile Homes)

REFERENCES: IC 6-2.5-5-29, 50 IAC 3.1-1-4, 45 IAC 2.2-5-65 through 45 IAC 2.2-5-69

I. Retail Sales of Manufactured Homes

The purchases of manufactured homes by authorized dealers are exempt from sales tax. The dealer shall issue a general exemption certificate, Form ST-105, to the manufacturer as a purchase for resale. When the dealer sells the manufactured home to the final consumer he is a retail merchant making a retail transaction. Accordingly, sales tax must be collected on the selling price of the manufactured home. Sales tax should be collected on sixty five percent (65%) of the selling price. Thirty five percent (35%) of the selling price is attributed to costs other than the cost of material used in manufacturing such structures. The selling price includes delivery, set-up, and utility connections as the manufactured home is not deemed delivered until it is set up.

II. Dealers of Manufactured Homes as Contractors

A dealer of manufactured homes is acting as a contractor when the dealer contracts to make an improvement to real estate by permanently affixing a manufactured home to real estate. A manufactured home is considered affixed to a permanent foundation to the extent that it cannot be moved without material and substantial change to the manufactured home and/or the land. The contract is for an improvement to realty even if the manufactured home is being permanently attached to land not owned by the purchaser of the manufactured home.

A permanent foundation would be evidenced by mortared walls of concrete block, brick, stone, tile, etc. or poured concrete. In these cases the foundation will be partially or totally load bearing. Additional elements that tend to indicate permanence include: permanent utility connections, room additions, patios and porches.

A dealer who permanently affixes a manufactured home to real property pursuant to a lump sum contract for sale without clearly separating selling price from permanent installation costs is acting as a lump sum contractor. When a dealer acts as a lump sum contractor, the dealer must remit use tax on sixty five percent (65%) of the wholesale invoice price of the manufactured home. Sales/use tax must be paid by the dealer on all materials and supplies used in the performance of the contract.

If the dealer segregates a contract into a time and materials contract, sales tax must be collected on sixty five percent (65%) of the unit's selling price and on the full sales price of other tangible personal property transferred as part of the time and material contract.

III. Pre-Owned Manufactured Homes

The gross retail income derived from the sale of a pre-owned manufactured home is exempt from the state gross retail tax.

IV. Modular Homes

Modular homes are not manufactured homes for purposes of this information bulletin. Modular homes are not attached to a chassis nor are the homes movable without specialized equipment. Modular homes are always permanently affixed to a permanent foundation. Thus, any contract to install a modular home is a contract for an improvement to realty. When a lump sum contract is used for sale and installation of a modular home, the contractor must pay sales or use tax on sixty five percent (65%) of the wholesale invoice price (his purchase price of the modular home). When any person purchases a modular home for the purpose of installing it for himself or another, the person shall pay sales or use tax on 65% of the purchase price of the modular home. If the person is acting as a contractor installing the modular home for another person, the contractor shall pay use tax on all materials used in installation.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #69
SALES TAX
DECEMBER 2002
(Replaces Bulletin #69 dated December 1999)

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

SUBJECT: Commercial Printers

REFERENCES: IC 6-2.5-1-10; IC 6-2.5-5-3; IC 6-2.5-5-4; IC 6-2.5-5-5.1; IC 6-2.5-5- 6; IC 6-2.5-5-36; IC 6-2.5-8-8.5

INTRODUCTION

This bulletin is to explain the tax exemption for items purchased by commercial printers.

Tax Exemptions for Items Purchased by Commercial Printers

IC 6-2.5-5-3 provides that "commercial printing as described in IC 6-2.5-10 shall be treated as the production and manufacture of tangible personal property." Commercial printing that is described in IC 6-2.5-10 is "the business of commercial printing that results in printed materials, excluding the business of photocopying." A commercial printer is, therefore, entitled to an exemption for machinery, tools and equipment that are directly used to perform a process or activity, or both, that is related to the production of printed materials for others. This includes equipment, (computers, scanners, etc.), that is used to perform what is commonly referred to as pre-press activities, which include the receiving, processing, moving, storing, and transmitting, either physically or electronically, of copy elements and images to be reproduced, and plate-making or cylinder-making. Exempt pre-press activities do not include drafting of copy or the creation of artwork for reproduction.

Commercial printers are also exempt from sales/use tax on purchases of capital equipment, consumables, and materials used in commercial printing under IC 6-2.5-5-4, IC 6-2.5-5-5.1 and IC 6-2.5-5-6. Like other manufacturers, commercial printers may also be exempt from tax under other sections of the Code.

A business or part of a business that performs one or more, but not all, of the processes or activities related to the production of printed materials (such as a pre-press house) is also exempt from sales and use tax on its purchases of machinery, tools and equipment, consumables, and materials, to the same extent that a business that performs all such commercial printing processes or activities would be exempt on its purchases of the same items. An exempt process or activity related to the production of printed materials should not become taxable simply because it is performed by an entity separate from the entity that performs the rest of the commercial printing processes or activities. Photocopying is expressly excluded from the type of commercial printing that is entitled to exemption under IC 6-2.5-5-3, IC 6-2.5-5-4, IC 6-2.5-5-5.1, and IC 6-2.5-5-6.

A commercial printer must collect and remit Indiana sales tax on the full price charged to the customer for the tangible personal property sold, unless the transaction is otherwise exempt from tax or the customer provides a direct pay permit, exemption certificate or a statement under IC 6-2.5-8-8.5.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #72
INCOME TAX
JANUARY 2003
(Replaces Information Bulletin #72 dated June 1993)

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

SUBJECT: S Corporation/Partnership/Fiduciary Election to File Composite Return On Behalf of Nonresident Shareholders/Partners/Beneficiaries

REFERENCES: IC 6-3-4-12, IC 6-3-4-13, IC 6-3-4-15

An S corporation, partnership or fiduciary may file a composite adjusted gross income tax return on behalf of some or all nonresident shareholders, partners or beneficiaries. Due to the similar treatment of composite returns for corporations, partnerships and fiduciaries, whenever this bulletin mentions "corporation" or "shareholder", it refers to the S corporation/partnership/fiduciary and the shareholder/partner/ beneficiary, respectively. If the nonresident shareholders properly elect to participate in a composite return, they will be relieved of the obligation to file an individual adjusted gross income tax return.

Any shareholder falling within the following categories must, in all cases, be excluded from the composite return:

a) any shareholder that is a corporation, partnership, or fiduciary;
b) any shareholder who received a distribution(s) during the year in excess of his/her distributive share of the corporation's ordinary income;
c) any shareholder who during the taxable year sold any portion of his/her interest in the corporation;
d) any shareholder who received income during the year from an Indiana source other than the corporation;
e) any shareholder who for a portion of the year was a resident of Indiana.

Those shareholders who for any reason are not included in the composite return must file Indiana Part-Year or Nonresident Income Tax Returns (Form IT-40PNR). The names, addresses and social security numbers of these excluded shareholders must be disclosed on the composite return.

The following limitations and conditions shall apply to those shareholders included in the composite return:

a) any short term capital gain (loss) plus any long term capital gain (loss) specifically allocated to partners shall be allowed subject to any "passive activity" loss limitations pursuant to IRC Section 469 and capital loss limitations imposed on noncorporate taxpayers by IRC Section 1211;
b) no deduction shall be permitted for interest paid on investment indebtedness under Section 163(d) of the IRC (limitation on interest investment indebtedness);
c) no deduction shall be permitted for net operating losses;
d) no personal exemptions shall be permitted;
e) no deduction shall be allowed for charitable contributions allowed or allowable pursuant to Section 170 of the Internal Revenue Code;
f) any college credit for individual contributions is limited on the composite return to the lower of each shareholder's state tax liability or $100 (no joint credit with spouse is permitted);
g) no credit is permitted for taxes paid to other states;

h) no credit carryovers are permitted.

i) any refund of state and/or county taxes will be remitted directly to the corporation.

Composite Filing Procedures

1) Send a copy of composite filing procedures for nonresident shareholders to each nonresident shareholder. The corporation must ascertain which shareholders elect to be included in the composite return and which shareholders do not elect to be included.

2) (a) Prepare a comprehensive schedule which sets out the calculation of tax attributable to each nonresident shareholder. Indicate the names, addresses and social security numbers of those individuals included in the composite return. Subject to the exemptions, deductions and credit limitations above, separately compute the Indiana tax liability of each nonresident shareholder who has authorized the corporation to file on his/her behalf. Attach this schedule to the Small Business Corporation Return (Form IT20S), the Partnership Return (Form IT-65), or the Fiduciary Income Tax Return (Form IT-41).

(b) For a partnership, composite income means each nonresident partner's distributive share of income from the partnership which is derived from sources within Indiana as determined by the use of the apportionment formula described in IC 6-3-2-2(b) on the partnership's income.

(c) Any limitations imposed on the respective shareholders by Section 469 of the Internal Revenue Code (passive activity loss rules) will apply to the composite return.

(d) For the beneficiary of a trust or estate, composite income means all distributions subject to Indiana adjusted gross income tax. For further information, see Information Bulletin #1, Fiduciary Income Tax Return.

3) On Form IT-20S, IT-65, or IT-41 enter the total tax liability of those nonresidents included in the composite return. Insert this amount on the line for "other tax" or "additional tax".

4) Insert the total tax withheld on behalf of the nonresident shareholders included in the composite return on the line for "other credits." This amount plus the total tax withheld on behalf of the nonresident shareholders not included in the composite return should conform to the Annual Reconciliation of Withholding (Form WH-3).

5) Attach a second schedule of names, addresses, social security numbers, the individual distributive shares and tax withheld for those shareholders who for any reason were excluded from the composite return.

6) On a monthly or quarterly basis, using Form WH-1 (Employers Withholding Tax Return), submit withholding tax payments on behalf of all nonresident shareholders along with any withholding for corporate employees.

7) File copy A of Form WH-18 (Indiana Miscellaneous Withholding Tax Statement for Nonresidents) with the Department of Revenue together with Form WH-3 (Annual Withholding Reconciliation) by February 28.

Copy B should be given to the recipient for their records.

Copy C should be attached to the composite return.

Copy D is for the payer's records.

Form WH-3 is mailed automatically to the payer in January.

The corporation filing a composite return for the nonresident shareholders is liable not only for the tax shown on the return but also for any additional tax, interest, and penalty as a result of a subsequent audit and examination.

The composite return shall be due with the corporation return. If the IRS allows the corporation an extension on its federal income tax return, the corresponding due dates for its Indiana income tax returns are automatically extended for the same period, plus thirty (30) days.

For purposes of IC 6-8.1-5-2(a), the return referred to is the composite return for those shareholders properly included in the composite return.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #79
INCOME TAX
JANUARY 2003
(Replaces Information Bulletin #79 dated June 1995)

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

SUBJECT: Income Derived From Investment Funds Holding U.S. Government Obligations
REFERENCES: IC 6-3-1-3.5; 45 IAC 1-1-127; 45 IA C 3.1-1-5
INTRODUCTION

The proportionate share of dividends or interest received from a mutual fund, regulated investment trust, or other fund derived from investments in direct federal government obligations may be deducted from Indiana adjusted gross income. This deduction is allowed only to the extent that such income is included in Indiana adjusted gross income. Earnings from investments in repurchase agreements do not qualify for this deduction. They are not considered to be derived from direct obligations of the federal government.

Distributions from individual retirement accounts (IRAs), pensions, and annuities represent ordinary income. Such investments do not qualify for a modification for interest earned on United States government obligations.

For further information on direct United States government obligations, please consult Income Tax Information Bulletin #19.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #85
NOMINEE WITHHOLDING PROCEDURES
JANUARY 2003
(Replaces Information Bulletin #85 dated September 1992)

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

SUBJECT: Nominee Withholding Procedures for Small Business Corporations, Partnerships and Fiduciaries
REFERENCES: IC 6-3-4-12; IC 6-3-4-13; IC 6-3-4-15

Withholding Requirements

Small business corporations (as defined in Section 1361 of the Internal Revenue Code), partnerships, trusts and estates must withhold Indiana adjusted gross income tax from certain payments or credits of income to nonresidents. The withholding agent must report the net income and tax withheld from this income on Form WH-18, Indiana Miscellaneous Withholding Tax Statement for Nonresidents. Withholding is required when:

a. a small business corporation pays or credits Indiana income amounts to any of its non-Indiana resident shareholders as taxable dividends or undistributed taxable income that was not previously taxed (IC 6-3-4-13);

b. a partnership pays or credits Indiana income amounts to any of its non-Indiana resident partners on their distributive shares of partnership income (IC 6-3-4-12), unless the partner is a foreign corporation qualified to do business in Indiana; or

c. a trust or estate (fiduciary) distributes Indiana income (except income attributable to interest or dividends) to a non-Indiana resident beneficiary (IC 6-3-4-15).

The nonresident shareholder, partner, or beneficiary is entitled to claim credit for the withheld tax when filing the proper Indiana return.

Nominee Withholding Procedures

If a small business corporation, partnership, or fiduciary withholds tax from income distributions to a nonresident small business corporation, partnership or fiduciary which in turn passes through the income to a nonresident shareholder, partner, or beneficiary, the original withholding agent may designate the ultimate nonresident recipient as a "Nominee" recipient who may then claim the withheld Indiana tax.

Example. Indianapolis Partners, Ltd., an Indiana partnership, distributes $1,000 of Indiana source rental income to one of its partners, the Ohio Revocable Trust located in Columbus, Ohio. The Ohio Revocable Trust is a simple trust which distributes all current income to the sole beneficiary, John Jones, a resident of Ohio. Indianapolis Partners, Ltd., must withhold $34 (3.4% of $1,000) from the distribution to the Ohio Revocable Trust.

Indianapolis Partners, Ltd., may designate John Jones as the "nominee" recipient of the income distribution on Form WH-18. The Form WH-18 must show the names and addresses of both the Ohio Revocable Trust and John Jones. The federal identification number of the trust would appear in the recipient's block next to the trust's name and address. Jones' social security number must appear in the block specified for "Recipient's Federal ID or SS Number."

Following the end of the partnership's tax year, Indianapolis Partners, Ltd. provides copies B and C of Form WH-18 to the Ohio Revocable Trust. The trust provides Copy C to John Jones for filing with John Jones' IT-40PNR. John Jones reports the $1,000 rental income on his IT-40PNR. The trust reports the $1,000 income and $1,000 distribution deduction on the federal fiduciary return, Form 1041. The trust's Indiana fiduciary return (IT-41) reports no taxable income due to distributions. The trust must attach a copy of the Form WH-18 showing the "pass through" of the withheld income tax to John Jones.

NOTE: If there is more than one partnership or fiduciary between the withholding agent and ultimate beneficiary, the withholding agent may complete Form WH-18 to reflect the initial distribution and nominee beneficiary as if there were no intermediary entities. Intermediary entities must attach a copy of the Form WH-18 to their returns to show the ultimate nominee beneficiary.

Example: Smith Farms, Inc., an Indiana S Corporation, distributes $10,000 of Indiana source farm income to the Estate of Mary Smith, an Illinois shareholder. The Estate of Mary Smith in turn distributes the income to two Illinois Trusts, the Smith Marital Trust and the Smith Credit Trust. The two trusts in turn distribute the income to Sam Smith, also a resident of Illinois.

Smith Farms, Inc. would complete Form WH-18 showing the Estate of Mary Smith and Sam Smith as the nominee recipient. The Estate of Mary Smith and the two trusts would each file Form IT-41 with a copy of the Form WH-18. Sam Smith would report the $10,000 of Indiana source income on his IT-40PNR and claim credit for the $340 of withheld tax.

Additional Information

Additional information about Indiana withholding requirements may be obtained from Information Bulletin #28, Application of State and County Adjusted Gross Income Tax to Residents with Out-of-State Income and Non-Residents with Indiana Source Income.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE

02980495.LOF

LETTER OF FINDINGS NUMBER: 98-0495
Adjusted Gross Income Tax
For Calendar Years 1992, 1993, 1994, and 1995

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

ISSUE(S)

I. Net Operating Loss – Carryback

Authority: 45 IAC 3.1-1-9

Taxpayer protests the adjustment to the net operating loss.

STATEMENT OF FACTS

Taxpayer protests the audit adjustment to its net operating loss. Taxpayer was audited for calendar years 1992 through 1995. The income before nonbusiness income was adjusted for the addback of property and income taxes deducted in arriving at Federal Taxable Income before NOL and special deductions. The apportionment factors were also adjusted as shown in the audit report. The aforementioned adjustments affected the taxable income for the years 1992 and 1993 and the losses for the years 1994 and 1995. The taxpayer had not elected to forgo the loss carry back, therefore, the 1994 loss was required to be carried back three years, however, this 1994 loss could not be applied to 1991 since 1991 was a loss year. As a result of the audit, the net operating loss for 1994 was applied to reduce the taxable income to zero for 1992 and 1993 with a $514,512 net operating loss available for carryforward to future periods.

Taxpayer filed a protest letter dated August 17, 1998 that states that it does not agree with the auditor's calculations. Taxpayer further states that detailed information would be provided and wishes to arrange for a meeting to discuss the issues.

In letters dated September 9, 1999, October 13, 1999, November 10, 1999, February 29, 2000, November 28, 2000, January 30, 2001, and February 6, 2001, the Department asked the taxpayer to provide detail regarding its objections to the audit. In a telephone conversation, it was determined that the taxpayer protests the loss carryforward adjustments. On March 16, 2001, a hearing was scheduled for April 4, 2001 that the taxpayer cancelled. On June 19, 2002 a hearing was rescheduled for July 17, 2002 that the taxpayer cancelled. On July 31, 2002 after discussions with the taxpayer's representative, a copy of the audit was mailed with a letter stating that the department must have a detailed brief. On September 9, 2002 the hearing officer allowed until November 15, 2002 for the taxpayer to provide a written brief and followed the discussion with a letter stating that no further extensions would be allowed.

I. Net Operating Loss – Carryback

DISCUSSION

Taxpayer protested the audit but has provided no detail or reasons for its disagreement. During a conversation with the hearing officer, it was determined that the taxpayer disagrees with the loss carryforwards as shown in the audit report.

The taxpayer did not elect to forgo the loss carryback in 1994 and did not carry the loss back or forward. The 1994 loss was required to be carried back three years; however, the 1994 loss could not be applied to 1991 since 1991 was a loss year. As a result, the net operating loss from 1994 was applied to reduce the taxable income to zero for 1992 and 1993 with a $514,512 net operating loss available for carryforward to future periods.

On numerous occasions, the Department asked for detail regarding taxpayer's objections to the audit. No information has been provided the Department.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 99-0375 & 99-0490
Gross Income & Sales/Use Tax
For the Years 1996, 1997, 1998

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

ISSUES

I. Withholding – Application to Out-of-State Contractors

Authority: IC 6-2.1-6-1; IC 6-2.1-3; 45 IAC 1-1-213; 45 IAC 1-1-121; 45 IAC 1-1-124; *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)

Taxpayer protests the Department's assessment of the gross income tax on payments for an amusement park ride to a non-resident contractor.

II. Sales/Use Tax – Application to Income from Lockers

Authority: IC 6-2.5-2-1; IC 6-2.5-3-1; IC 6-2.5-4-1; IC 6-2.5-4-4; IC 6-2.5-4-10

Taxpayer protests the Department's assessment of the sales/use tax on Taxpayer's locker rentals.

III. Sales/Use Tax – Application to Shuttle Bus

Authority: IC 6-2.5-5-27; 45 IAC 2.2-3-22, 45 IAC 2.2-5-61; *Panhandle Eastern Pipeline Company v. Indiana Department of State Revenue*, 741 N.E.2d 816 (Ind. Tax Ct. 2001)

Taxpayer protests Department's assessment of the sales/use tax on the Taxpayer's shuttle bus.

STATEMENT OF FACTS

The Taxpayer is an amusement resort located in Indiana. A majority of the accommodations are within a short walking distance from the attractions and amusements. Guests may stay at a cottage, inn, motel, or suite and receive free passes for general admission to the park. A private swimming pool, camping, and cabins are also available. Shuttle buses are available to transport guests to and from the campground. There are 26 adult rides and 9 kiddy rides as well as a wide variety of gift, souvenir, and sportswear shopping.

Some of the Taxpayer's operations are leased to independent contractors. These operations include most of the concession stands, games of chance, and souvenir stands. The operators of these facilities pay a percentage of their gross revenue to the taxpayer, which is classified as concession revenue.

