INDIANA ELECTION COMMISSION
ORDER 2003-28

IN THE MATTER OF THE	)	ADMINISTRATIVE CAUSE
ADMINISTRATIVE DISSOLUTION OF:	)	NUMBER: 03-4559-99
Woolery for State Senate Committee	)	
	)	

ORDER ADMINISTRATIVELY DISSOLVING COMMITTEE

This administrative dissolution proceeding came before the Indiana Election Commission (hereinafter "the Commission") at its March 6, 2003 meeting. The Commission, after due consideration of the evidence and record, hereby determines as follows:

1) Notice of hearing has been served pursuant to IC 3-9-1-12 and posted pursuant to IC 5-14-1.5;
2) The above-named committee has not filed any report of expenditures within the previous three (3) calendar years; and
3) The last reported cash on hand does not exceed one thousand dollars ($1000) and the committee filed a report under IC 3-9.

Further, the Commission finds:

1) There is no evidence that the committee continues to receive contributions, make expenditures, or otherwise functions as a committee;
2) The prudent use of public resources makes further efforts to collect any outstanding civil penalty imposed against the committee wasteful or unjust; and
3) According to the best evidence available to the Commission, the dissolution of the committee will not impair any contract or impede the collection of a debt or judgment by any person.

IT IS THEREFORE ORDERED that Woolery for State Senate Committee is hereby administratively dissolved.

IT IS FURTHER ORDERED that all outstanding civil penalties previously imposed by the Commission against Woolery for State Senate Committee are hereby waived.

SO ORDERED THIS 6th DAY OF MARCH, 2003:
THE INDIANA ELECTION COMMISSION:

Dudley Cruea, Chairman	**Butch Morgan, Member**
S. Anthony Long, Vice-Chairman	**Claudia E. Cummings, Member**

INDIANA ELECTION COMMISSION
ORDER 2003-29

IN THE MATTER OF THE	)	ADMINISTRATIVE CAUSE
ADMINISTRATIVE DISSOLUTION OF:	)	NUMBER: 03-4403-100
Clay for the Legislature Committee	)	
	)	

ORDER ADMINISTRATIVELY DISSOLVING COMMITTEE

This administrative dissolution proceeding came before the Indiana Election Commission (hereinafter "the Commission") at its March 6, 2003 meeting. The Commission, after due consideration of the evidence and record, hereby determines as follows:

1) Notice of hearing has been served pursuant to IC 3-9-1-12 and posted pursuant to IC 5-14-1.5;
2) The above-named committee has not filed any report of expenditures within the previous three (3) calendar years; and
3) The last reported cash on hand does not exceed one thousand dollars ($1000) and the committee filed a report under IC 3-9.

Further, the Commission finds:

1) There is no evidence that the committee continues to receive contributions, make expenditures, or otherwise functions as a committee;
2) The prudent use of public resources makes further efforts to collect any outstanding civil penalty imposed against the committee wasteful or unjust; and
3) According to the best evidence available to the Commission, the dissolution of the committee will not impair any contract or impede the collection of a debt or judgment by any person.

IT IS THEREFORE ORDERED that Clay for the Legislature Committee is hereby administratively dissolved.

IT IS FURTHER ORDERED that all outstanding civil penalties previously imposed by the Commission against Clay for the Legislature Committee are hereby waived.

SO ORDERED THIS 6th DAY OF MARCH, 2003:
THE INDIANA ELECTION COMMISSION:

Dudley Cruea, Chairman	**Butch Morgan, Member**
S. Anthony Long, Vice-Chairman	**Claudia E. Cummings, Member**

INDIANA ELECTION COMMISSION
ORDER 2003-30

IN THE MATTER OF THE	)	ADMINISTRATIVE CAUSE
ADMINISTRATIVE DISSOLUTION OF:	)	NUMBER: 03-4105-101
Citizens for Chochos	)	
	)	

ORDER ADMINISTRATIVELY DISSOLVING COMMITTEE

This administrative dissolution proceeding came before the Indiana Election Commission (hereinafter "the Commission") at its March 6, 2003 meeting. The Commission, after due consideration of the evidence and record, hereby determines as follows:

1) Notice of hearing has been served pursuant to IC 3-9-1-12 and posted pursuant to IC 5-14-1.5;
2) The above-named committee has not filed any report of expenditures within the previous three (3) calendar years; and
3) The last reported cash on hand does not exceed one thousand dollars ($1000) and the committee filed a report under IC 3-9.

Further, the Commission finds:

1) There is no evidence that the committee continues to receive contributions, make expenditures, or otherwise functions as a committee;
2) The prudent use of public resources makes further efforts to collect any outstanding civil penalty imposed against the committee wasteful or unjust; and
3) According to the best evidence available to the Commission, the dissolution of the committee will not impair any contract or impede the collection of a debt or judgment by any person.

IT IS THEREFORE ORDERED that Citizens for Chochos is hereby administratively dissolved.

IT IS FURTHER ORDERED that all outstanding civil penalties previously imposed by the Commission against Citizens for Chochos are hereby waived.

SO ORDERED THIS 6th DAY OF MARCH, 2003:
THE INDIANA ELECTION COMMISSION:

Dudley Cruea, Chairman	**Butch Morgan, Member**
S. Anthony Long, Vice-Chairman	**Claudia E. Cummings, Member**

INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT

Title: Brownfields Program Comfort and Site Status Letters Policy
Identification Number: W-0051
Date Originally Effective: April 18, 2003
Dates Revised: None
Other Policies Repealed or Amended: None
Brief Description of Subject Matter: IDEM Brownfields Program's policy regarding issuance of a Comfort or Site Status Letter to stakeholders redeveloping contaminated property.
Citations Affected: IC 13-23-13; IC 13-24-1; IC 13-25-4

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

Policy Statement

Pursuant to IDEM's petroleum response authority (IC 13-24-1), its hazardous substance response authority (IC 13-25-4), its leaking underground storage tank response authority (IC 13-23-13), and its duty to