An examination of the taxpayer's method of collecting and remitting withholding tax was conducted. The examination revealed that, during 1998, the Taxpayer purchased an amusement ride from a Florida corporation. The manufacturer billed the Taxpayer separately for the "labor and material to construct the ride." Taxpayer paid use tax on the portion of the bill identified as material. The ride was constructed in Florida, shipped to Indiana, and then installed by the manufacturer at the Taxpayer's Indiana business location. The manufacturer is a regular "C" corporation which is not qualified with the Indiana Secretary of State to conduct business within Indiana. Manufacturer has also never filed an Indiana income tax return.

In addition, the Taxpayer provides lockers for rent so that individuals can store their clothes while swimming. Taxpayer did not collect sales and use tax on these rentals of tangible personal property. Furthermore, during 1996, the Taxpayer purchased a shuttle bus. The bus was used to transport individuals to and from the park to their accommodations. No tax was paid to the vendor or the Bureau of Motor Vehicles on the purchase of the bus.

I. Withholding – Application to Out-of-State Contractors

DISCUSSION

Taxpayer argues that to impose withholding is improper as Taxpayer allegedly falls under an exception to the withholding requirement. Alternatively, Taxpayer argues that the imposition of the withholding tax is in violation of the Commerce Clause of the U.S. Constitution. The Taxpayer argues that taxing the purchase and subsequent installation of the ride is in violation of the Commerce Clause as the purchase is alleged to be solely within interstate commerce.

The Indiana Code provides for withholding tax in this situation, and IC 6-2.1-6-1 states in relevant part:

(a) As used in this section, "nonresident contractor" does not include a foreign corporation qualified to do business in Indiana.

(b) Except as provided in subsection (c), each calendar year each individual, firm, organization, or governmental agency of any kind who makes payments to a nonresident contractor for performance of any contract, except contracts of sale, shall withhold from such payments the amount of gross income tax owed upon the receipt of those payments under this article. When withholding the gross income tax, the withholding agent shall compute the amount owed by applying the highest rate applicable under IC 6-2.1-2 to any portion of the payments.

As such the manufacturer meets the definition of a nonresident contractor as defined by both IC 6-2.1-6-1 and 45 IAC 1-1-214. The administrative regulations provide guidance in this area as well. 45 IAC 1-1-213 provides in relevant part:

Withholding for Gross Income Tax Purposes Indiana gross income tax is required to be withheld from any and all payments made to a nonresident contractor for performance of any work or services which are taxable to the State of Indiana. The withholding will be made at the higher rate under IC 6-2-1-3(g) on all payments made during the year to an nonresident contractor which exceeds the sum of $1,000.

At the time of the purchase of the ride, 45 IAC 1-1-121 stated in relevant part:

Sec. 121 Income from the Performance of a Contract or Service. Gross income derived from the performance of a contract or service within Indiana is subject to gross income tax. Below is a list of some of the situations, which have arisen in dealing with service income, with an indication of the taxability of each:...

(c) Gross receipts from contracts entered into by nonresidents to furnish and install tangible personal property in Indiana are subject to gross income tax. See <u>Holland Furnace Co. v. Department of Treasury</u>, 133 F.2d 212 (7th Cir., 1943), cert. Denied, 320 U.S. 746 (1943). The problem with these and similar cases (see Regulation 6-2-1-7(a)(030) *[45 IAC 1-1-120; now 45 IAC 1.1-3-3]*, <u>Gross Income Tax Div. V. Surface Combustion Corp.</u> *supra*) is in deciding if the contract is simply one of sale with incidental services taking place within the State, which may be tax-exempt as a transaction in interstate commerce, or one of service which is taxable if it takes place in Indiana. The Department interprets the relevant court decisions to mean that whenever a product is shipped in parts as a convenience to transportation and the seller then assembles it or supervises assembly on the customer's premises, the transaction is a sale if the following conditions are met: Installation consists of no more than setting the product on bases or connecting it to pipes, wires, supports, etc., provided by the customer; the product remains personal property after installation; the property is suitable for sale to other customers in the regular course of the seller's business; and the service necessary to installation is of such a technical nature that only the seller is capable of providing the necessary skilled workmen. *If these conditions are not met or if, in addition to assembly, the seller performs additional services, such as installation, testing, construction, etc., the transaction will not be considered a sale, but will be treated as a construction contract... (emphasis added).*

The Taxpayer relies on the idea that the purchase and subsequent installation of the ride was a single "contract of sale," and thus, falls under the exception to the withholding requirement set forth under IC 6-2.1-6-1. This argument is faulty, as the Taxpayer has offered no proof that the shipment of the ride to Taxpayer only involved the mere assembly without installation, testing, or construction. Indeed, the record indicates taxpayer paid use tax on only a portion of the purchase price of the item, breaking out the associated labor costs for the assembly and delivery of the equipment- including information on the portions of the labor costs for the out-of-state location and Indiana.

IC 6-2.1-3-3 requires in relevant part "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," to the extent that the labor costs occurred out-of-state, the withholding requirement would not apply to the portion of the contract identified as payments for labor costs related to the manufacture of the tangible personnel property while out-of-state.

Taxpayer cites *Gross Income Tax Division of Indiana v. Surface Combustion Corp.*, 111 N.E.2d 50 (Ind. 1953), for the Taxpayer's alternative reliance upon the Commerce Clause of the United States Constitution but, ignores the general rule that taxing interstate commerce is governed by four requirements: 1) the tax is applied to an activity with a substantial nexus to the taxing state; 2) the tax is fairly apportioned; 3) the tax does not discriminate against interstate commerce; 4) the tax is fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). In the Taxpayer's situation, all four requirements are met. First, the Taxpayer has substantial nexus to this state as it is an Indiana business with its principal place business and the park at issue here within the state of Indiana. Second, the withholding tax is fairly apportioned to all Indiana residents who fall under

IC 6-2.1-6-1. Third, the tax does not discriminate against interstate commerce because Indiana residents are required to collect the same tax for work done by Indiana residents. Fourth, the tax is fairly related to the services provided by Indiana.

Therefore, without proof that the ride manufacturer's workmen were present for the mere purpose of assembly the Taxpayer's constitutional argument must fail. Additionally; the facts meet the requirements set out in *Complete Auto* for a state's taxing without offending the Commerce Clause.

FINDING

Taxpayer's protest is denied as to the Indiana labor costs and sustained as to withholding on the out-of-state labor costs.

II. Sales/Use Tax – Application to Income from Lockers

DISCUSSION

Taxpayer protests the Department's assessment of the sales/use tax on the Taxpayer's rental lockers.

IC 6-2.5-2-1 provides in relevant part:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

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

IC 6-2.5-3-1 provides definitions and states in relevant part:

(a) "Use" means the exercise of any right or power of ownership over tangible personal property.

(b) "Storage" means the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana.

IC 6-2.5-4-1 provides in relevant part:

(a) A person is a retail merchant making a retail transaction when he engages in selling at retail.

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

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

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

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

(3) the property is transferred conditionally or otherwise.

IC 6-2.5-4-10 provides in relevant part:

(a) A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person.

IC 6-2.5-4-4 provides in relevant part:

(a) A person is a retail merchant making a retail transaction when the person rents or furnishes rooms, lodgings, or other accommodations, such as booths, display spaces, banquet facilities, and cubicles or spaces used for adult relaxation, massage, modeling, dancing, or other entertainment to another person:

(1) if those rooms, lodgings, or accommodations are rented or furnished for periods of less than thirty (30) days; and

(2) if the rooms, lodgings, and accommodations are located in a hotel, motel, inn, tourist camp, tourist cabin, gymnasium, hall, coliseum, or other place, where rooms, lodgings, or other accommodations are regularly furnished for consideration.

The Taxpayer's argument regarding the imposition of sales tax upon the rental lockers is that the lockers are permanently attached to the Taxpayer's real estate and cannot be removed without causing damages to the premises or lockers. Thus, the lockers are not tangible personal property, which is the focus of the tax imposed by IC 6-2.5-4-10(a). The Department, while in no way conceding that the lockers are to be considered real property and only for the sake of illustration, would note that even if it accepted taxpayer's bare assertion-unsupported by statute, regulation, or case law- that the rental lockers are not tangible personal property, the underlying facts would demonstrate this to be a transaction involving the rental of accommodations for less than 30 days. Such activity would still be considered a retail transaction under, IC 6-2.5-4-4 thus rendering taxpayer's argument moot.

IC 6-2.5-4-1 is applicable to taxpayer's rental of these lockers, which is the rental of tangible personal property and which constitutes a taxable retail transaction. Therefore, the rental of the lockers is taxed pursuant to IC 6-2.5-2-1.

FINDINGS

Taxpayer's protest is denied.

III. Sales/Use Tax –Application to Shuttle Bus

DISCUSSION

Taxpayer protests the assessment of sales/use tax on the Taxpayer's purchase of a shuttle bus for use in Taxpayer's business.

IC 6-2.5-5-27 provides in relevant part:

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

45 IAC 2.2-3-22 provides in relevant part:

No vehicle shall be licensed by Indiana for highway use in Indiana unless the registered owner thereof shall present to the licensing agency at the time such vehicle is first licensed in his name proper evidence, as prescribed by the Department, of the payment of the state gross retail tax or use tax owing in respect to his acquisition of ownership of such vehicle, or shall then pay to such agency upon forms and receipts prescribed by the Department, the amount of any such tax owing and unpaid on the purchase of such vehicle.

45 IAC 2.2-5-61 provides in relevant part:

(a) The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property.

(b) Definition: Public Transportation. 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,...; however, the fact that a company possesses a permit or authority... 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.

Taxpayer relies upon IC 6-2.5-5-27 for the proposition that the purchase of its bus is exempt from the sales/use tax. Taxpayer maintains this position despite not being in predominantly engaged in the business of transporting property. The Indiana Tax Court has expressed a position contrary to that of the Taxpayer in *Panhandle Eastern Pipeline Company v. Indiana Department of State Revenue*, 741 N.E.2d 816 (Ind. Tax Ct. 2001). There, in discussing the exemption provided by IC 6-2.5-5-27, it was held, "if a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominantly engaged in transporting the property of another, it is not entitled to the exemption." *Id.* at 819. Therefore, although the bus may be primarily used for the transportation of the taxpayer's guests, since the Taxpayer is not predominantly engaged in the transporting of the property of another, it is not entitled to the exemption.

FINDINGS

Taxpayer's protest is denied.

DEPARTMENT O F STATE REVENUE

04990460.LOF

LETTER OF FINDINGS NUMBER: 99-0460
Gross Retail and Use Tax
For the Period 1995–97

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

The Department restates the issue the taxpayer has raised into the following issues:

I. Gross Retail and Use Tax – Status of Personal Property as Tangible or Intangible –"Pre-Written," "Canned" or "Off-the-Shelf" Software

Authority: 17 U.S.C. §§ 101 and 202 (1994 and 2000); I.R.C. (26 U.S.C.) § 38 (1988 and 1994); IC §§ 6-2.5-3-1(a), -2(a) (1993); *Stephens v. Cady*, 55 U.S. (14 How.) 528 (Dec. Term 1852); *Williams Elecs., Inc. v. Arctic Int'l, Inc.*, 685 F.2d 870 (3d Cir. 1982); *Norwest Corp. v. Commissioner*, 108 T.C. 358 (U.S. Tax Ct. 1997); *Wal-Mart Stores, Inc. v. City of Mobile*, 696 So.2d 290 (Ala. 1996); *Bernstein v. Glavin*, 725 N.E.2d 455 (Ind. Ct. App.), *trans. denied* 741 N.E.2d 1248 (Ind. 2000); *South Cent. Bell Tel. Co. v. Barthelmy*, 643 So.2d 1240 (La. 1994); *Comptroller of the Treasury v. Equitable Tr. Co.*, 464 A.2d 459 (Md. 1983); *First Data Corp. v. Nebraska Dep't of Revenue*, 639 N.W.2d 898 (Neb. 2002); *A & D Tech. Supply Co. v. Nebraska Dep't of State Revenue*, 607 N.W.2d 857 (Neb. 2000); *Hasbro Indus., Inc. v. Norberg*, 487 A.2d 124 (R.I. 1985); *Citizens and S. Sys., Inc. v. South Carolina Tax Comm'n*, 311 S.E.2d 717 (S.C. 1984); *South Cent. Utah Tel. Ass'n, Inc. v. Auditing Div.*, 951 P.2d 218, 224 (Utah 1997); *Chittenden Tr. Co. v. King*, 465 A.2d 1100 (Vt. 1983); *Pennsylvania and W. Va. Supply Corp. v. Rose*, 368 S.E.2d 101 (W. Va. 1988); Sales Tax Information Bulletin # 8 (1990)

The taxpayer argues that the software transactions in issue involved nontaxable licenses of intangible personal property, rather than leases of taxable tangible personal property.

II. Gross Retail and Use Tax – Retail Unitary Transactions –"Pre-Written," "Canned" or "Off-the-Shelf" Software

Authority: 17 U.S.C. §§ 101, 202 and 204(a) (1994 and 2000); IC §§ 6-2.5-1-1, -1-2, 3-2(a), -4-1 (1993); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Effects Assocs., Inc. v. Cohen*, 908 F.2d 555 (9th Cir. 1990); *RRX Indus., Inc. v. Lab-Con,* *Inc.*, 772 F.2d 543 (9th Cir. 1985); *Earman Oil Co. v. Burroughs Corp.*, 625 F.2d 1291 (5th Cir. 1980); *Shugrue v. Continental Airlines, Inc.*, 977 F. Supp. 280 (S.D.N.Y. 1997); *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994); *Colonial Life Ins. Co. v. Electronic Data Sys. Corp.*, 817 F. Supp. 235 (D. N.H. 1993); *Aplications,* [sic] *Inc v. Hewlett-Packard Co.*, 501 F. Supp. 129 (S.D.N.Y. 1980), *aff'd* 672 F.2d 1076 (2nd Cir. 1982); *Chatlos Sys., Inc. v. National Cash Register Corp.*, 479 F. Supp. 738 (D. N.J. 1979), *aff'd and remanded* 635 F.2d 1081 (3rd Cir. 1980); *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39 (D. S.C. 1974); *Neilson Bus. Equip. Ctr., Inc. v. Monteleone,* 524 A.2d 1172 (Del. 1987); *Bernstein v. Glavin*, 725 N.E.2d 455 (Ind. Ct. App.), *trans. denied* 741 N.E.2d 1248 (Ind. 2000); *Cowden & Sons Trucking, Inc. v. Indiana Department of State Revenue,* 575 N.E.2d 718 (Ind. Tax Ct. 1991); *South Cent. Bell Tel. Co. v. Barthelmy*, 643 So.2d 1240 (La. 1994); *Austin's of Monroe, Inc. v. Brown*, 474 So.2d 1383 (La. Ct. App. 1985); *Comptroller of the Treasury v. Equitable Tr. Co.*, 464 A.2d 459 (Md. 1983); *USM Corp. v. Arthur D. Little Sys., Inc.*, 546 N.E.2d 888 (Mass. Ct. App. 1989); *Communications Groups, Inc. v. Warner Communications, Inc.*, 527 N.Y.S.2d 341 (N.Y. Civ. Ct. 1988); *Hasbro Indus., Inc. v. Norberg,* 487 A.2d 124 (R.I. 1985); *Crescent Amusement Co. v. Carson,* 213 S.W.2d 27 (Tenn. 1948); *Camara v. Hill*, 596 A.2d 349 (Vt. 1991); *Chittenden Tr. Co. v. King*, 465 A.2d 1100 (Vt. 1983); *Pennsylvania and W. Va. Supply Corp. v. Rose,* 368 S.E.2d 101 (W. Va. 1988); 45 IAC § 2.2-4-2 (1992 and 1996)

The taxpayer contends that the true object of the assessed transactions was the licensing of software, not the leasing of the tangible personal property on which the software was located.

STATEMENT OF FACTS

During calendar years 1995-97 ("the audit period") the taxpayer, an Indiana-chartered corporate manufacturer, changed the software it used at its Indiana headquarters. The taxpayer obtained copies of two non-customized software application programs (commonly referred to as "pre-written," "canned" or "off-the-shelf" software) from the same transferor, which also provided the taxpayer with consulting and training services and maintenance agreements. As evidence of the terms of the transaction, the taxpayer has tendered in evidence a "Software License Agreement" (hereinafter "the Agreement") for the copies of the applications obtained from the taxpayer's transferor, together with the addenda and attachments to that agreement. The taxpayer paid no gross retail tax at the time it obtained the copies of the software.

Relying in part on Sales Tax Information Bulletin # 8, the field auditor assessed use tax on everything obtained from the software transferor except the consulting and training charges, which the transferor had stated separately on its invoices to the taxpayer. The taxpayer timely protested the part of the proposed assessment levied on the copies of the canned software. The Department will provide additional facts below in the Discussion if and as needed.

SUMMARY OF FINDINGS

For the reasons set out below, the Department finds that the pre-written software the taxpayer obtained was tangible personal property, and as such the taxpayer's use of it was subject to tax. Accordingly, the Department sustains the assessment and denies the taxpayer's protest.

I. Gross Retail and Use Tax – Status of Personal Property as Tangible or Intangible –"Pre-Written," "Canned" or "Off-the-Shelf" Software

DISCUSSION

A. INTRODUCTION: THE TAXPAYER'S ARGUMENT

The taxpayer argues that the assessed software transactions are excluded from imposition of gross retail (i.e., sales) and use taxes. It bases its position on three propositions: first, that the Gross Retail and Use Tax Act applies only to tangible, not intangible, personal property; second, that canned software programs, and licenses of such applications, are intangible personal property; and third, that canned software programs therefore are not subject to imposition of Indiana sales or use taxes by virtue of being intangible personal property.

The taxpayer supports the first proposition by pointing to the references to tangible, and the lack of any references to intangible, personal property in several sections of the Gross Retail and Use Tax Act as evidence that it does not apply to intangible personal property. *See, e.g.*, IC § 6-2.5-3-2(a) (the use tax imposition statute). The taxpayer also construes "tangible" as being a synonym of "corporeal," and "intangible" as being a synonym of "incorporeal," citing to legal dictionary definitions of "corporeal" and "corporeal property" to support its interpretation. *See* BLACK'S LAW DICTIONARY 310 (5th ed. 1979) (defining "corporeal" and "corporeal property," and contrasting corporeal and incorporeal property). In addition, the taxpayer contends that a statute imposing a listed tax must be construed against the Department (i.e., against taxability) and in favor of the taxpayer. As authority for this position it cites *Lincoln National Life Insurance Company v. Department of State Revenu*e, [1955-1986 Transfer Binder] Ind. Tax Rep. (CCH) ¶ 200-460 (Noble County Cir. Ct. Oct. 20, 1981), [1955-1986 Transfer Binder] Ind. Tax Rep. (CCH) ¶ 200-460, Conclusion of Law 3, at 10,773.

In support of its second proposition, the taxpayer submits that off-the-shelf software programs are not corporeal, and therefore are incorporeal and intangible, as distinguished from the packages containing them. In the taxpayer's view software programs are intangible partly because they are intellectual property and partly because they are not perceivable by any of the senses. The Department infers from the latter argument that the taxpayer is referring to the unaided senses.

The taxpayer's third proposition is based on the second. Based on the premise that, in the taxpayer's view, the canned software applications and the licenses of those programs are intangible rather than tangible personal property, it contends that they are therefore also not subject to imposition of Indiana gross retail and use taxes. The taxpayer further submits that the Department made an unauthorized attempt to expand the sales and use tax imposition statutes to apply to off-the-shelf software applications by issuing Sales Tax Information Bulletin # 8, which the taxpayer submits the decision in *Lincoln National* issued shortly thereafter superseded in any case.

As supporting authority for its argument, the taxpayer cites to *Lincoln National* and to *Manpower International, Inc. v. Wisconsin Department of Revenue*, [1993-1998 Transfer Binder], Wis. Tax Rep. (CCH) ¶ 400-240 (Wis. Ct. App. Aug. 22, 1996). These opinions, of an Indiana trial court and the Wisconsin Court of Appeals, respectively, neither of which is published in the respective official state reports, each held that canned computer software is intangible rather than tangible personal property and as such not subject to sales tax. The taxpayer also cites to statutory definitions of "tangible personal property" or "corporeal personal property," all of which explicitly include computer software (usually canned, off-the-shelf or non-customized), from the gross retail and use tax laws of nine other states. The taxpayer argues that these definitions support the idea that pre-written software applications are tangible personal property, and as such are subject to state sales and use taxes, only if the legislature in question has explicitly so defined the term "tangible personal property." Since, in the taxpayer's view, the Indiana General Assembly has not done so, canned software is not "tangible personal property" the use of which is subject to Indiana use tax. The taxpayer refers to IC § 6-2.5-3-1(d), which refers to both tangible and intangible personal property, as evidence that the legislature understands the difference between them. Lastly, the taxpayer cites to IC § 6-1.1-10-39 and 50 IAC § 4.2-4-3(g)(3), and to Rev. Proc. 69-21, 1969-2 C.B. 303, all of which the taxpayer contends treat software programs as being intangible personal property or an intangible asset. The Department will refer in the following Discussion to additional details of the taxpayer's argument if and as needed.

B. THE GROSS RETAIL AND USE TAX ACT APPLIES TO TANGIBLE PERSONAL PROPERTY.

The taxpayer's first proposition, i.e. that the Gross Retail and Use Tax Act applies only to tangible personal property, is correct. IC § 6-2.5-3-2(a) in particular imposes the use tax "on the storage, use, or consumption of tangible personal property in Indiana, …." *Id.* IC § 6-2.5-3-1(a) defines "use" as "the exercise of any right or power of ownership over tangible personal property." *Id.* However, the taxpayer's second and third underlying propositions, i.e. that canned software recorded on a tangible medium is not tangible personal property and not subject to Indiana gross retail and use taxes, are wrong, as the Department will explain below.

C. COPIES OF PRE-WRITTEN SOFTWARE ARE TANGIBLE PERSONAL PROPERTY AND SUBJECT TO GROSS RETAIL AND USE TAXES.

1. "Tangible" Means Perceptible by Any Sense, Aided or Unaided.

The taxpayer's argument that things that are imperceptible to the senses are incorporeal is incorrect. It does not follow from the fact that the *unaided* senses cannot perceive something that it is incorporeal and therefore intangible. Things that cannot be so perceived are nevertheless tangible to humans because they can correct or enhance their senses with appliances and devices such as eyeglasses and contact lenses, machines such as computers, and even computer programs. For example, a personal computer user who is blind or severely visually impaired can buy or lease a software program designed to aid such people.

It therefore follows that the aided, and not just the unaided senses, determine what things are or are not corporeal and tangible to human beings. Reported sales and use tax opinions on computer software from several other states recognize this point. In *South Central Bell Telephone Co. v. Barthelmy*, 643 So.2d 1240 (La. 1994), the court observed:

> In defining tangible, "seen" is not limited to the unaided eye, "weighed" is not limited to the butcher or bathroom scale, and "measured" is not limited to a yardstick. … *That we use a read/write head to read the magnetic or unmagnetic spaces [on media containing a computer program] is no different than any other machine that humans use to perceive those corporeal things which our naked senses cannot perceive.*

Id. at 1246 (internal quotation marks omitted; emphasis added). The court then went on to hold that a copy of a canned computer software program is corporeal, and as such is tangible personal property subject to use tax. *Id*. at 1246 and 1250, respectively. At least four other state courts of last resort had already held copies of off-the-shelf software to be tangible and taxable. *Hasbro Indus., Inc. v. Norberg,* 487 A.2d 124, 128-29 (R.I. 1985); *Citizens and S. Sys., Inc. v. South Carolina Tax Comm'n*, 311 S.E.2d 717, 719 (S.C. 1984); *Chittenden Tr. Co. v. King*, 465 A.2d 1100, 1101 (Vt. 1983); and *Pennsylvania and W. Va. Supply Corp. v. Rose*, 368 S.E.2d 101, 104 (W. Va. 1988). They did so by construing statutory definitions of "tangible personal property" essentially the same as the definition of "corporeal" the present taxpayer cites, but without the "unaided-senses" gloss that the taxpayer has implied. In addition, since the Louisiana Supreme Court issued *South Central Bell*, the supreme courts of three other states have followed it to reach the same result that opinion did. *Wal-Mart Stores, Inc. v. City of Mobile*, 696 So.2d 290, 291 (Ala. 1996), *overruling State v. Central Computer Servs., Inc.*, 349 So.2d 1160 (Ala. 1977); *First Data Corp. v. Nebraska Dep't of Revenue*, 639 N.W.2d 898, 904 (Neb. 2002), construing *A & D Tech. Supply Co. v. Nebraska Dep't of State Revenue*, 607 N.W.2d 857, 866 (Neb. 2000); *South Cent. Utah Tel. Ass'n, Inc. v. Auditing Div.*, 951 P.2d 218, 224 (Utah 1997). There is thus a significant body of persuasive judicial precedent from other states, contrary to the taxpayer's position, that holds that pre-written software is corporeal and tangible for sales and use tax purposes.

Neither *Lincoln National* nor *Manpower International* is valid authority to the contrary. As previously noted, neither opinion has appeared in the official court reporters of Indiana or Wisconsin, respectively. *Lincoln National* is a trial court judgment from which no appeal was taken. Although the Indiana Supreme Court has not ruled on the question, a majority of the panels of the Indiana Court of Appeals have held that a cited unpublished judgment has no effect as precedent. "[A] conclusion of law by a circuit court in a case from which no appeal has been taken is not binding precedent …." *Indiana Dep't of Natural Resources v. United Minerals, Inc.,* 686 N.E.2d 851, 857 (Ind. Ct. App. 1st Dist. 1997). *Accord, Hartford Acc. & Indem. Co. v. Dana Corp.,* 690 N.E.2d 285, 294 n.10 (Ind. Ct. App. 2d Dist. 1997) (quoting *United Minerals*) and *Indiana High School Athletic Ass'n v. Durham*, 748 N.E.2d 404, 413 n.5 (Ind. Ct. App. 5th Dist. 2001) (citing *United Minerals*). By the same logic, an unpublished trial court decision in a tax case could not overrule Sales Tax Information Bulletin # 8. Nor does an unpublished opinion of an appeals court of another jurisdiction, cited as precedent contrary to policies embodied in the Indiana Rules of Appellate Procedure and the rules of the issuing court. See Ind. R. App. P. 65D (2001), former Ind. R. App. P 15(A)(3) (1972) (repealed 2001) and Wis. Stat. § 809.23(3) (Cum. Supp. 2001) (each stating in substance that unpublished opinions may only be cited by the parties to that case to establish claim or issue preclusion or law of the case). *See also Miller Brewing Co. v. Best Beers of Bloomington, Inc.,* 579 N.E.2d 626, 633 n.4 (Ind. Ct. App. 1st Dist. 1991) (stating that citing an unpublished federal district court opinion was inappropriate under both the Indiana Rules of Appellate Procedure and the local appellate rules for the circuit covering the district court). Citing to such authorities on appeal is inappropriate. *United Minerals*, 686 N.E.2d at 857 n.1; *Hartford Acc. & Indem. Co.,* 690 N.E.2d at 294 n.10, citing *United Minerals.*

Nor do the taxpayer's citation to IC § 6-1.1-10-39 or 50 IAC § 4.2-4-3(g)(3), or its selective citations to statutory definitions of "tangible personal property" in the sales and use tax laws of other states support its argument. As regards IC § 6-1.1-10-39 and 50 IAC § 4.2-4-3(g)(3), it is important to emphasize that the issue in this protest is whether this Department is correct in levying use tax on the taxpayer under IC § 6-2.5-3-2(a) on its use of the copies of the software in question. The issue is not whether the taxpayer's possession of those copies subjected it to property tax, which this Department does not even administer.

The fact that a few states may have statutorily defined "tangible personal property" to explicitly include computer software has no relevance whatever to resolving the question of whether the Indiana legislature, by failing to do so in recodifying the Gross Retail and Use Tax Act, intended to exclude software from the scope of that term. As far as the Department's research reveals, the Indiana rule of statutory interpretation that the legislature is presumed, in passing a statute, to have been aware of other laws on the same subject, applies only to other statutes of the Indiana legislature, statutes of the United States, and reported opinions interpreting those laws. The Department has not found any reported Indiana opinion that has held that the rule also includes statutes of other states. Since the General Assembly cannot be presumed to have been aware of such laws, it follows that the Department has no duty to consider them in interpreting the Gross Retail and Use Tax Act.

Authority or lack of authority aside, if the definition of "tangible" were restricted to "perceptible by the unaided senses alone," applying that definition would, taken to its logical conclusion, lead to subjective, inconsistent, arbitrary and absurd results. Perceptible to whose unaided senses? Only to those of people with 20/20 vision? If that were the case, then packaging that includes printed, pictorial or other graphic material, would be tangible and taxable only to buyers and lessees with perfect eyesight who can see and read the package, but intangible and non-taxable to visually impaired buyers and lessees who cannot.

The taxpayer's distinction of the allegedly intangible copy of the program from the tangible packaging containing it does not advance its argument. Copies of the actual pre-written computer programs would be tangible and taxable if written in human-readable or "source code" form in a book or manual. However, if the copies were written on or copied to a disk in binary "object code" they would be intangible and non-taxable. This would be the case notwithstanding the fact that a computer—which, among other functions, acts as a sense-enhancing device—could read and execute the object code. The computer thereby enables the buyer or lessee not just to use that program, but also to see or (if the buyer or lessee has a sensory impairment) to at least experience it, in operation.

The taxpayer's thesis that things are intangible if they are incorporeal is thus unsustainable in fact, law, and application. The Department cannot administer the practical, workaday, nuts-and-bolts aspects of the Gross Retail and Use Tax Act on the basis of such metaphysical, what-is-real, how-many-angels-can-stand-on-the-head-of-a-pin distinctions. The only realistic way to administer these taxes is to apply a standard of tangibility that uniformly applies to every retail purchaser and lessee, regardless of the uncorrected sensory acuity of any given natural person. Defining "tangible" as meaning anything that can be perceived by any sense, aided or unaided, provides that standard.

2. Copies of "Canned" Software Are Not Intellectual Property, But Are Instead Tangible Personal Property.

i. Introduction—The Distinction Between Intellectual Property and a Copy of Intellectual Property

The taxpayer has also contended that the copies of the software programs in issue are intangible because they are intellectual property. It is clear to the Department from the Agreement that the transferor considered the programs to be trade secrets, both when it created them and when the parties entered into that agreement. However, the Agreement also states that the copies of the programs transferred to the taxpayer bore copyright legends. It is therefore unclear whether the transferor disclosed and published these programs, and if so to what extent and when publication occurred, or whether the programs remained unpublished and secret.

However, if the programs did remain trade secrets, the taxpayer nevertheless had the right under the Agreement to, and in fact did, employ in its business the specific copies of the programs transferred to it. That action was a "use" as IC § 6-2.5-3-1(a) defines that word, and was also the taxable event that triggered liability for, and supported the auditor's assessment of, use tax. *See also Comptroller of the Treasury v. Equitable Tr. Co.*, 464 A.2d 248, 252-53 (Md. 1983) (holding that use of copies of software programs the court characterized as trade secrets nevertheless was a sale of those copies for sales tax purposes).

The taxpayer would also be liable if the copies of the programs in fact were, or became, protected by copyright, for the same reason. Copyright law draws an explicit distinction between a copyright and a copy, as the Department will explain below. That distinction also provides a complete response to the taxpayer's contention that Sales Tax Information Bulletin #8 was an unauthorized expansion of the sales and use tax imposition statutes.

ii. The Copyright Act of 1976, the Copyright-Copy Distinction and the Definition of "Copies"

In 1980, the General Assembly recodified the Gross Retail and Use Tax Act, chapter 30 (Special Session), 1963 Indiana Acts 60, into what is now IC article 6-2.5. Pub. L. No. 52, § 1, 1980 Ind. Acts 590, 590-620. Four years before that, Congress had recodified and updated the law of copyright in the Copyright Act of 1976, Pub. L. No. 94-553, Title I, § 101, 90 Stat. 2541, codified as Title 17 U.S.C. (1976 and Supp. III 1979). That act draws a distinction between a copyright and a copy in 17 U.S.C. § 202, which read in 1980, and still reads, as follows:

> *Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied. Transfer of ownership of any material object, including the copy or phonorecord in which the work is first fixed, does not of itself convey any rights in the copyrighted work embodied in the object;* nor, in the absence of an agreement, does transfer of ownership of a copyright or of any exclusive rights under a copyright convey property rights in any material object.

Id. (emphasis added by the Department), *quoted in Bernstein v. Glavin*, 725 N.E.2d 455, 460-61 (Ind. Ct. App.), *trans. denied* 741 N.E.2d 1248 (Ind. 2000). A copy thus is not the same as the copyright. Rather, a copy is the product of the idea the copyright memorializes.

A copy may consist of any substance and may be perceived with either the unaided or aided senses. The Copyright Act of 1976 defined, and still defines, "copies" as being

> *material objects*, other than phonorecords, in which a work is fixed by *any* method now known or later developed, and *from which the work can be perceived*, reproduced, or otherwise communicated, either directly or *with the aid of a machine or device*. The term "copies" includes the *material object*, other than a phonorecord, in which the work is first fixed.

17 U.S.C. § 101, *quoted in Williams Elecs., Inc. v. Arctic Int'l, Inc.*, 685 F.2d 870, 877 (3d Cir. 1982) (first and last emphases added by the Department; all other emphases added by the court). Concerning this definition, the legislative history stated that "it makes no difference what the form, manner, or medium of fixation may be[.]" H.R. REP. NO. 94-1476, at 52, *reprinted in* 1976 U.S.C.C.A.N. 5659, 5665 *and in Williams Electronics*, 685 F.2d at 877 n.8. There is thus no distinction under copyright law between a copy of a computer program and a copy of any other copyrighted work, at least as far as the copyright owner's exclusive rights to reproduce and make the initial distribution of copies of that work are concerned. *See* 17 U.S.C. § 106(1) (granting the copyright owner the exclusive right to reproduce copies of the protected work). *See also* 17 U.S.C. §§ 106(3) and 109(a) (respectively granting the copyright owner the exclusive right to distribute copies of the protected work but permitting the lawful owner of a copy to sell or dispose of it without the copyright owner's authorization (commonly called the "first sale" doctrine)). As long as the copyright holder has authorized its creation and initial distribution (i.e., if infringement is not an issue), a copy is a copy is a copy.

At least one use tax opinion, *South Central Bell*, has used the copyright-copy distinction to indicate that it is the latter, and not the former, that is subjected to tax when canned software is involved. 643 So.2d at 1248. *See also Equitable Trust*, 464 A.2d at 252 n.5 (quoting 17 U.S.C. § 202 and observing in dicta that "[i]f the programs are in fact copyrighted, no intangible rights would be involved in the sale by the proprietors…." *Id.*). The United States Tax Court has also recognized the distinction as one justification for its holding copies of pre-written software to be tangible personal property eligible for the investment tax credit of I.R.C. (26 U.S.C.) § 38 (1988). *Norwest Corp. v. Commissioner*, 108 T.C. 358, 375 (1997), discussed in *First Data*, 639 N.W.2d at 902. (The present taxpayer's citing of Rev. Proc. 69-21, 1969-2 C.B. 303, as analogous authority supporting its position, is therefore misplaced. Rev. Proc. 69-21 deals with the expensing or amortization of a taxpayer's costs of developing software, not the investment tax credit for the price of copies of software already developed by someone else.)

ii. Effect of the Copyright-Copy Distinction and the Definition of "Copies" on Interpreting the Term "Tangible Personal Property" in the Gross Retail and Use Tax Act

Under the Indiana rules of statutory interpretation, a statute must be construed in the light of the factual and legal situation existing at the time of its enactment. *State ex rel. Glenn v. Smith*, 87 N.E.2d 813, 815 (Ind. 1949). The Copyright Act of 1976, which took effect on January 1, 1978, had been in effect for just over twenty-six months on the date of the Indiana sales and use tax recodification. *Compare* Copyright Act § 102, 90 Stat. at 2598 (setting January 1, 1978 effective date) *with* Pub. L. No. 52, § 1, 1980 Ind. Acts 590, 590 (showing act approved March 3, 1980) *and id*. § 6 at 621 (declaring the existence of an emergency and that the act took effect on passage). At that time the copyright-copy distinction had existed in case law and statute for over one hundred twenty-five years. *See generally Stephens v. Cady*, 55 U.S. (14 How.) 528, 529 and 531 (Dec. Term 1852) (respectively discussing the distinction and holding that a copyright of a map was not subject to execution, that the successful bidder at an execution sale of an engraved printing plate of the map did not also thereby acquire the copyright, and that the buyer should be enjoined from printing the map). *See also* Copyright Act of 1909, ch. 320, § 41, 35 Stat. 1075, 1084, formerly codified as 17 U.S.C. § 27 (1976) by the Copyright Act of 1947, ch. 391, § 27, 61 Stat. 652, 660. It is therefore reasonable to presume that the legislature, in recodifying the Gross Retail and Use Tax Act, was generally aware of the Copyright Act of 1976. It is also reasonable to presume that the it was aware in particular of the copyright-copy distinction, both historically and as codified in 17 U.S.C. § 202, and that the definition of "copies" in 17 U.S.C. § 101 drew no distinctions among lawful copies of the various kinds of copyrightable works.

Contemporaneous legislation, not precisely *in pari materia* (i.e., on the same subject), may be referred to in order to discern the intent of the legislature of the use of particular terms, or in the enactment of particular provisions. *Stout v. Board of Comm'rs of Grant County*, 8 N.E.222, 224 (Ind. 1886). "Statutes [also] are not to be considered as isolated fragments of law, but as parts of one great system." *Walgreen Co. v. Gross Income Tax Div.*, 75 N.E.2d 784, 785 (Ind. 1947) " 'Statutes are to be construed in connection and in harmony with the existing law and as a part of a general and uniform system of jurisprudence.' " *State Bd. of Accounts v. Indiana Univ. Found.*, 647 N.E.2d 342, 348 (Ind. Ct. App. 1995), quoting *Schwartz v. Castleton Christian Church, Inc.*, 594 N.E.2d 473, 476 (Ind. Ct. App. 1992). In light of the previously described state of copyright law, it is reasonable to presume that the General Assembly therefore would have understood, and intended, the phrase "tangible personal property" in the Gross Retail and Use Tax Act to exclude copyrights, but to include copies of the protected work capable of transfer from entity to entity, regardless of whether the copies could be perceived with the unaided or the aided senses.

iii. Sales Tax Information Bulletin # 8

In 1981, the year after the recodification of the Gross Retail and Use Tax Act and three years after the Copyright Act of 1976 took effect, the Department issued Sales Tax Information Bulletin # 8 (revised 1983, 1990 and 2002). In that bulletin the Department announced a policy of treating non-customized software as being tangible personal property, and therefore subject to Indiana gross retail and use taxes. However, the taxpayer was wrong to cite the original version of this bulletin as being the one in effect during the audit period. It is not the original Sales Tax Information Bulletin # 8, but rather the 1990 revision of this bulletin, that bears on this protest. That revision read in relevant part as follows:

> As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser.

Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the tact that the program may require some modification for a purchaser's particular computer. *Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook.*

Id. at 3 (emphasis added). (The 2002 version of Sales Tax Information Bulletin # 8 repeats the above quotation with no change other than to formatting.)

The above-emphasized language makes it clear that Sales Tax Information Bulletin # 8 is consistent with the expansive definition of "copies" and the copyright-copy distinction found in 17 U.S.C. §§ 101 and 202, respectively. The Indiana legislature is legally presumed to have been familiar with both of these matters, for the reasons previously discussed above, and to have taken them into account in imposing taxes on the sale or use of "tangible personal property." It follows that the taxpayer is incorrect in asserting that the Department engaged in an unauthorized expansion of the sales and use tax imposition statutes in promulgating Sales Tax Information Bulletin # 8, including the 1990 version of that bulletin. In addition, although unnecessary to uphold the validity of that bulletin, it is significant that other jurisdictions, both before and after the Department promulgated the 1990 version and its above-quoted analogy of a copy of a computer program to a copy of other intellectual property, have judicially recognized the validity of such an analogy. *South Central Bell*, 643 So.2d at 1247; *Equitable Trust*, 464 A.2d at 254; *Hasbro Industries*, 487 A.2d at 128-29; *Chittenden Trust*, 465 A.2d at 1102. *See also Citizens and Southern Systems*, 311 S.E.2d at 718 (noting the trial court's use of the analogy). Contrary to the taxpayer's assertion, it is not entitled to have the term "tangible personal property" construed in its favor and against the Department. That term, in light of the above-described legal context in which it was enacted, is not ambiguous. Since there is no ambiguity, the rule of statutory interpretation that tax imposition statutes must be construed in favor of a taxpayer and against the Department does not apply.

FINDING

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

II. Gross Retail and Use Tax – Retail Unitary Transactions –"Pre-Written," "Canned" or "Off-the-Shelf" Software

A. THE TAXPAYER'S ARGUMENT

The taxpayer contends that assessing use tax on the copies of the software is invalid because the physical media on which the software was transferred to it were not the essence or true object of the transaction. It argues that object was to license the allegedly intellectual, intangible, incorporeal property constituting the canned software programs, rather than to acquire the tangible, corporeal media on which they were recorded and stored. The taxpayer has not cited any authority in support of its argument. However, that argument clearly refers to the "true object" test set out in *Cowden & Sons Trucking, Inc. v. Indiana Department of State Revenue*, 575 N.E.2d 718, 724 n.5 (Ind. Tax Ct. 1991), and the opinions there discussed. The Department will refer in the following Discussion to additional details of the taxpayer's argument if and as needed.

B. THE INDIANA COURTS HAVE NOT HELD THAT THE "TRUE OBJECT" TEST OR UNITARY TRANSACTION ANALYSIS APPLY TO MIXED TRANSACTIONS OF GOODS AND INTELLECTUAL PROPERTY.

The taxpayer bases its argument on two unstated assumptions: first, that the "true object" test applies to mixed transactions of intellectual property and tangible personal property, and second, that the transaction in issue in this protest is such a transaction. Neither of these assumptions is correct.

The Indiana courts developed the "true object" test to analyze the gross income tax or sales and use tax consequences, and the Department promulgated 45 IAC § 2.2-4-2 to analyze the sales and use tax consequences, of mixed or unitary transactions that include goods and services. However, since the Department did not propose to levy use tax on the consulting services the transferor rendered the taxpayer, there is no factual foundation for applying either the "true object" test or unitary transaction analysis to the copies of the software alone. There is certainly no legal basis for doing so, even if the content of the copies is protected intellectual property. As far as the Department's research shows, the Indiana courts have never applied the "true object" test or unitary transaction analysis to such goods. Nor could either the "true object" test or 45 IAC § 2.2-4-2, according to their literal terms, apply to such a transaction, since a service is different from the intellectual property of which a copyright, patent or trade secret consists. " 'To be a service, work must be performed for the benefit of a particular customer. Designing a generally marketable product is not a service because the cost of design is spread among all customers, and their identity is unknown at the time the product is designed.' " *Hasbro Industries*, 487 A.2d at 128 n.5, quoting Robert L. Cowdrey, Note, Software and Sales Taxes: The Illusory Intangible, 63 B.U. L. REV. 181, 212 (1983).

C. THE TRANSFERS OF THE SOFTWARE COPIES IN ISSUE ARE NOT MIXED TRANSACTIONS OF GOODS AND INTELLECTUAL PROPERTY.

Even if the "true object" test or unitary analysis did apply to such transactions, however, the transfers in issue in this protest are not of that type. The Copyright Act of 1976 includes a statute of frauds that governs copyright transfers. "A transfer of copyright ownership, other than by operation of law, is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed or such owner's duly authorized agent." 17 U.S.C. § 204(a), *quoted in Bernstein*, 725 N.E.2d at 459. *See generally* 17 U.S.C. § 101 (defining "transfer of copyright ownership"). " 'The rule is really quite simple: If the copyright holder agrees to transfer ownership to another party, that party must get the copyright holder to sign a piece of paper saying so. It doesn't have to be the Magna Charta; a one-line pro forma statement will do.' " *Id*. at 460, quoting *Effects Assocs., Inc. v. Cohen*, 908 F.2d 555, 557 (9th Cir. 1990). For example, language transferring " 'all right, title and interest…in and to all programs and software' " is sufficient. *Shugrue v. Continental Airlines, Inc.*, 977 F. Supp. 280, 285-86 (S.D.N.Y. 1997), *quoted in Bernstein*, 725 N.E.2d at 460. However, there is no language whatever in the present Agreement, simple or elaborate, indicating that the transferor of the copies of the software also intended to transfer, or that the taxpayer intended to acquire, any interest in the software copyrights or trade secrets (if they were trade secrets) of which the copies were examples.

Therefore, the taxpayer's "true object" test argument fails by virtue of what the Department has said previously on the legal distinction between a copy of intellectual property and the property itself. It follows from this distinction that if the "true object" test applies at all, then the object of the present transaction was to transfer property interests in the copies of the software, not any ownership rights in the programs copied. This result is consistent with those reached by courts that have rejected taxpayers' arguments that under the applicable test, however described, the point of a transaction in copies of software is the transfer of intellectual property. *South Central Bell*, 643 So.2d at 1246-47 ("essence or real object of the transaction"); *Chittenden Trust*, 465 A.2d at 1101-02 ("focus of the transaction"); *Pennsylvania and West Virginia Supply*, 368 S.E.2d at 104 ("essence of the transactions").

The fact that the Agreement uses license terminology is not to the contrary. "[T]he license to use the software, without transferring the software, would be of no use to [the taxpayer], and the license to use the software is inseparable from the physical manifestation of the software in recorded form." *South Central Bell*, 643 So.2d at 1249. In this federal circuit, whatever the effect of license language in a software agreement might be in an intellectual property dispute, for day-to-day legal purposes the subject of such contracts is treated, as between the parties, as being goods. *See ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1450 (7th Cir. 1996) (holding software "shrinkwrap" licenses to be enforceable under the common law of contract and the Uniform Commercial Code ("U.C.C.")), citing *Microsoft Corp. v. Harmony Computers & Elecs., Inc.*, 846 F. Supp. 208 (E.D.N.Y. 1994). This position is consistent with those of opinions of other courts that have held canned software to be goods subject to U.C.C. Article 2, which governs the sale of goods. Those opinions include: *RRX Indus., Inc. v. Lab-Con, Inc.*, 772 F.2d 543, 546-47 (9th Cir. 1985); *Earman Oil Co. v. Burroughs Corp.*, 625 F.2d 1291, 1293 n.5 (5th Cir. 1980); *Colonial Life Ins. Co. v. Electronic Data Sys. Corp.*, 817 F. Supp. 235, 238-39 (D. N.H. 1993); *Aplications,* [sic] *Inc v. Hewlett-Packard Co.*, 501 F. Supp. 129, 133 (S.D.N.Y. 1980), *aff'd* 672 F.2d 1076 (2nd Cir. 1982); *Chatlos Sys., Inc. v. National Cash Register Corp.*, 479 F. Supp. 738, 742-43 (D. N.J. 1979), *aff'd and* *remanded* 635 F.2d 1081 (3rd Cir. 1980); *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39, 44-45 (D. S.C. 1974); *Neilson Bus. Equip. Ctr., Inc. v. Monteleone*, 524 A.2d 1172, 1174 (Del. 1987); *Austin's of Monroe, Inc. v. Brown*, 474 So.2d 1383, 1388 (La. Ct. App. 1985); *USM Corp. v. Arthur D. Little Sys., Inc.*, 546 N.E.2d 888, 894 (Mass. Ct. App. 1989); *Communications Groups, Inc. v. Warner Communications, Inc.*, 527 N.Y.S.2d 341, 343-44 (N.Y. Civ. Ct. 1988); and *Camara v. Hill*, 596 A.2d 349, 351 (Vt. 1991).

D. IT WOULD BE IMPOSSIBLE AND UNDESIRABLE TO APPLY THE "TRUE OBJECT" TEST OR UNITARY TRANSACTION ANALYSIS TO TRANSACTIONS OF GOODS DESIGNED FROM INTELLECTUAL PROPERTY.

There are two additional reasons why it would be impossible to apply the "true object" test or 45 IAC § 2.2-4-2 to transactions involving copies of computer software. Under either the "true object" test or unitary transaction analysis, it is at least possible to separate and quantify the goods and services elements of a transaction, although it often does not occur in fact. However, it is impossible to do so as between the raw materials and the intellectual property components of a copy of that property: As *South Central Bell* noted regarding software in particular:

> One cannot escape the fact that software, recorded in physical form, becomes inextricably intertwined with, or part and parcel of the corporeal object upon which it is recorded, be that a disk, tape, hard drive, or other device.…That the information can be transferred and then physically recorded on another medium is of no moment, and does not make computer software any different than any other type of recorded information that can be transferred to another medium such as film, video tape, audio tape, or books.

643 So.2d at 1247. Even if such a separation were possible, however, giving it administrative or legal recognition would have a devastating effect on the sales and use tax laws. As stated in *Equitable Trust*:

There is scarcely to be found any article susceptible to sale or rent that is not the result of an idea, genius, skill and labor applied to a physical substance.…If these elements should be separated from the finished product and the sales [or use] tax applied only to the cost of the raw material, the sales [and use] tax act would, for all practical purposes, be entirely destroyed.

464 A.2d at 258, quoting *Crescent Amusement Co. v. Carson*, 213 S.W.2d 27, 29 (Tenn. 1948).

FINDING

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

DEPARTMENT OF STATE REVENUE

04990583.LOF

LETTER OF FINDINGS NUMBER: 99-0583
For the Period: 1995 through 1998

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

ISSUES

I. Sales/Use Tax – Diagnostic Analyzers

Authority: IC 6-2.5-3-5(a); 45 IAC 2.2-3-16; Information Bulletin #31; IC 6-2.5-3-2; Information Bulletin #20; IC 6-2.5-1-2; IC 6-2.5-4-1; IC 6-2.5-3-1

The taxpayer protests the assessment of use tax on diagnostic analyzers.

STATEMENT OF FACTS

Taxpayer is a global manufacturer of laboratory diagnostic equipment and supplies. The taxpayer provides its customers with diagnostic equipment without charge. The taxpayer's customers then buy items (e.g., reagents) used in performing medical diagnostic tests. The taxpayer has no location in Indiana but does have "seeded" diagnostic equipment that it owns at various customer locations in Indiana. More facts will be provided as needed.

I. Sales/Use Tax – Diagnostic Analyzers

DISCUSSION

Two types of diagnostic equipment are at issue. The first type involves what will be called "S" instruments which were manufactured in Florida. The second type, which will be referred to as "X, Y, and Z" analyzers, were purchased by the taxpayer from Company D. Thus the taxpayer's arguments can be broken out as follows:

(1) Regarding "S" instruments, the taxpayer argues that the items were made in Florida and that use tax was paid to Florida;
(2) Regarding the "X, Y, and Z" analyzers, taxpayer argues that it bought the diagnostic division of Company D. The acquisition included the three types of analyzers (namely—X, Y, and Z—which were already placed at medical facilities in Indiana, per the taxpayer) and various other business assets. The taxpayer states that the acquisition of the medical diagnostic

division of Company D does not constitute a retail transaction, it is in fact a casual sale, since Company D is not in the business of selling off its divisions.

"S" Instruments

The taxpayer states that it "self-constructed [S] assets manufactured in Florida for [its own] use" and that "use tax from the [S] instruments manufactured in Florida and seeded in Indiana is due and paid to the state of Florida." Further, the taxpayer says:

Florida requires use tax to be calculated on tangible personal property removed from inventory for your [*sic*.] own use. Indiana Regulation, Rule 45 IAC 2.2-3-16 reads "Liability for Indiana use tax shall be reduced by a credit for the amount of any sales, purchase, or use tax paid to any other state … with respect to the tangible personal property on which Indiana use tax applies."

The "S" seeded instruments were manufactured in Florida and capitalized on [the taxpayer's] books. These instruments were then placed at medical facilities in Indiana. Once these instruments were removed from inventory, Florida use tax was due and paid to Florida.

As alluded to in the taxpayer's quote above a credit is provided for sales/use tax paid to another state. The Indiana Code, Indiana Administrative Code, and Information Bulletin #31 (Sec. II-B) each deal with the credit.

IC 6-2.5-3-5(a) provides:

A person is entitled to a credit against the use tax imposed on the use, storage, or consumption of a particular item of tangible personal property equal to the amount, if any, of sales tax, purchase tax, or use tax paid to another state, territory, or possession of the United States for the acquisition of that property.

45 IAC 2.2-3-16 reads in full,

Liability for Indiana use tax shall be reduced by a credit for the amount of any sale, purchase, or use tax paid to any other state, territory or possession of the United States with respect to the tangible personal property on which Indiana use tax applies.

And finally the relevant part of Information Bulletin #31, Sec. II-B:

A person is entitled to a credit against the Indiana use tax which is equal to the amount of sales tax, purchase tax, or use tax properly and validly paid to another state ….

The taxpayer at hearing submitted documentation showing that use tax was paid to Florida on the "S" instruments at issue.

To recapitulate: the "S" instruments are "self-constructed assets manufactured in Florida for [the taxpayer's] own use" and "seeded" without charge (i.e., free) at customer locations "with the understanding the customer will buy from the taxpayer the supplies called reagents that are used in performing medical diagnostic tests …." Also, the taxpayer capitalized the "S" instruments on the taxpayer's books. Documentation was provided showing that use tax was paid to Florida.

"X, Y, and Z" Analyzers

Turning to the Company D division acquired analyzers (X, Y, and Z), the taxpayer states:

For the tax year 1996, [taxpayer] acquired the medical diagnostic division of [Company D]. Included in this purchase were X, Y, and Z analyzers already placed at medical facilities located in Indiana. …

The acquisition of the Company D medical diagnostic division by [taxpayer] would not meet the definition of a retail transaction. …

[Company D] is not in the business to sell off their business assets. Therefore this transaction would meet the definition of an isolated or occasional sale which would be exempt from Indiana sales and use tax.

A retail transaction is defined in relevant part by IC 6-2.5-1-2 and IC 6-2.5-4-1 as:

IC 6-2.5-1-2 (a) "Retail transaction" means a transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-1, that constitutes making a wholesale sale as described in IC 6-2.5-4-2, or that is described in any other section of IC 6-2.5-4.

(b) "Retail unitary transaction" means a unitary transaction that is also a retail transaction.

IC 6-2.5-4-1 (a) A person is a retail merchant making a retail transaction when he engages in selling at retail.

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

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

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

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

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

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

(3) the property is transferred conditionally or otherwise.

The pertinent parts of the Indiana Code regarding use tax are as follows:

IC 6-2.5-3-1 (a) "Use" means the exercise of any right or power of ownership over tangible personal property.

(b) "Storage" means the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana.

(c) "A retail merchant engaged in business in Indiana" includes any retail merchant who makes retail transactions in which a person acquires personal property for use, storage, or consumption in Indiana and who maintains:

(1) an office, place of distribution, sales location, sample location, warehouse, storage place, or other place of business which is located in Indiana and which the retail merchant maintains, occupies, or uses, either permanently or temporarily, either directly or indirectly, and either by himself or through an agent or subsidiary; or

(2) a representative, agent, salesman, canvasser, or solicitor who, while operating in Indiana under the authority of and on behalf of the retail merchant or a subsidiary of the retail merchant, sells, delivers, or takes orders for sales of tangible personal property to be used, stored or consumed in Indiana.

And IC 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Taxpayer argues that it was a "casual sale" and that Company D is not in the business of selling off entire divisions. Information Bulletin #20 is of import in this context. It states in part:

Indiana Sales Tax is not imposed upon transactions involving casual sales (except for sales of vehicles, aircraft, or watercraft where use tax is paid upon licensing).

A "casual sale" is an isolated or occasional sale of tangible personal property when:

(1) Such property was originally acquired by the seller for the seller's own use or consumption; and

(2) The seller, in the ordinary course of his or her regularly conducted business, does not acquire such property for the purpose of resale. …

The taxpayer provided documents showing that purchase of Company D's division included business assets such as real property, machinery and equipment, office equipment, permits/licenses, contracts/sales orders, business records, computer software assets, and inventory. Company D's ordinary and regular course of business is not to sell off all of these items.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220000272.LOF

LETTER OF FINDINGS NUMBER: 00-0272
Adjusted Gross Income Tax – Business/Non-Business Income
Tax Administration—Penalty
For Tax Years 1992-1994

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

ISSUES

I. Adjusted Gross Income Tax – Business Versus Non-Business Income: Gains from the Sale of Stock

Authority: IC § 6-3-1-20; 45 IAC 3.1-1-29; IC § 6-3-1-21; 45 IAC 3.1-1-30; IC § 6-8.1-5-1(b); 45 IAC 3.1-1-31; *May Department Stores v Indiana Department of Revenue*, 749 N.E.2d 651 (Ind.Tax, 2001)

Taxpayer protests the auditor's reclassification of gains from the sale of stock in foreign corporations from non-business to business income.

II. Adjusted Gross Income Tax – Business Versus Non-Business Income: Litigation Settlements

Taxpayer protests the auditor's reclassification of litigation settlement amounts from non-business to business income.

III. Adjusted Gross Income Tax – Business Versus Non-Business Income: Joint Venture

Authority: IC § 6-3-1-19; IC § 6-2.1-5-10

Taxpayer protests the auditor's reclassification of taxpayer's interest in a joint venture from non-business to business income.

IV. Adjusted Gross Income Tax – Business Versus Non-Business Income: Interest Income and Management Fees

Taxpayer protests the auditor's reclassification of interest income and income from management fees from non-business to business income.

V. Tax Administration – Penalty

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

Taxpayer protests the imposition of the 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer is a diversified, worldwide producer of chemical and related products in two different industries, chemical specialties and food and functional products. Taxpayer sells its products directly to customers from plants and warehouses. Taxpayer also uses distributors to sell its products, particularly in markets outside the United States. During the audit period, taxpayer had a chemical manufacturing plant in Indiana. Taxpayer closed this plant in 1995. Taxpayer had no other Indiana facilities during the audit period.

Taxpayer produces rosin and resins for the writing, printing, tissue, towel and packaging markets; fibers and textile yarns for the hygiene, furnishings, and auto markets; rosin, hydrocarbons, resins and peroxides for the tape, label, packaging, ink, insulation, construction and household products markets. Taxpayer also produces celluloses for the paint, adhesives, cosmetics, pharmaceuticals, food and beverage, oil well and smokeless powder industries. Taxpayer also produces food gums, aroma chemicals, and photopolymer resins.

The audit made numerous adjustments to taxpayer's gross and adjusted gross income tax. Taxpayer protested the following: the reclassification of the following items from non-business to business income: gains from the sale of stock in foreign corporations; litigation settlements; interest in a joint venture; interest income and management fees. Taxpayer also protested the 10% negligence penalty. Additional facts will be added as necessary.

I. Adjusted Gross Income Tax – Business/Non-Business Income: Gains from Sale of Stock

DISCUSSION

Taxpayer protests the recharacterization of gains from the sale of stock in foreign corporations from non-business to business income.

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."

IC § 6-3-1-21 defines "nonbusiness income" as "all income other than business income." *See also*, 45 IAC 3.1-1-31. Secondly, IC § 6-3-1-20 defines "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations." *See also*, 45 IAC 3.1-1-29:

> "Business Income" Defined. "Business Income" is defined in the Act as income from transactions and activity in the regular course of the taxpayer's trade or business, including income from tangible and intangible property if the acquisition, management, or disposition of the property are integral parts of the taxpayer's regular trade or business.
>
> Nonbusiness income means all income other than business income.
>
> The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, non-operating income, etc., is of no aid in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business.

The Indiana Tax Court in *May Department Stores v. Indiana Department of Revenue*, 749 N.E.2d 651 (Ind. Tax 2001), 2001 Ind. Tax Lexis 32, clarified the statutory and regulatory language cited above, and outlined the transactional and functional tests the Department must apply to distinguish business from non-business income.

In *May*, the Indiana Tax Court construed the definitions of "business income" under IC §§ 6-3-1-20 and 6-3-1-21 (non-business income). As the court noted, the "distinction between business and nonbusiness income is important in calculating a taxpayer's tax liability... whether income is deemed business or nonbusiness income determines whether it is allocated to a specific state or whether it is apportioned between Indiana and other states wherein the taxpayer is conducting its trade or business." *May*, 749 N.E.2d 651 at 656. The court found that "... in passing IND. CODE § 6-3-1-20, the General Assembly provided two tests for defining business income... the 'transactional' and 'functional' tests." Id. at 662. The court goes on to say that IC § 6-3-1-20 "requires that not only the property's disposition but also its acquisition and management must be integral parts of the taxpayer's regular trade or business." Id. at 664.

Under the transactional test, the nature of the particular transaction generating the income is the controlling factor the Department uses to identify business income pursuant to *May*. Three considerations enter into the Department's identification process: the frequency and regularity of similar transactions; the former practices of the business; and taxpayer's subsequent use of the income.

Under the functional test, gain from the disposition of a capital asset is considered business income if the asset disposed of was used by the taxpayer in its regular trade or business operations. According to the court in *May*, the regulation found at 45 IAC 3.1-1-30 requires the Department to consider the following in determining the scope of a taxpayer's trade or business:

1. The nature of taxpayer's trade or business.
2. The substantiality of the income derived from activities and transactions and the percentage of that income which forms taxpayer's total income for a given tax period.
3. The length of time the property producing income was owned by taxpayer.
4. The taxpayer's purpose in acquiring and holding the property producing income.

Under the functional test, the Department must focus on the property being disposed of and the relationship between the property at issue and taxpayer's business operations. The question to be asked is whether the property, its use and /or disposition, forms an integral part of taxpayer's business.

Taxpayer owned 50% of the stock of a Japanese corporation, and 62% of the stock of an Australian corporation, allegedly holding both stock portfolios as investments. Taxpayer sold all of its stock in the Japanese corporation in 1992 and all of its stock in the Australian corporation in 1993. Taxpayer's protest stated that taxpayer's interests in these corporations were merely investments. At the hearing, taxpayer's representative argued that taxpayer did not have any of the legal hallmarks of a unitary relationship with either corporation; Japanese and/or Australian nationals staffed each, and each corporation was organized and managed pursuant to Japanese and/or Australian laws and customs. Taxpayer also argued that the activities of these two corporations had nothing to do with the Indiana chemical manufacturing plant's activities. The Indiana plant, until its closure in 1995, manufactured packaging materials, such as cellophane, for CD cases, VHS tape boxes, and the like.

In assessing whether or not income is business or non-business, the Department looks at a taxpayer's entire business operations. In this particular taxpayer's case, its worldwide diversity of interests and its prominence in chemical manufacturing in particular have created a sufficient connection between the two foreign corporations and the Indiana chemical manufacturing plant.

Taxpayer's reliance on the absence of indicators for a unitary relationship between itself and the two foreign corporations is misplaced. It is immaterial and too formulaic that foreign nationals staffed the corporations and that they were organized pursuant to the laws of the country where each was located. A sweeping generalization that the percentage of stock ownership was for investment purposes only does not clear the bar of the Audit Division's finding that the gain from the stock sale was business income. Under the totality of the circumstances—taxpayer and the two foreign corporations are all chemical manufacturers, the Japanese corporation's name was hyphenated with taxpayer's, the lack of information provided about the transactions surrounding the acquisition, management, and disposition of the funds acquired in the sale, and taxpayer's failure to explain how 50% and 62% ownership percentages do not constitute management presence—the Department finds that the gain from the sale of stock is business income.

FINDING

Taxpayer's protest concerning the reclassification of gain from the sale of stock in foreign corporations from non-business income to business income is denied.

II. Adjusted Gross Income Tax – Business versus Nonbusiness Income: Litigation Settlements

DISCUSSION

Taxpayer protests the reclassification of litigation settlement amounts from non-business to business income. *See* legal discussion *supra*, under Issue I. During the tax years at issue, specifically 1993, there were three areas of litigation that produced substantial dollar settlements for taxpayer. One of the suits was an insider trading action against a brokerage house and a bank. Taxpayer sued both institutions for damages taxpayer incurred as a result of the unlawful disclosure of information causing the target corporation's stock price to increase. Taxpayer has failed to provide sufficient information, i.e., solid facts, about the business of the target company, the purpose behind the acquisition, and how the target company would have functioned within taxpayer's overall business operations. Since taxpayer has failed to meet its burden of proof on this issue, the Audit Division's proposed assessment stands.

The second legal action concerned a patent infringement suit. Taxpayer's patent was for systems and processes involved in the manufacturing of polymers. Taxpayer testified that the settlement payment was "over and above the main object of the lawsuit, which was to stop" the defendants from infringing on taxpayer's patent. Since taxpayer is in the business of manufacturing polymers, any legal action taken to protect that manufacturing process, and any monies received due to that protective legal action, is business income and directly related to taxpayer's operations. Taxpayer's protest on this issue is denied.

The third legal action concerned the specific performance of a prime contractor in a government contract. Taxpayer was the subcontractor to aid development of the Titan IV rocket. The prime contractor controlled everything about the project, and a dispute arose about cost reimbursements. Taxpayer sued the prime contractor in the state where all work was performed, Utah. The litigation settled when the prime contractor agreed to pay taxpayer's costs pursuant to the contract, taxpayer's contract price for its work, plus damages for losses incurred as a result of untimely cost reimbursements. Since development of rocket components is very closely tied to chemical manufacturing, any monies gained through a protective contract enforcement action at law would be business income to taxpayer. Nonpayment injures business operations; successfully seeking legal redress against a breaching or non-performing party to a contract necessarily results in business income. Taxpayer's protest on this issue is denied.

FINDING

Taxpayer's protest concerning the reclassification of dollar amounts received in settlement of litigation from non-business to business income is denied.

III. Adjusted Gross Income Tax – Business versus Non-Business Income: Joint Venture

DISCUSSION

Taxpayer protests the reclassification of its interest in an alleged joint venture from non-business to business income. Taxpayer entered into an arrangement with another company as subcontractors to a third to develop and manufacture rocket components. All activities associated with this effort took place in Utah. The Indiana Code includes joint ventures in its definition of partnerships at IC § 6-3-1-19. IC § 6-2.1-5-10 imposes on such entities the following duty:

(a) Every individual, partnership, corporation...shall file an information return with the department if he has the control or custody of, receives, or makes payment of:

(1) dividends of six hundred dollars ($600) or more;
(2) interest of six hundred dollars ($600) or more;
(3) rents, premiums, annuities, compensations, or other fixed or determinable annual or periodic amounts, which are subject to the tax imposed by this article and must be reported by the taxpayer under federal income tax law;
(4) salaries, wages, or compensation of one hundred dollars ($100) or more;

which are paid, payable, or credited to another taxpayer and are subject to the gross income tax.

There is no evidence that taxpayer had ever filed such information returns. As noted by the auditor, taxpayer, at a strategic point in the audit process, refused to provide any information or documents supporting its position that income from the joint venture was non-taxable in the state of Indiana. The manufacturing of rocket components is very closely tied to chemical manufacturing. The assessment was based on the best information available at the time of the audit; taxpayer offered nothing at the hearing to overcome the presumption that the assessment was and is correct. Taxpayer has failed to meet its burden of proof on this issue.

FINDING

Taxpayer's protest concerning the reclassification of taxpayer's interest in a joint venture from non-business to business income is denied.

IV. Adjusted Gross Income Tax – Interest Income and Management Fees

DISCUSSION

Taxpayer protests the reclassification of interest income and income from management fees from non-business to business income. The interest payments were payments on long-term loans to entities in which taxpayer held minority stock interests. These entities were not functional parts of taxpayer's business; the transactions themselves were made for investment purposes. Pursuant to the legal discussion set forth in Issue I *supra*, taxpayer did not receive business income. Taxpayer's protest on this issue is sustained.

The other issue concerns management fees from one of taxpayer's subsidiaries. This subsidiary manages properties of aqueous systems and has plants in Missouri, New Jersey, Texas, Virginia, and several European countries. Taxpayer did not provide sufficient facts about what the subsidiary does, nor what the properties consist of, and their purpose, for the Department to discern the exact nature of the management fees and the services taxpayer provided to the subsidiary. Therefore, taxpayer has not met its burden of proof on this issue. Taxpayer's protest on this issue is denied.

FINDING

Taxpayer's protest concerning the reclassification of interest income from non-business to business income is sustained. Taxpayer's protest concerning the reclassification of management fees from non-business to business income is denied.

V. 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, regulations, and case law.

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's failure to pay the proper amount of adjusted gross income tax was based on its interpretation of the difference between business and non-business income under United States Supreme Court case law concerning issues of nexus and sufficient minimum contacts with Indiana—i.e., Indiana's power to tax. Taxpayer should have ascertained what Indiana's statutes, regulations, and case law delineated at the time of the failure to pay the tax. All the *May* case, *supra*, did was pull together the threads of the business versus non-business tangle into one piece of fabric. Indiana's statutes and regulations regarding business versus non-business income are well within the Constitutional strictures of the cases taxpayer cited in the protest of these proposed assessments.

Given the totality of the circumstances, the Department finds taxpayer was negligent in carelessly construing the applicable statute and regulations. A careful and thoughtful review would have revealed taxpayer's duty to pay the adjusted gross income tax this Letter of Findings has determined taxpayer must pay.

FINDING

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

DEPARTMENT OF STATE REVENUE

0120010204.LOF

LETTER OF FINDINGS NUMBER: 01-0204
Individual Income Tax
For Tax Years 1998 through 1999

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

ISSUE

I. Income Tax – County Tax

Authority: IC 6-3.5-6-1; IC 6-3.5-7-1; 45 IAC 3.1-1-109

Taxpayer protests the Department's assessment of county income tax.

STATEMENT OF FACTS

Taxpayers are nonresident shareholders in an Indiana business located in a county adopting a county income tax. As the result of an investigation, the Indiana Department of Revenue ("Department") issued assessments for county income taxes for the years in question. Taxpayer protests these assessments. Further facts will be supplied as necessary.

I. Income Tax – County Tax

DISCUSSION

Taxpayers own shares in an Indiana business, and received distributions from the business. The Department conducted an investigation of the business and discovered that the business had underreported commissions received for January 1998 and December 1999, resulting in understatement of Adjusted Gross Income. Also, the Department decided that the business had not withheld the proper amounts of county income tax on the distributions to shareholders, in this case the taxpayers. The Department based its decision on IC 6-3.5-6-1, IC 6-3.5-7-1 and 45 IAC 3.1-1-109. IC 6-3.5-6-1 states in relevant part:

> "Adjusted gross income" has the same definition that the term is given in IC 6-3-1-3.5. However, in the case of a county taxpayer who is not treated as a resident county taxpayer of a county, the term includes only adjusted gross income derived from his principal place of business or employment.
>
> …

IC 6-3.5-7-1 states in relevant part:

> (a) Except as otherwise provided in this section, as used in this chapter, "adjusted gross income" has the meaning set forth in IC 6-3-1-3.5(a).
>
> (b) In the case of a county taxpayer who is not a resident of a county that has imposed the county economic development income tax, the term "adjusted gross income" includes only adjusted gross income derived from the taxpayer's principal place of business or employment.
>
> …
>
> 45 IAC 3.1-1-109 states:
>
> Subchapter S Corporations-Withholding Requirements. Small business corporations electing Subchapter S status under Internal Revenue Code section 1372 are required to withhold adjusted gross income tax and county adjusted gross income tax on any nonresident shareholder's share of taxable income of the corporation, whether distributed or undistributed, and pay such amounts to the Department in the manner described in Regulation 6-3-4-12(010) *[45 IAC 3.1-1-108]*. Such corporations shall make monthly (or quarterly) and annual returns as provided in Regulation 6-3-4-12(020) *[45 IAC 3.1-1-108]* and furnish a copy of form WH-18 to each nonresident shareholder as provided in that regulation.

The additional county tax assessed by the Department was based on distributions from the corporation to the taxpayers as shareholders. While the Department is correct that 45 IAC 3.1-1-109 holds S Corporations responsible for collecting county adjusted gross income tax, IC 6-3.5-7-1(b) explains that county income tax includes only adjusted gross income derived from the taxpayer's principal place of business or employment.

Taxpayers did not have a place of business or employment in an Indiana county during the audit period. The distributions taxpayers received as shareholder of the corporation are not subject to county taxes as explained in IC 6-3.5-7-1(b). In this case, taxpayers were only subject to Indiana adjusted gross income tax, which were properly paid, not county taxes.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420010356.LOF

LETTER OF FINDINGS NUMBER: 01-0356 ST
Sales and Use Tax
For Tax Periods: 1999

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

ISSUE

Sales and Use Tax – Imposition

Authority: IC 6-8.1-5-1(b), IC 6-8.1-5-1(b), IC 6-2.5-3-2(a), 45 IAC 2.2-3-12(c)

The taxpayer protests the imposition of use tax on two items.

STATEMENT OF FACTS

The taxpayer is a storage tank painting contractor that does work for both industrial and governmental entities. After an audit, the Indiana Department of Revenue, hereinafter, referred to as the "department," assessed additional use tax, interest, and penalty. The taxpayer protested a portion of the assessment and a hearing was held on the imposition of the use tax.

Sales and Use Tax – Imposition

DISCUSSION

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

Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. IC 6-2.5-3-2(a) The taxpayer protests the imposition of the use tax in two situations. The first situation concerns the imposition of use tax on tangible personal property in the provision of a service. During the audit period, the taxpayer purchased both equipment and supplies that it used in sandblasting the storage tanks prior to painting the storage tanks. The department assessed use tax on the equipment and supplies. The taxpayer protests the assessment on the supplies of slag abrasive.

The taxpayer bases this protest on two premises. First, the taxpayer contends that the slag abrasive was used in a contract furnishing a service to an exempt organization, a governmental entity. The sales and use taxability of supplies used to perform a service contract for an exempt organization is stated at 45 IAC 2.2-3-12(c) as follows:

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

In this case, the taxpayer used the slag abrasive in sandblasting the storage tanks and preparing them for the application of paint. The slag abrasive is clearly a supply used by the taxpayer that did not become a part of the storage tank. Therefore, pursuant to the above-cited Regulation, the slag abrasive is not granted exempt status because it was used on storage tanks owned by an exempt governmental entity.

Alternatively, the taxpayer argues that the slag abrasive is not taxable because the governmental entity is required to dispose of the slag and the taxpayer cannot take it with him or reuse it. No exemption to imposition of the use tax exists for tangible personal property used in performing a service contract because the contractor cannot take the used material with him or reuse it.

The taxpayer also protests the assessment of use tax on the tangible personal property listed in the audit as reference #655835. The taxpayer contends that the department inadvertently assessed use tax on a quotation of a price for certain material that the taxpayer never actually purchased. The taxpayer offered adequate evidence that it never purchased or used the subject equipment. Therefore, use tax was improperly imposed on that reference number.

FINDING

The taxpayer's first protest is denied and the second protest is sustained.

DEPARTMENT OF STATE REVENUE

0420010242
0420020091
0420020054.LOF

LETTER OF FINDINGS NUMBERS: 01-0242; 02-0091; 02-0054
Indiana Sales and Use Tax
For the Tax Years 1994 through 1997

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

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

ISSUES

I. Transportation Equipment Used to Move Work-in-Process

Authority: IC 6-2.5-1-1 et seq.; IC 6-2.5-5-3(b); IC 6-2.5-5-27; IC 6-8.1-5-1(b); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Panhandle Eastern Pipeline Co., v. Indiana Dept. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); 45 IAC 2.2-3-8; 45 IAC 2.2-5-8(f)(3); 45 IAC 2.2-5-8(f)(4)

According to taxpayer, the audit erred when it determined that equipment – used to transport work-in-process within its production facility and to move work-in-process to third-party processors – was subject to the gross retail tax. Alternatively, taxpayer maintains that it is engaged in "public transportation" and that certain of its equipment is entitled to the associated exemption.

II. Monitoring Equipment Used Within the Steel Production Process

Authority: 45 IAC 2.2-5-8(b), (c); 45 IAC 2.2-5-8(g)

Taxpayer maintains that three categories of specialized equipment used within its steel production process – a data collection system, chart recorder and charts; and video camera and monitor – are integral to the control of that production process. According to taxpayer, the equipment is not subject to the state's gross retail tax.

III. Strapping Dispenser and Banding Tool

Authority: 45 IAC 2.2-5-8(b); 45 IAC 2.2-5-8(d)

Taxpayer maintains that its strapping dispenser and associated banding tool, used to secure coils of steels, are exempt from sales and use tax.

IV. Materials and Equipment Used to Meet Environmental Control Requirements

Authority. IC 6-2.5-5-30; 45 IAC 2.2-5-70; The American Heritage Dictionary of the English Language (4th ed. 2000)

Taxpayer protests the audit's determination that the purchase of tangible personal property used to meet environmental control requirements is subject to sales and use tax.

V. Gross Retail and Use Tax on Materials Incorporated Into Realty – Direct Payment Permits Issued to Contractors

Authority: IC 6-2.5-8-9(b); 45 IAC 2.2-4-22(e)

Taxpayer argues that, having permitted various contractors to use its "direct pay permit," it is not responsible for sales or use taxes on those purchases.

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 asks that the Department exercise its discretion to abate the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer manufactures rolled steel sheets at three locations. One of the three manufacturing sites is located within Indiana. An audit investigation was conducted resulting in an additional assessment of sales and use tax. Taxpayer protested a number of those additional assessments. An administrative hearing was conducted, and this Letter of Findings follows.

DISCUSSION

I. Transportation Equipment Used to Move Work-in-Process.

Taxpayer argues that certain of its transportation equipment is entitled to an exemption from the state's sales and use taxes.

In Indiana, a sales tax is imposed on retail transactions and a complementary use tax is imposed on tangible personal property that is stored, used, or consumed in the state. IC 6-2.5-1-1 et seq. In this instance, taxpayer invokes a regulatory exemption, 45 IAC 2.2-5-8(f)(3), which states as follows: "Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process."

Taxpayer purchased certain equipment which is employed in transporting coils of finished and semi-finished steel. According to taxpayer, because this equipment is used in transporting "work-in-process," it is not subject to sales or use tax.

A. Railroad Turnouts:

Taxpayer maintains that its purchase of material used to construct "railroad turnouts" comes within the purview of the exemption. The "railroad turnouts" are sections of railroad track located at taxpayer's Indiana manufacturing site. According to taxpayer, the turnouts are exclusively used to transport unfinished steel from its out-of-state manufacturing sites to the Indiana location.

The dispute was originally framed as an issue of whether the turnouts are taxable "transportation equipment" under 45 IAC 2.2-5-8(f)(3) or – as taxpayer contends – exempt "real property." However, classification of the turnouts as either real or personal property is irrelevant because, inter alia, taxpayer is responsible for use tax on the materials used to construct the turnouts. As set out in 45 IAC 2.2-3-8:

> The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such personal property. All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition unless the ultimate recipient could have purchased it exempt.

Taxpayer is the "ultimate recipient" of the materials used to construct the railroad turnouts. Because there is no indication taxpayer was "exempt" at the time it acquired the turnouts, and because there is no indication that the contractor paid sales tax at the time *it* acquired the materials, taxpayer is subject to use tax under 45 IAC 2.2-3-8.

In addition, taxpayer has failed to demonstrate that the railroad turnouts are used to transport "work-in-process." Even if – as taxpayer contends – the turnouts are exclusively used to transport unfinished steel from its out-of-state manufacturing sites to its Indiana facility, the exemption is not available for "[t]ransportation equipment used to work-in-process, semi-finished, or finished goods between plants... if the plants are not part of the same integrated production process." 45 IAC 2.2-5-8(f)(4). Taxpayer has failed to establish that its out-of-state manufacturing sites and the Indiana facility operate in such a way as to form a seamless manufacturing operation sufficient to justify exempting each and every item of equipment found within that integrated operation.

B. Over-the-Road Transportation Vehicles:

One of taxpayer's operating divisions acquired a number of trucks and, thereafter, operated as a transportation company. Taxpayer uses these trucks to transport its steel coils from its Indiana manufacturing facility to third-party processors. The third-party processors perform various operations required by the taxpayer's customers. These operations include cutting, slitting, and coating the steel coils. After these operations are complete, the third-party processors then package the coils and ship them to customers.

The audit concluded that the trucks were not entitled to an exemption because they were not transporting work-in-process. Specifically, the audit report stated that, "The movement of these rolls to a third-party processor for completion or further processing places the goods outside of [taxpayer's] integrated production process and into a third-party processor's production process."

Taxpayer disagrees taking the position that its "integrated production process" is not complete until the steel coils are transported to the third-party processors and that the work performed by the third-party processors is an "essential and integral part" of its production of rolled carbon steel. According to taxpayer, its own production process is not complete until the "most marketable product" is produced. To that end, taxpayer cites a number of authorities including <u>Indiana Dept. of State Revenue v. Cave Stone, Inc.</u>, 457 N.E.2d 520 (Ind. 1983) and <u>General Motors Corp. v. Indiana Dept. of State Revenue</u>, 578 N.E.2d 399 (Ind. Tax Ct. 1991). Taxpayer is correct in that both cases deal with issues associated with transporting work-in-process between different stages of the appellant taxpayers' manufacturing process. However, in <u>Cave Stone</u>, the court found that appellant taxpayer's transportation equipment was exempt because the equipment was being used *within* that taxpayer's own production process whereby it manufactured crushed stone. <u>Cave Stone</u> 457 N.E.2d at 521, 523. Similarly, in <u>General Motors</u>, the court found that packaging materials – used to transport automobile parts from the manufacturer's component plants to its own final assembly plants – was entitled to the exemption, because the materials were employed within the manufacturer's integrated manufacturing process. <u>General Motors</u>, 578 N.E.2d at 402, 404.

The production equipment exemption is found at IC 6-2.5-5-3(b) which states as follows:

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

Taxpayer argues for an interpretation of the exemption statute which would allow it to claim an exemption for equipment used to deliver its steel coils to third-party processors. Taxpayer maintains that to deny the exemption is "illogical."

There is no dispute that taxpayer is involved in the manufacture and production of steel products and that certain equipment used *within* its manufacturing facilities is entitled to the exemption. It may even be reasonably assumed that the third-party processors are also entitled to claim an exemption for equipment used to transport work-in-process within *its* manufacturing process. However, the regulation does not permit the application of the exemption to include trucks used to transport taxpayer's steel to its third-party processors once that steel leaves taxpayer's own facility.

Specifically, 45 IAC 2.2-5-8(f)(3) states that "[t]ransportion equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process." The taxpayer's trucks are not entitled to this exemption because there is no indication that the trucks are used to move the steel within taxpayer's "production process." Even if the third-party processors were not independent vendors but were one of taxpayer's own remote facilities, there is still no assurance that the trucks would be entitled to the exemption because there is no indication that taxpayer's manufacturing plant and the remote processors would together form "one continuous integrated production process for the purpose of exemption from sales/use tax." <u>General Motors</u>, 578 N.E.2d at 402. As specified in 45 IAC 2.2-5-8(f)(4), "Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, *if the plants are not part of the same integrated production process.*" (*Emphasis added*).

Alternatively, taxpayer argues that the trucks are exempt from tax under IC 6-2.5-5-27 which states that "[t]ransactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation or property." In interpreting that exemption, the Indiana Tax Court has stated that, "If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption." <u>Panhandle Eastern Pipeline Co., v. Indiana Dept. of State Revenue</u>, 741 N.E.2d 816, 819 (Ind. Tax Ct. 2001).

Taxpayer is not entitled to claim the exemption because it is simply transporting its own steel coils and because taxpayer, as a steel manufacturer, is not predominantly engaged in the business of providing "public transportation." Nonetheless, taxpayer counters by arguing that the trucks are owned by an independent division which services the vehicles and maintains its own books and records. Perhaps so. In which case, taxpayer fails to explain on what basis it is entitled to claim the sales and use tax exemption for trucks belonging to an entirely independent entity.

C. Crane and Flatbed Trucks.

Taxpayer argues that a crane and two of its flatbed trucks are used to move work-in-process and are entitled to an exemption from sales and use tax.

The audit performed a "crane study" to determine the extent to which taxpayer's cranes were used in a taxable and exempt manner. The audit report stated, "Cranes that move finished goods, raw materials, or perform maintenance duties are taxable, while those that move work-in-process are exempt." In addition, the audit conducted a "mobile equipment study" to determine both the taxable and exempt usage for taxpayer's vehicles. According to the audit report, "This study indicated that taxpayer's trucks and tractors were being used in various ways," and concluded that taxpayer's trucks and tractors "moving work-in-process were exempted or partially exempted pursuant to 45 IAC 2.2-5-8. However, those pieces of equipment performing maintenance duties or movement of furnished goods are fully or partially taxable." For example, the audit concluded that one of taxpayer's "Semi-Tractors" was 95 percent exempt and that a particular "Mobile Crane" was 80 percent exempt.

The results of both the crane study and the mobile equipment were reviewed by the taxpayer. In both instances, the audit report indicates that the taxpayer "agree[s] with the percentages determined by the study."

In its protest, taxpayer cites to a "crane and two flatbed trucks" indicating that this equipment "is used 100% of the time to transport exempt work-in-process." Taxpayer maintains that it has "verified that the crane and flatbed trucks are used to transport work-in-process goods from the [taxpayer's] facility to its own vehicles or, in less frequent instances, between production steps on [taxpayer's] property."

Taxpayer has failed to meet the burden of proof necessary to overcome the presumption of correctness attached to the original audit report and consequent assessment pursuant to IC 6-8.1-5-1(b). "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Id. The audit report indicates that the proposed assessment is based on a detailed and rational consideration of the exempt and non-exempt use of taxpayer's transportation equipment. The report also indicates that – at least initially – taxpayer agreed with the report's conclusions concerning each specific piece of equipment. Taxpayer's bare assertion, that it later verified that the crane and flatbed trucks are exclusively used in a tax exempt manner, does not permit the Department to set aside the conclusions reached in the original audit report.

FINDING

Taxpayer's protest is respectfully denied.

II. Monitoring Equipment Used Within the Steel Production Process

Taxpayer purchased certain equipment used to monitor its steel production process. The audit determined that this equipment was not directly employed in the direct production of the steel and denied taxpayer's claim that the monitoring equipment was exempt from sales and use tax.

Taxpayer argues that the regulations permit the equipment to be classified as "exempt." To that end, taxpayer cites to 45 IAC 2.2-5-8(b), (c) which states as follows:

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

Taxpayer seeks the manufacturing exemption for three categories of monitoring equipment. The first category consists of a chart recorder and paper for the chart recorder. This equipment is used to monitor production along taxpayer's galvanized steel manufacturing line. The recorder is attached to the production line and provides the operators with information on the speed of the line as well as the electricity used in the production process. According to taxpayer, the operators use this information to adjust the galvanized steel production line.

The second category consists of video equipment. The video camera is located over the steel production line and transfer images to video monitors visible to the production line personnel. According to taxpayer, the production line personnel use the monitoring equipment to control the speed of the production line, ensure that the coil is moving properly through the production process, and ensure that the steel is free from defects.

The third category consists of a data collection system which tracks information on utilities – primarily water and steam – consumed in the steel production process. The data collection system gathers information on the ph, flow, and temperature of the water and steam. Taxpayer's personnel monitor this data and adjust the production line to ensure that the steel being produced meets certain quality specifications. According to taxpayer, without the data collection system, it would be unable to produce marketable steel.

Taxpayer has failed to demonstrate that this monitoring equipment has a direct and immediate effect on the steel being produced. It would appear that the monitoring equipment operates in a manner removed at least one step from the actual production of the steel; the monitoring equipment does not directly function to change the form, composition, or marketability of the steel. Undoubtedly, all of the monitoring equipment plays an important part in the production of taxpayer's steel. However, as noted in 45 IAC 2.2-5-8(g), "The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required... by practical necessity does not itself mean that the property 'has an immediate effect upon the article being produced.'"

FINDING

Taxpayer's protest is respectfully denied.

III. Strapping Dispenser and Banding Tool

Taxpayer purchased a strapping dispenser and a banding tool. This equipment is used to wrap a band of steel strapping around coils of steel in order to ensure that the steel remains coiled during shipping and delivery.

Taxpayer maintains that the strapping dispenser and banding tool operate within its continuous production process and, under 45 IAC 2.2-5-8(b), (d), the equipment is exempt from sales and use tax. The regulation provides in relevant part:

> The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.
>
> Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Taxpayer is in the business of producing steel coils, and its customers are interested in obtaining that steel. Therefore, the object of a taxpayer/customer transaction is the transfer of the steel coils from manufacturer to consumer. The steel strapping facilitates the transfer of the steel but is not the *object* of the transaction. The fact that steel strapping accompanies the coils of steel is entirely tangential to the purchase of the steel. Whether the coils of steel were bound with chains, contained in a wooden crate, or even tack-welded in a "closed" position is irrelevant to the customer.

Accordingly, the application of the steel strapping occurs after taxpayer's production activity "has altered the [steel coil] to its completed form...." 45 IAC 2.2-5-8(d). Because the taxpayer uses the strapping dispenser and banding tool after taxpayer's production activity is complete, taxpayer was not entitled to claim the exemption at the time taxpayer acquired that equipment.

FINDING

Taxpayer's protest is respectfully denied.

IV. Materials and Equipment Used to Meet Environmental Control Requirements

Taxpayer made certain purchases associated with its environmental regulation compliance efforts. Specifically, taxpayer purchased slag used to build roads located within its landfill. Taxpayer purchased a tank to hold the sodium bisulfate used to treat contaminated lake water. The audit determined that neither the purchase of the slag or tank was exempt from sales and use tax.

The Indiana Code exempts the purchase of certain environmental control equipment from the state's sales and use tax. IC 6-2.5-5-30 provides as follows:

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

The Department promulgated a regulation to assist in the application of the statute. 45 IAC 2.2-5-70 states, in relevant part, as follows:

> The state gross retail tax does not apply to sales of tangible personal property which constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominately used and acquired for the purpose of complying with any state, local or federal environment [quality] statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture. (1) Consumed as used in this regulation... means the dissipation or expenditure by combustion, use or application and does not mean or include the obsolescence, discarding, disuse, depreciation, damage, wear or breakage of tools, machinery, devices or furnishings. (2) Incorporated as used in this regulation... means the material must be physically combined into and become a component of the environmental quality device, facility, or structure. The material must constitute a material or integral part of the finished product.

Taxpayer builds roads into its landfill site in order to make possible the disposal of certain waste products associated with the production of steel. It is not disputed that, in order to operate this landfill, taxpayer must adhere to regulations and guidelines established by the Environmental Protection Agency and the Indiana Department of Environmental Management. For example, the landfill must be constructed in such a way as to insure that groundwater is not contaminated. There is no contention that the roads are used in a dual capacity, i.e. the roads are used to transport material to the landfill and also used to transport raw material to taxpayer's production facility.

The audit denied the exemption because the "slag for the roads [did] nothing for the functionality of the landfill... the roads [did] not directly affect how wastes are disposed of."

The term "facility" is defined as, "Something created to serve a particular function." The American Heritage Dictionary of the English Language (4th ed. 2000). Taxpayer's landfill is an environmental "facility" built and operated in order to comply with state and federal environmental regulations. The landfill was not built as an expedient means for disposing of unwanted or hazardous materials. But for the state and federal regulations, taxpayer would not have built the landfill or would not have built the landfill in the manner it which was actually constructed. Taxpayer's roads are an integral part of the landfill facility, are physically "incorporated" into that facility, and form a "component part of the environmental... facility." Therefore, under IC 6-2.5-5-30 and 45 IAC 2.2-5-70, taxpayer's purchase of the slag is exempt from sales and use tax.

Taxpayer purchased a storage tank which, pursuant to the environmental equipment exemption, taxpayer argues is exempt from sales and use tax. Taxpayer maintains that it purchased the tank in order to comply with state and federal environmental regulations.

During the steel manufacturing process, taxpayer uses quantities of chlorinated lake water to cool its production equipment and its work-in-process steel coils. Before taxpayer returns the lake water to its original source, taxpayer is required to remove the chlorine. Taxpayer mixes the wastewater with sodium bisulfate to neutralize the chlorine. Prior its use in this treatment process, the sodium bisulfate is stored in a tank. It is this particular storage tank which is the subject of taxpayer's protest.

It is not disputed that the chlorine removal is mandated by state and federal environmental regulations. It is not disputed that the tank is used only for the storage of sodium bisulfate and that the sodium bisulfate is used exclusively for the treatment of wastewater. However, the audit denied the exemption because the tank was "merely a storage tank holding raw chemicals for eventual introduction into the wastewater treatment process...."

Taxpayer operates an elaborate system of pipes, equipment, and structures in order to process and treat lake water both at the time the water is first introduced into its manufacturing plant and at the time the wastewater is returned to the lake. It is apparent that the sodium bisulfate tank is "incorporated into" the taxpayer's treatment facility and that the treatment facility is operated predominately "for the purpose of complying with... state, local, or federal environmental quality statutes, regulations or standards...." IC 6-2.5-5-30. Accordingly, taxpayer's purchase of the sodium bisulfate storage tank is exempt from sales and use tax under IC 6-2.5-5-30 and 45 IAC 2.2-5-70.

FINDING

Taxpayer's protest is sustained.

V. Gross Retail and Use Tax on Materials Incorporated Into Realty – Direct Payment Permits Issued to Contractors

Taxpayer protests the assessment of sales tax on materials incorporated into its real property.

During the period of time covered by the audit report, taxpayer maintains that it issued its direct pay permit to various contractors hired to make improvements to taxpayer's realty. The direct pay permit is issued by the state and allows the taxpayer to acquire tangible personal property without the immediate necessity of paying sales tax. IC 6-2.5-8-9(b). Thereafter, at the time when taxpayer determines the use and taxability of the tangible personal property, the taxpayer "must then pay the tax on that purchase directly to the department." Id.

Taxpayer's direct pay permit reads in part as follows: "Direct pay permits may be issued to contractors on lump sum contracts for the improvements of realty if the contractor supplies a breakdown of the costs of the materials. If no breakdown of the cost of the materials is available, the contractor will be liable for tax on the materials."

Taxpayer argues that it is not subject to use tax liability for those transactions for which taxpayer either issued a purchase order or contracted for an improvement to taxpayer's realty on the basis of lump sum contracts. 45 IAC 2.2-4-22(e) states as follows:

> With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner: (1) He converts construction material into realty on land he owns and then sells the improved real estate; (2) He utilizes the construction material for his own benefit; or (3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price. A disposition under [(3) Lump sum contract] will be exempt from the use tax if the contractor received a valid exemption certificate from the ultimate purchaser or [recipient] of the construction material (as converted), provided such person could have initially purchased such property exempt from the state gross retail tax.

The taxpayer issued the direct pay permit to its contractors in order to permit the contractors to acquire various building materials tax-free. In each of the transactions at issue, the contractor – having received taxpayer's direct pay permit – purchased the material tax free. However, there is no indication that taxpayer ever established that any of the materials would be used in a tax-free manner. Taxpayer may not employ its direct pay permit – issued entirely for taxpayer's convenience – in a manner for which it was never intended.

FINDING

Taxpayer's protest is respectfully denied.

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 at the time of the original audit.

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 evidence sufficient to establish to establish that its failure to pay the deficiency was due to reasonable cause and not due to willful neglect.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420020057.LOF

LETTER OF FINDINGS NUMBER: 02-0057
Indiana Gross Retail Tax
For the Tax Years 1997, 1998, and 1999

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

ISSUES

I. Taxpayer's Ammonia Cooling System – Gross Retail Tax

Authority: IC 6-2.5-1-1 et seq.; IC 6-2.5-5-3(b); Indianapolis Fruit Co. v. Dept. of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998); Mid-America Energy Resources v. Dept. of State Revenue, 681 N.E.2d 259 (Ind. Tax Ct. 1997); 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(d); 45 IAC 2.2-5-8(e)

Taxpayer argues that the audit erred when it determined that taxpayer's purchase of an ammonia cooling system was subject to the state's gross retail (sales and use) tax. Taxpayer maintains that the cooling system is used within its manufacturing process and, because the cooling system has an immediate effect on its product, it is entitled to the manufacturing exemption.

II. 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 urges the Department of Revenue (Department) to exercise its discretion to abate the ten percent negligence penalty imposed at the time of the original audit. Taxpayer believes it is entitled to abatement of the penalty because any errors it made in calculating its sales and use tax liability were not due to its own negligence.

STATEMENT OF FACTS

Taxpayer produces refrigerated, ready-to-bake, dough products at an Indiana manufacturing facility. A tax audit was conducted resulting in additional assessments of use tax. Taxpayer disagreed with a number of those additional assessments and submitted a protest. An administrative hearing was conducted, and this Letter of Findings follows.

DISCUSSION

I. Taxpayer's Ammonia Cooling Systems – Gross Retail Tax

After taxpayer's products have been individually packaged and palletized, the products are transferred to a refrigerated "finished goods storage area" (taxpayer's terminology). In that storage area, the products are cooled to a pre-determined temperature – between 33 and 40 degrees F. – before being transferred to an off-site shipping warehouse. Taxpayer was assessed use tax on the purchase price of an ammonia refrigeration system used to cool the finished goods storage area; the audit concluded that the ammonia refrigeration system was not part of taxpayer's production activities and imposed an additional use tax assessment. Taxpayer disagrees arguing that its manufacturing process is not complete until after the products leave the finished goods storage area.

In Indiana, a sales tax is imposed on retail transactions and a complementary use tax is imposed on tangible personal property that is stored, used, or consumed in the state. IC 6-2.5-1-1 et seq. In this instance, taxpayer relies on the tax exemption found at IC 6-2.5-5-3(b). That particular exemption states that: "Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." It is taxpayer's contention that the ammonia refrigeration equipment falls within the definition of "direct use" as provided in 45 IAC 2.2-5-8(c). That regulation reads as follows:

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

Taxpayer's refrigerated dough products are mixed to specific temperature. It is taxpayer's contention that its products are not complete until the products reach a certain temperature in its refrigerated finished goods storage area. According to taxpayer, the temperature in the refrigerated storage area is critical in controlling the amount of carbon dioxide gas within the product. If the temperature is too high, too much carbon dioxide gas will be produced resulting in low density, low weight product. If the temperature is too low, too little carbon dioxide will produce a high density, high weight product. In addition, maintenance of the proper temperature is needed to achieve and maintain an optimum pressure within the individual dough containers.

There is no question that taxpayer is involved in the production of tangible personal property and is entitled to claim the exemption for equipment directly involved in the direct production of that personal property. The issue is whether the ammonia refrigeration system, used to cool taxpayer's finished goods area, is employed *within* taxpayer's production process.

As used within the exemption statute, "production" is broadly defined and "focuses on the creation of a marketable good." Mid-America Energy Resources v. Dept. of State Revenue, 681 N.E.2d 259, 264 (Ind. Tax Ct. 1997). In Indianapolis Fruit Co. v. Dept. of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998), the court held that appellant taxpayer's equipment involved in the production of ripened bananas was entitled to the sales and use tax exemption. Id. at 1386. The court found that appellant taxpayer's introduction of ethylene gas into the banana ripening process was "sufficient to constitute production." Id. at 1385. In contrast, the court held that appellant taxpayer's tomato ripening equipment was not entitled to the exemption because that particular ripening activity "was essentially passive in nature." Id. at 1386. The court summarized the distinction as follows: "With respect to the bananas, [taxpayer] actively induced the ripening; it did no such thing with respect to the tomatoes. In other words, the difference is that, with respect to the bananas, [taxpayer] made something happening; with respect to the tomatoes, [taxpayer] let something happen."

Taxpayer's production of refrigerated dough products is not complete until the most marketable product is achieved. That marketable product is not obtained until the individual product items have reached a desired consistency, density, and pressure. Those particular qualities are not realized until the products have been cooled to a particular temperature and then maintained at the temperature for a specified amount of time.

None of this occurs spontaneously because taxpayer's cooling activities are analogous to the banana ripening activities in Indianapolis Fruit. In that particular case, the appellant taxpayer would not have obtained saleable bananas without the introduction of ethylene gas because the bananas would not have satisfactorily ripened on their own. Similarly, taxpayer would not have obtained a marketable refrigerated dough product without acting to cool that product for a pre-determined time and to a pre-determined temperature. Taxpayer's dough product, as it comes immediately off the production line, is unmarketable and unusable. Although unrefrigerated dough would have produced carbon dioxide even without the cooling equipment, unless taxpayer had acted upon the dough in such a way as to directly control the carbon dioxide level, taxpayer's room temperature dough products would be as unmarketable as unripened or spoiled bananas. As set out in 45 IAC 2.2-5-8(d), "'Direct use in the production process' begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form...." Taxpayer's dough products have not achieved their "completed form" at the time the products first leave taxpayer's production line. However, after 48 hours in the "finished goods storage area," the dough products are ready to be marketed to the ultimate consumer. As in Indianapolis Fruit, during the 48 hours the products are maintained in the finished goods storage area, taxpayer is "[making] something happen."

However, taxpayer errs when it claims that its production "is not complete until after the products leave the finished goods storage area." Taxpayer's exemption claim is limited to the extent that the ammonia refrigeration system was acquired for "direct use in the direct production, manufacture... of other tangible personal property." IC 6-2.5-5-3(b). After 48 hours of cooling, the product has achieved the proper amount of carbon dioxide, the individual product containers have achieved the desired amount of pressure, and the previously unfinished products can be purchased and used by the consumer. It is at this point that "direct production" ceases and the finished product is simply being preserved in a saleable condition. There is nothing within IC 6-2.5-5-3(b) or 45 IAC 2.2-5-8(c) which permits a manufacturer to claim the exemption for equipment being used to preserve an otherwise finished product. To the contrary, 45 IAC 2.2-5-8(e), Example One, specifically provides that "Purchases of refrigeration equipment used in milk production during the production process are exempt. However, refrigeration equipment used to store milk products *subsequent* to production is taxable." (*Emphasis added*). Accordingly, to the extent that the ammonia refrigeration equipment is directly used for 48 hours in the direct production of its refrigerated dough products, taxpayer is entitled to the exemption available under IC 6-2.5-5-3(b) and 45 IAC 2.2-5-8(c). However, to the extent the ammonia refrigeration equipment is used to maintain the finished product in a saleable condition before transfer to taxpayer's shipping warehouse, the exemption is unavailable.

FINDING

Taxpayer's protest is sustained.

II. Abatement of the Ten Percent Negligence Penalty

Taxpayer protests the assessment of the ten percent negligence penalty on the amount of use tax deficiency determined at the time of the original audit.

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 offered evidence sufficient to establish to establish that it exercised "ordinary business care" and that its failure to pay the use tax deficiency was due to reasonable cause and not due to willful neglect. The audit report indicated that taxpayer maintained a "very extensive and highly utilized use tax accrual system in place" and that taxpayer's sales tax records and procedures "were found to be substantially correct."

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

2820020185.LOF

LETTER OF FINDINGS NUMBER: 02-0185
Controlled Substance Excise Tax
For Tax Period 1998

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

ISSUE

I. Controlled Substance Excise Tax – Validity of Assessment

Authority: IC 6-8.1-5-1; 45 IAC 15-5-3

Taxpayer protests the validity of the Department's assessment of Controlled Substance Excise Tax.

STATEMENT OF FACTS

Police reports were provided to the Indiana Department of Revenue ("Department"). The reports explained that taxpayer was found to be in possession of Psilocyn (Hallucinogenic Mushrooms). After the dismissal of criminal charges, the Department issued an assessment of Controlled Substance Excise Tax ("CSET"). Taxpayer protests this assessment. Taxpayer failed to attend the scheduled administrative hearing. Further facts will be supplied as necessary.

I. Controlled Substance Excise Tax – Validity of Assessment

DISCUSSION

Taxpayer protests the Department's assessment of CSET. Taxpayer states that the criminal charges for possession of Psilocyn against him were dropped due to mishandling of evidence by a lab technician, who was in turn charged with criminal conduct. Taxpayer believes that the inadmissibility of the evidence in the criminal courts strips the Department of its ability to use the evidence in its assessment.

The Department reminds taxpayer that the administrative hearing is not a court of law, and refers to 45 IAC 15-5-3(b)(7), which states:

> The hearing will be conducted in an informal manner. The purpose of the hearing is to clearly establish the taxpayer's specific objections to the assessment and the reasoning for these objections. The hearing is not governed by any rules of evidence. The department is expressly excluded from the requirements of the Administrative Adjudication Act.

Next, the Department refers to IC 6-8.1-5-1(a), which states in relevant part:

> 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.

Also, the Department refers to IC 6-8.1-5-1(b), which states in relevant part:

The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

After reviewing the police reports, the Department issued its assessment. The Department routinely assesses excise taxes on items other than controlled substances, without physically examining the goods. In the instant case, the police reports are sufficient for the Department to issue its assessment.

Taxpayer's only other argument is that assessment of the CSET is inequitable due to his status as a student. Taxpayer explains that he is working as a graduate student and is saving his money to pursue a doctoral degree, and payment of the CSET would hamper the achievement of this goal. Taxpayer provides no citation to any court decision, statute, regulation or other legal source to support the use of a taxpayer's financial status as grounds for dismissing an assessment.

Therefore, the Department may base its assessment of CSET on the police reports, as explained in IC 6-8.1-5-1(a) and 45 IAC 15-5-3(b)(7). Taxpayer has not met the burden of proving the proposed assessment wrong, as required by IC 6-8.1-5-1(b). Taxpayer's status as a student and income level are irrelevant.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120020365.LOF

LETTER OF FINDINGS NUMBER: 02-0365
Individual Income Tax
For the Tax Year 1998

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

ISSUE

I. Constitutionality of the Federal Income Tax

Authority: U.S. Const. amend. XVI; I.R.C. § 61; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; Cheek v. United States, 498 U.S. 192 (1991); Stanton v. Baltic Mining Co., 240 U.S. 103 (1916); Brushaber v. Union Pacific R.R. Co., 240 U.S. 1 (1916); Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895); Springer v. United States, 102 U.S. 586 (1880); Hylton v. United States, 3 U.S. 171 (1796); United States v. Connor, 898 F2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F2d 1328 (7th Cir. 1984); United States v. Romero, 640 F2d 1014 (9th Cir. 1981); 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); Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer argues that the federal income tax system – and by derivation, Indiana's individual income tax – is unconstitutional and that application of the income tax system to ordinary citizens is the result of a vast, decades-long, conspiracy to obfuscate the original intent and extent of the Sixteenth Amendment and the Internal Revenue Code.

STATEMENT OF FACTS

The Department of Revenue (Department) sent the taxpayer a "Demand Notice for Payment" on June 19, 2002. The notice indicated that taxpayer owed unpaid "Individual Income" taxes for the year ending December 31, 1998.

On July 25, 2002, taxpayer submitted a protest to the Department. The protest contained a heading indicating that the protest was an "Administrative Notice of Debt Not Owed and Violation of Agent's Authority and Denial of Administrative Due Process." The taxpayer's protest outlined a series of complaints: taxpayer complained that the Department's "Demand Notice" was unsigned; the United States Constitution did not authorize imposition of an income tax on individual income; and only corporate income was subject to the state's taxing authority. Contained within the letter was a request that the amount of unpaid income taxes, otherwise ascribed to the taxpayer, be immediately abated. Taxpayer stated that "If [Department representatives] do not rescind threats of a tax warrant and lien on my property, or if your office sends me any more unsigned, threatening letters, [taxpayer] will make a claim for damages against you in your personal capacity...." Taxpayer requested that the taxes be abated or the taxpayer "[would] file a lawsuit for... damages in US District Court."

Substantiating the taxpayer's protest, taxpayer attached a copy of her 1998 U.S. Individual Income Tax Return. The return was noticeably absent information concerning the taxpayer's 1998 income because it simply contained eighteen sets of "zeroes."

The Department notified taxpayer by means of a July 29 letter (signed) indicating that her protest would be reviewed and assigned to a hearing officer. The protest was duly assigned, and an initial contact letter (signed) was sent to the taxpayer on July 29 indicating that the taxpayer would be given an opportunity to explain the basis for her protest during an administrative hearing. Taxpayer declined the opportunity to respond. A second letter (signed, certified) was sent to the taxpayer again offering taxpayer the opportunity to explain the basis for her protest. Taxpayer responded on September 14 stating the initial "Demand Notice" was "a complete falsehood" and requesting "an explanation in writing." The Department replied on September 19 by means of a letter (signed) stating that taxpayer's bare "falsehood" explanation was somewhat inadequate and that taxpayer's September 14 letter "did not resolve [the] issue of the protested state taxes." Again, taxpayer was invited to take advantage of the available administrative hearing process and to further explain the basis for her protest. Taxpayer responded on October 6 stating that the reason she did not pay state income taxes was because she "declared my taxable income as -0-." Taxpayer stated that she was enclosing a video tape – "Theft by Deception: Deciphering the Federal Income Tax" – which would explain the basis for taxpayer's claim that she owed no state income tax. Taxpayer requested that the Department view the tape "in its entirety." The Department responded by means of an October 10 letter (signed) stating that the Hearing Office would view the video tape and asking if the taxpayer intended to "take part in an administrative hearing either in person or by phone." Taxpayer responded with October 24 letter stating that she "[did] not want to take part in an administrative hearing."

Based upon the taxpayer's initial protest letter, subsequent correspondence, and the contents of the "Theft by Deception" video tape, the Department has attempted to frame the issues raised by taxpayer, and responds to those issues by means of this Letter of Findings.

DISCUSSION

I. Constitutionality of the Federal Income Tax

Taxpayer argues that the current federal and state income tax system is unconstitutional and that numerous court decisions support this proposition. According to taxpayer, only "non-resident aliens and foreign corporations" are subject to federal or state income taxes. The current tax structure is predicated on a "fraud unrivaled in history." Further, by "digging through" the Constitution, the tax statutes, and the tax regulations, an "ordinary citizen" will discover that the "conventional wisdom is incorrect," that the income tax laws do not apply to the "income of average Americans," that ordinary people who lose their "blind faith" and abandon "conventional wisdom" will escape the taxing authorities' conspiratorial efforts subjecting them to the burden of federal and state income taxes.

Taxpayer's first argument is that the income tax is an unapportioned tax, repugnant to the Constitution, and that the U.S. Const. amend. XVI "granted no new taxing authority to the U.S. government." Taxpayer's argues that the individual income tax is a "direct tax" that must be apportioned in accordance with the Constitution. Taxpayer errs. There is nothing in the Constitution which states that wages or income cannot be taxed. From the founding of the republic, it has been the consistent opinion of the Supreme Court, that the phrase "direct tax" refers to a tax on real property. Hylton v. United States, 3 U.S. 171 (1796); Springer v. United States, 102 U.S. 586 (1880); Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601 (1895); Brushaber v. Union Pacific R.R. Co., 240 U.S. 1 (1916).

Taxpayer cites to Brushaber, 240 U.S. 1 (1916) for support of the proposition that the federal income tax is an unapportioned tax and is offensive to the Constitution. The case permits no such conclusion. Rather, the Court rejected an argument to contrary and stated as follows:

> Nothing could serve to make this clearer than to recall than in the Pollock Case, in so far as the law taxed incomes from other classes of property than real estate and invested personal property, that is income from "professions, trades, employments or vocations," its validity was recognized; indeed it was expressly declared that no dispute was made upon that subject, and attention was called to the fact that taxes on such income had been sustained as excise taxes in the past. Id. at 17. (Internal citations omitted).

Taxpayer's reliance on the Brushaber opinion is unwarranted. The Court clearly stated that, "[T]he command of the Amendment [is] that all income taxes shall not be subject to apportionment by a consideration of the sources from the taxed income may be derived..." Brushaber, 240 U.S. at 18.

Taxpayer may be legitimately entitled to argue that the tax statutes and accompanying regulations are overly complicated. However, the language and effect of the enabling constitutional amendment is plain. "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." U.S. Const. amend. XVI.

Taxpayer cites to Stanton v. Baltic Mining Co., 240 U.S. 103 (1916) for support of the proposition that the federal income tax is unconstitutional as an encroachment of the limitations placed upon the federal government. Specifically, taxpayer cites to the text in the case which states that "as the Sixteenth Amendment authorizes only an exceptional direct income tax without apportionment, to which the tax in question does not conform, it is therefore not within the authority of that Amendment." Id. at 112 Taxpayer takes the quotation entirely out of context. The cited above statement is not a holding of the court; rather it is the petitioner's argument thereafter directly rejected by the Court. A few lines later the Court states that the cited proposition "is plainly in conflict with the meaning of the Sixteenth Amendment as interpreted in the Brushaber Case, it may also be put out of view." Id.

Taxpayer relies on the videotape presentation purporting to establish that she was not subject to federal and state individual income tax. The premise of the videotape is that only non-resident aliens and foreign corporations are subject to income tax. By means of the videotape presentation, taxpayer asserts that the income tax system, as originally established, is constitutionally limited to non-resident aliens and foreign corporations. Taxpayer argues that the current "conventional wisdom" to the contrary is incorrect and that a vast "cover-up" has been implemented over the years by attorneys, tax experts, government officials, and others of that ilk in order perpetuate a "premeditated fraud' on the unsuspecting citizenry. According to taxpayer's presentation, if the ordinary person would only research the statutes and regulations, that person would discover that the income tax "does not include the income of average Americans."

Taxpayer contends that – given the constitutional limitations on federal and state taxing authority – the income tax was originally imposed only on non-resident aliens and foreign corporation, and that through the conspiratorial machinations of tax professionals, the tax was gradually extended to average citizens. Taxpayer's contention is totally without merit, and the Department will not expend its resources in addressing each and every detail of this unfounded, convoluted, and illogical proposition.

Taxpayer's argument does not comport with the law or with ordinary common sense. There is not a single state or federal court decision which remotely supports taxpayer's argument. To the contrary, federal and state courts have consistently, repeatedly, and without exception determined that the average citizen's wages – no matter in what form the taxpayers have attempted to characterize, define, or label those wages – are income subject to taxation. United States v. Connor, 898 F2d 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 F2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); Coleman v. Commissioner of Internal Revenue, 791 F2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); United States v. Koliboski, 732 F2d 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 F2d 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.... [Taxpayers] 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."). As recently as 1991, the Supreme Court characterized as "frivolous" the notion that "the income tax law is unconstitutional." Cheek v. United States, 498 U.S. 192, 205 (1991).

In addressing taxpayer's argument, 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).

Taxpayer's contention, that she was entitled to declare "0" as Indiana adjusted gross income because she filled the corresponding federal return with a string of zeroes, is meritless. The statute is unambiguous. Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 62 not simply as whimsically reported by the taxpayer. *See* Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209, 1213 (Ind. Tax Ct. 1996). Notwithstanding the brief instructions contained on the Indiana tax return, taxpayer is required to actually perform the calculations necessary to determine taxpayer's liability for Indiana adjusted gross income tax. Given that taxpayer received gross income (I.R.C. § 61) in 1998, is an "individual" under IC 6-3-1-9, was a resident of Indiana for during that year (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 1998 income.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120020389.LOF

LETTER OF FINDINGS NUMBER: 02-0389
Income Tax
Calendar Year 2001

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

ISSUE

I. Tax Administration – Bad Check Penalty

Authority: IC 6-8.1-10-5

The taxpayer protests the bad check penalty.

STATEMENT OF FACTS

The bad check penalty was assessed on a returned check resulting from an income tax return filed for the calendar year 2001. The taxpayer is an individual.

I. Tax Administration – Bad Check Penalty

DISCUSSION

The taxpayer requests waiver or reduction of the 100% bad check penalty as the error was unintentional.

The taxpayer was victimized by embezzlement. During the investigation of the embezzlement, the taxpayer closed the existing checking account and opened a new checking account to prevent the cashing of any more fraudulent checks. Before closing the checking account, the taxpayer issued a check to the Department for the payment of 2001 income taxes in the amount of $246. As the checking account was closed before the Department could present the check for payment to the bank, the check "bounced". The Department sent notices of liability to the taxpayer concerning the returned check on June 18, 2002 and July 10, 2002. The taxpayer did not respond to the notices until July 19, 2002 as the taxpayer was out-of-town and unable to access their mail.

The statute for bad checks, IC 6-8.1-10-5(c) reads: "If the person subject to the penalty under this section can show that there is reasonable cause for the check not being honored, the department may waive the penalty imposed under this section."

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

The Department finds the taxpayer was inattentive to tax duties as the taxpayer did not respond to Department notices until mid-July. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

2820020428.LOF

LETTER OF FINDINGS NUMBER: 02-0428 CSET
Controlled Substance Excise Tax
For Tax Period: 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

1. Controlled Substance Excise Tax – Imposition

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

Taxpayer protests the imposition of the Controlled Substance Excise Tax.

STATEMENT OF FACTS

As the result of a sting operation, the taxpayer was arrested on November 19, 1996 for possession of marijuana and cocaine. On April 12, 2002, the appropriate County Prosecuting Attorney sent the Indiana Department of Revenue, hereinafter referred to as the "department," a request for the assessment of controlled substance excise tax relating to the defendant's possession of marijuana. The department issued a Record of Jeopardy Finding, Jeopardy Assessment, Notice and Demand on May 9, 2002 in a base tax amount of $15, 339.45. The taxpayer filed a protest to the assessment. A hearing on the protest to the imposition of the controlled substance excise tax was held on October 23, 2002.

1. Controlled Substance Excise Tax – Imposition

DISCUSSION

IC 6-7-3-5 imposes the Controlled Substance Excise Tax on the possession of marijuana in the State of Indiana. Departmental 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 marijuana subject to the imposition of the tax 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 drugs, presence on property where drugs 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 Taxpayer had not only the requisite intent but also the capability to maintain dominion and control over the substance. Hurst at 374.

The issue to be determined in this case is whether or not Taxpayer had possession of the marijuana. The taxpayer contends that he never had actual or constructive possession of the marijuana because the marijuana was thrown in the back of his car and he was arrested before he ever had access to the marijuana. The taxpayer contends that since he was under arrest, he had no capability to maintain dominion and control over the marijuana.

The police officer's report and Affidavit For Probable Cause contradict the taxpayer's version of the transaction. The texts of these documents indicate that the taxpayer and confidential informant exchanged the marijuana for the money inside the taxpayer's house. When he was arrested, the taxpayer was holding a trash bag filled with the marijuana. After the taxpayer's arrest outside of his house, the police discovered the brown wrapping paper inside the defendant's residence. The taxpayer's transfer of the marijuana from the brown packaging paper to the trash bag and carrying the marijuana filled trash bag outside the house indicate that the taxpayer had actual possession of the marijuana.

The controlled substance excise tax was properly imposed on the taxpayer.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220020492P.LOF

LETTER OF FINDINGS NUMBER: 02-0492P
Adjusted Gross Income Tax
For Calendar Year Ended December 31, 2000

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

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the proposed penalty assessment for the late payment of its income tax. The due date of the return was April 15, 2001. Taxpayer filed its return late on October 10, 2001 with payment of sixty-one percent (61%) of its tax liability. The Department issued its late payment assessment on January 2, 2002.

Taxpayer filed a penalty protest letter dated January 18, 2002. Taxpayer states that its CPA firm did not advise that it would have a tax liability until almost the end of the extension period. It had anticipated a zero liability on all of its 2000 returns.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that it did not become apparent that significant tax liabilities would be due for Indiana until it filed its return.

Taxpayer did not make payment by the original due date of the return as required under IC 6-8.1-10-2.1 (a)(2). The penalty is ten percent (10%) of the amount of the tax not paid, if the person fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment.

Taxpayer made payment after the due date of the return and has not provided reasonable cause to allow the Department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220020513P.LOF

LETTER OF FINDINGS NUMBER: 02-0513P
Gross and Adjusted Gross Income Tax
For Calendar Years 1998 and 1999

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

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the proposed penalty assessment for the underpayment of estimated tax. Taxpayer states that it relied exclusively upon its independent outside accountants to calculate and advise on the timing of all federal and state estimated tax payments. A substantial miscalculation of estimated Gross Receipts Tax by those advisors resulted in underpayments of estimated Indiana taxes for both 1998 and 1999.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed for the underpayment of estimated income taxes for 1998 and 1999. Taxpayer states that it relied upon its independent outside accountants to calculate the estimated taxes and the miscalculation did not come to light until September 2000 when the 1999 Indiana return, as prepared by the outside accountants, was being reviewed by its own personnel. Taxpayer further states that the failure to properly calculate and timely remit estimated payments was inadvertent and not the result of idle carelessness.

To avoid the penalty, the quarterly estimate must equal at least twenty percent (20%) of the total income tax liability for the current taxable year or twenty-five percent (25%) of the final income tax liability for the prior taxable year. Taxpayer failed to make the quarterly estimated payments and has not provided reasonable cause to allow a penalty waiver. Procedures should have been in effect to assure that taxes were timely paid.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120020514P.LOF

LETTER OF FINDINGS NUMBER: 02-0514P
Individual Income Tax
Calendar Year 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(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer, in a letter dated October 15, 2002 states that it remitted its first quarter estimated tax payment in the same envelope as its 2000 Indiana tax return mailed on April 15, 2001. The envelope contained two checks, one that was cashed, and one that was not. Taxpayer states he is certain that the check was enclosed and requests an abatement of penalty.

Taxpayer was assessed a penalty for the underpayment of estimated taxes.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer states that it timely remitted its estimated payment for the first quarter 2001 taxes with its 2000 tax return which the Department lost. In addition, the Department cashed the check for the 2000 return and he is certain that the first quarter estimated tax payment was in the same envelope.

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

IC 6-3-4-4.1 (c) states that "In the case of an underpayment of the estimated tax as provided in Section 6654 of the Internal Revenue Code, there shall be added to the tax a penalty in an amount prescribed by IC 6-8.1-10-2.1 (b)".

Taxpayer has not provided reasonable cause; therefore, the Department finds the penalty appropriate.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220020517P.LOF

LETTER OF FINDINGS NUMBER: 02-0517P
Gross Income Tax
For Calendar Year 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(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is a late filer. Taxpayer states it has no business function and was merely incorporated for the purpose of outlining bylaws by which its group abides and also for liability protection. It has no business function. The department issued a penalty billing for failure to file the IT-20 timely.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's letter states that it has no business function and generates no taxable income. Taxpayer further states it was formed for the outlining of bylaws and for liability protection. It believes this is the first late filing penalty assessed.

Based upon the above information, taxpayer requests that the penalty be waived.

IC 6-8.1-10-2.1(g) states:

A person who fails to file a return for a listed tax that shows no tax liability for a taxable year, other than an information return (as defined in section 6 of this chapter), on or before the due date of the return shall pay a penalty of ten dollars ($10) for each day that the return is past due, up to a maximum of two hundred fifty dollars ($250).

Taxpayer failed to file its return timely and has not provided reasonable cause. The department finds that a penalty is proper.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420020519P.LOF

LETTER OF FINDINGS NUMBER: 02-0519P
Sales Tax
For July 2002

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

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was assessed a late payment penalty.

Taxpayer, in a letter dated October 21, 2002 requests that the department waive the late payment penalty because it has never been late and was busy with insurance/police reports after a thief broke into its business.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer was assessed a ten percent (10%) penalty because it paid its tax after the due date.

Taxpayer states it was busy with insurance and police reports after a break-in and has never been late. Taxpayer requests a penalty waiver.

Taxpayer has not provided reasonable cause to allow a waiver of the penalty assessed and the taxpayer had another late filed return previously.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220020523P.LOF

LETTER OF FINDINGS NUMBER: 02-0523P
Adjusted Gross Income Tax
For Calendar Year 1999

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

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer failed to remit its entire tax liability by the due date of the return for calendar year 1999. The department issued a penalty billing and interest billing.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's representative in a letter dated July 2, 2002 states that the taxpayer's 1998 return resulted in an overpayment amount of $2,486 that was recorded on Line 17. And on line 18 for the "Amount from line 17 to be refunded: it recorded "none" because it wished to have the overpayment applied to the following year's return. The instructions did not indicate that an overpayment could not be applied to the following year. When it prepared the taxpayer's 1999 Form IT-10S, it carried over the 1998 overpayment credit. At the time, it was not aware that the Department had refunded the taxpayer the 1998 overpayment. This discrepancy caused a late payment of the 1999 tax liability of $1,823 in addition to a penalty of $182.20 and interest of $181.30. After the tax notice was received the taxpayer issued a check in the amount of $1,823 for the 1999 tax liability. Taxpayer requests a penalty and interest waiver.

Taxpayer was issued a refund for the amount of tax overpaid in 1998 because there is no provision to carry an overpayment forward. The result was a shortage in the 1999 tax year. The taxpayer has not provided reasonable cause to allow a penalty waiver and the Department has no authority to waive interest.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420020541P.LOF

LETTER OF FINDINGS NUMBER: 02-0541P
Use Tax
For Calendar Years 1999, 2000, and 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(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was audited for calendar years 1999, 2000, and 2001. Upon audit it was discovered that the taxpayer failed to remit use tax on sixty-eight percent (68%), seventy-five percent (75%), and ninety-six percent (96%) of its non-taxed taxable purchases for calendar years 1999, 2000, and 2001 respectively.

Taxpayer requests abatement of the penalty because this was not taxpayer negligence but a misunderstanding of Indiana Use Tax law. The year 2000 had no other liability with the exception of the extended warranty issue and the prior audit for 1993 through 1996 did not address the extended warranty issue.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that it has attempted to pay its use tax liability and was not aware that tax was due on its extended warranty sales.

Information Bulletin #2 clearly states that the warranties that contain the right to have property supplied in the event it is needed are not subject to sales tax. However, any parts or tangible personal property supplied pursuant to this type of agreement are subject to use tax.

45 IAC 15-11-2(b) states, "Negligence, on behalf of the 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."

Taxpayer has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010063.SLOF

SUPPLEMENTAL LETTER OF FINDINGS: 01-0063 SLOF
Adjusted Gross Income Tax
For the Tax Periods Ending in 1996, 1997, and 1998

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

ISSUE

I. Disallowance of Royalty and Interest Expense Deductions – Adjusted Gross Income Tax

Authority: IC 6-3-2-2(l); Horn v. Commissioner of Internal Revenue, 968 F.2d 1229 (D.C. Cir. 1992); Park 100 Dev. Co. v. Indiana Dept. of State Revenue, 429 N.E.2d 220 (Ind. 1981)

Taxpayer argues that the conclusion reached in the original Letter of Findings – whereby the Department disallowed the deduction of certain interest and royalty payments – was erroneous because it was based upon a misunderstanding of the parties' business relationships.

STATEMENT OF FACTS

There are three parties relevant to this Supplemental Letter of Findings; taxpayer, parent company, and Delaware holding company. The taxpayer is an out-of-state company in the business of selling industrial, medical, and specialty gases.

The parent company is an out-of-state entity which owns both the taxpayer and Delaware holding company. The parent company is not an Indiana taxpayer. Over a period of time, the parent company had acquired taxpayer and a number of entities all of which were engaged in a similar business. At some point, the parent company realized that – along with taxpayer and the other related entities – it had also acquired and developed certain intellectual property. The intellectual property consisted of trademarks, trade names, trade dress, and the like. It is not disputed the taxpayer and parent company's other affiliated members had unrestrained access to and use of the intellectual property before the intellectual property was transferred to Delaware holding company.

In 1996, the parent company formed Delaware holding company. The parent company exchanged the intellectual property for Delaware holding company's stock in an I.R.C. § 351 exchange. According to taxpayer, Delaware holding company is governed by a board of directors consisting of two parent company officers and two independent officers.

Thereafter, Delaware holding company arranged for an independent appraisal of the value of the intellectual property. Having made a determination of the value of the intellectual property, Delaware holding company entered into a series of 17 licensing agreements which permitted taxpayer – along with 16 other similarly situated entities owned by the parent company – continued use of the intellectual property. In exchange for the right to use of the intellectual property, taxpayer made royalty payments to Delaware holding company. In certain circumstances, pursuant to the terms of the royalty agreement, taxpayer also made interest payments to Delaware holding company.

Having received taxpayer's royalty and interest payments, Delaware holding company, together with similar payments received from the 16 different other affiliated entities, loaned those amounts to the parent company. The loans were made to the parent at the market rate of 8.75%. There is no indication that these loans have been repaid to Delaware holding company.

Taxpayer points out that Delaware holding company incurred certain expenses related to the maintenance of the intellectual property. Delaware holding company had a full-time employee. Delaware holding company employed a specialized law firm to assist in the management and protection of the intellectual property assets.

On their face, the state tax consequences of this three-way arrangement are as follows; taxpayer claims a deduction for the royalty and interest payments from its Indiana Adjusted Gross Income; Delaware holding company has no state tax liability because Delaware does not tax income attributable to intellectual property; parent company does not pay state income tax on those amounts received as loans from Delaware holding company.

The original Letter of Findings found that taxpayer was not entitled to deduct from its Indiana adjusted gross income the royalty and interest payments made to Delaware holding company. Taxpayer challenges that conclusion arguing that the original Letter of Findings misstated the factual circumstances surrounding the payments. A rehearing was granted, and this Supplemental Letter of Findings results.

DISCUSSION

I. Disallowance of Royalty and Interest Expense Deductions – Adjusted Gross Income Tax

The original Letter of Findings agreed with the audit that taxpayer should not be permitted to deduct the royalty and interest payments from its Indiana source income. It arrived at the conclusion pursuant to IC 6-3-2-2(l). The statutory provision states that "[i]f the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana... the department may require in respect to all or any part of the taxpayer's business activity... the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income."

The original Letter of Findings concluded that permitting the taxpayer to deduct the royalty and interest expenses distorted taxpayer's Indiana income. Disallowance of the deductions would more "fairly represent" the amount of taxpayer's income apportioned to Indiana and would effectuate a more equitable apportionment of the taxpayer's Indiana income.

In addition, the original Letter of Findings justified its conclusion on the basis of the "sham transaction" doctrine based on a determination that the transfer of the intellectual property to Delaware holding company and taxpayer's consequent royalty payment lacked a legitimate business purpose.

Taxpayer disagrees. Taxpayer points out that the intellectual property/royalty payments were not the typical two-party circular transactions designed wholly to elude state tax liability; e.g. (1) original owner transfers its intellectual property to wholly-owned holding company, (2) wholly-owned holding company charges original owner royalties, (3) wholly-owned holding company promptly "loans" the royalties back to original owner.

Taxpayer is correct in pointing out that these are not "two-party" transactions. Rather, the transactions involve three distinct participants; parent company, taxpayer, and Delaware holding company. The taxpayer is also correct in pointing out that the parties have taken unto themselves certain trappings of business legitimacy. Delaware holding company arranged for an independent evaluation of the intellectual property's value; the amount of royalty payments was established by reference to the independent evaluation; Delaware holding company has an employee; Delaware holding company engaged a law firm to "police" the intellectual property; the corporate governance of Delaware holding company is at least partially independent.

In addition, taxpayer argues that the Department's conclusion was "entirely contrary" to Department's conclusion in an earlier Letter of Findings published June 1, 2002. According to taxpayer, the June 2002 Letter of Findings (*Hereinafter* June 2002 LOF) "recognize[d] that the licensing of the trademarks and corporate logos to affiliated subsidiaries was a bona fide transaction" and that to allow the deduction in the June 2002 LOF and thereafter to deny it to taxpayer "is arbitrary and discriminatory." However, taxpayer overlooks the particular circumstances surrounding the June 2002 LOF. In that particular Letter of Findings, the holding company performed substantive activities for the petitioning taxpayer other than simply "holding" the petitioning taxpayer's intellectual property. The holding company controlled the operation of the petitioning taxpayer's Indiana retail stores. The holding company performed the taxpayer's asset and inventory purchases, accounting, payroll, invoicing, payables, property tax payments. The holding company "charge[d] and administrative fee to each store based on sales volume; allocate[d] a charge for rent to each store; charge[d] a service fee for inventory items purchased by the stores from the [holding company]; and charge[d] a one percent (1%) royalty fee for use of the trademarks and logos." The June 2002 LOF concluded that the petitioning taxpayer, the parent company, and the holding company possessed a separate and distinct economic vitality; their existence was based on more than simple tax avoidance. Taxpayer's contention – that the relationship between itself, Delaware holding company, and parent company is analogous to the parties described in the June 2002 LOF – is unwarranted. There is little indication that the taxpayer's own Delaware holding company performed services or possessed an economic substance similar to that of the holding company described within the June 2002 LOF.

The Department has no quarrel with and does not challenge the validity of the value placed on the intellectual property subsequent to the transfer of that property to Delaware holding company. The Department does not challenge the amount of royalties Delaware holding company charged taxpayer – along with the 16 other affiliates – for the right to use that intellectual property. Similarly, the Department does not challenge the propriety of the interest charges levied against taxpayer. The Department does not challenge Delaware holding company's unrestrained right to loan its assets to the parent company with, apparently, little or no expectation that those amounts will be repaid. The Department certainly does not quarrel with Delaware's decision not to tax holding companies' income derived from the management of intellectual property.

However, the Department does maintain that, under IC 6-3-2-2(l), allowing taxpayer to claim the royalty and interest expenses as a deduction from its Indiana adjusted gross income "do[es] not fairly represent the taxpayer's income derived from sources within the state of Indiana." Taxpayer's parent company is certainly free to transfer its intellectual property to whomever it wants. However, *for purposes of determining taxpayer's adjusted gross income,* there is little or no economic or business justification for the formation of the Delaware holding company other than for allowing taxpayer to obtain the attendant tax benefits. The parent's company's decision to transfer the intellectual property – previously freely accessible to taxpayer and the other affiliated companies – allowed the taxpayer to shift a portion of its Indiana income to Delaware for no other readily discernible reason than to allow that income shift. Taxpayer has not shown that the transfer of the intellectual property to Delaware holding company served any other significant purpose other than tax avoidance – circumstances falling squarely within the "sham transaction" doctrine. "Transactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 F.2d 1229, 1236-37 (D.C. Cir. 1992). *See also* Park 100 Dev. Co. v. Indiana Dept. of State Revenue, 429 N.E.2d 220 (Ind. 1981). It was such circumstances that IC 6-3-2-2(l) was plainly intended to reach. The Department was entitled to ignore the effect of the federal royalty and interest deductions and to allocate the royalty and interest income to Indiana.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220010114.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 01-0114SLOF
Responsible Officer – Bingo Penalty and Withholding Tax
For Tax Years 1999 through 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

Withholding Tax – Responsible Officer Liability

Authority: IC 6-3-4-8

Taxpayer protests the assessment of responsible officer liability for withholding taxes.

STATEMENT OF FACTS

Taxpayer was the president of a not-for-profit organization. After an investigation, the Department of Revenue (the "Department") found that the not-for-profit organization had not withheld Indiana adjusted gross income tax and county adjusted gross income tax from wages paid to an employee who worked for the not-for-profit organization. Taxpayer was personally assessed for the taxes because she was listed as the president of the not-for-profit organization. Taxpayer protested the finding and the subsequent assessment of withholding tax liability.

A Letter of Findings was issued on December 20, 2001. The Department denied taxpayer's protest and determined taxpayer (1) failed to provide evidence that the employee for which withholding tax was previously withheld was no longer an employee during the assessment periods; and (2) failed to provide evidence that she was not the responsible officer during the assessment periods.

In November of 2002, additional information was supplied to the hearing officer assigned to this case.

Withholding Tax – Responsible Officer Liability

DISCUSSION

IC 6-3-4-8 provides in pertinent part:

(a) Except as provided in subsection (d), every employer making payments of wages and subject to tax under IC 6-3, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect and pay over income tax on wages paid by such employer to such employee, shall at the time of the payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department.... Such employer making payments of any wages:

(1) shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld under this section and shall not be liable to any individual for the amount deducted from his wages and paid over in compliance or intended compliance with this section; and

(2) shall make return of and payment to the department monthly of the amount of tax which, under IC 6-3 and IC 6-3.5, he is required to withhold.

This additional information supports taxpayer's assertion that the employee for which withholding tax was previously withheld was no longer an employee during the assessment periods.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE
TAX POLICY DIRECTIVE #8
JANUARY 2003
(Replaces Tax Policy Directive #8 dated September 1994)

PURPOSE: Tax Policy Directives are intended to provide the general public with information concerning the Department's official position in regard to a specific issue. These directives may be relied upon by taxpayers until superseded by another policy directive, a change in statute or regulation, or a court decision that would render the policy directive void.

SUBJECT: Application of Sales and Use Tax to Demonstrator Automobiles

REFERENCES: IC 6-2.5-3-2; U.S. Treasury Reg. 1.132-5(o)(2);
Revenue Procedure 2001-56; IC 9-13-2-42

INTRODUCTION

The purpose of this Directive is to provide interpretation of the Indiana Sales and Use Tax as it applies to the use of demonstrator automobiles, both new and used. This Directive is applicable to Indiana automobile dealers as defined in IC 9-13-2-42. Dealers that title and register automobiles are not affected by this Directive. This Directive is applicable to all persons operating a vehicle under a dealer license plate.

DISCUSSION

The following instructions are effective as of the date of issuance of this Directive.

1. Vehicles made available to school driver education programs or not-for-profit organizations are not subject to the Indiana sales and use tax.
2. Vehicles provided to other than full-time salespersons (for example, family members, part-time salespersons, mechanics, managers of the dealership and other individuals) are subject to use tax at the rate of twenty (20) cents per mile times the Indiana sales tax rate. The vehicle dealer will pay the tax annually. Dealers are required to keep records of each vehicle, the miles driven, and when use tax was paid for the miles driven.
3. In lieu of accounting for the miles driven, the dealer may elect to report the use tax on two (2) percent of the dealer's cost of purchasing the vehicle for each month (or fraction of a month) that the vehicle is used as a demonstrator times the Indiana sales tax rate.
4. The definition of full-time salesperson is synonymous with the definition provided in U.S. Treasury Reg. 1.132-5(o)(2), which provides that the salesperson spend at least one half (1/2) of a normal business day performing the function of a floor salesperson, work at least one thousand (1,000) hours per year, and derive twenty five percent (25%) of his/her gross income from sales activities. Vehicles used by full-time salespersons for "qualified automobile demonstration use" are not subject to sales and use tax. "Qualified automobile demonstration use means a vehicle:
    a. That is currently in the inventory of the dealership;
    b. That is available for test drives by customers during the normal business hours of the employer;
    c. In which the salesperson has no personal possessions stored;
    d. That must be driven within the dealer's sales area. For the purposes of this directive, dealer's sales area means an area within a radius of 75 miles from the dealership;
    e. That is not used by individuals other than the full-time sales person (for example, family members); and
    f. That may not be used for personal vacation trips.
5. Personal use of automobile demonstrators by full-time salespersons will be the value reportable to the Internal Revenue Service or charged to the full-time salesperson in accordance with the provisions of Revenue Procedures 2001-56 times the sales tax rate.

CONCLUSION

The above instructions are intended to be all inclusive. However, the Department recognizes and acknowledges that events unanticipated by this Directive may arise and in such case the Tax Policy Division of the Department should be contacted for guidance.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
TAX POLICY DIRECTIVE #11
JANUARY 2003
(Replaces Directive #11 dated August 1999)

PURPOSE: Tax Policy Directives are intended to provide the general public with information concerning the Department's official position in regard to a specific issue. These directives may be relied upon by taxpayers until superseded by another policy directive, a change in statute or regulation, or a court decision that would render the policy directive void.

SUBJECT: Other Tobacco Products Tax

REFERENCE: IC 6-7-2

INTRODUCTION:

The purpose of this tax policy directive is to provide interpretation of the Other Tobacco Products Tax as it applies to the wholesale price of tobacco products, and who is a tobacco distributor that is liable for the tax. This directive applies to other tobacco product distributors as defined in IC 6-7-2-2.

DISCUSSION:

The other tobacco products tax is imposed on tobacco distributors per IC 6-7-2-7, which reads:

> A tax is imposed on the distribution of tobacco products in Indiana at the rate of eighteen percent (18%) of the wholesale price of the tobacco products. The distributor of the tobacco products is liable for the tax. The tax is imposed at the time the distributor:
>
> (1) brings or causes tobacco products to be brought into Indiana for distribution;
> (2) manufactures tobacco products in Indiana for distribution; or
> (3) transports tobacco products to retail dealers in Indiana for resale by those retail dealers.

An unlicensed wholesaler/retailer purchasing tobacco products through a catalogue or other media from a person not licensed as an Indiana distributor must register as a distributor and pay the eighteen percent (18%) tax on the wholesale price of the other tobacco products. A wholesaler/retailer failing to register and comply with the law commits a Class B misdemeanor. However, the offense is a Class D felony if it is committed with intent to evade the tax imposed or to defraud the state.

The term "wholesale price" is defined at IC 6-7-2-6: "As used in this chapter, 'wholesale price' means the price at which the manufacturer of the tobacco products sells tobacco products to distributors, excluding any discount or other reduction."

The Department's position is that temporary reduction or discounts for the purpose of promoting certain tobacco products are deductible from the original price in determining the "wholesale price" of tobacco products if the finished tobacco product(s) container is prepackaged indicating a monetary discount. The "wholesale price" for other tobacco products prepackaged in multiple units is the actual price paid and not on an imputed cost based on the manufacturer's price per single unit. Purchase discounts, quantity discounts, trade discounts, or any other reduction are not deductible when determining the "wholesale price" of tobacco products for purposes of imposing the Other Tobacco Products Tax.

A manufacturer, importer, broker, or shipper of other tobacco products into Indiana for the purpose of giving such products away for any type of promotional purpose must pay the tax due on all such products. In applying the Other Tobacco Products Tax to samples, the "wholesale price" is the standard price charged for the single unit tobacco product before deduction of any discount, including temporary promotional discounts.

Kenneth L. Miller
Commissioner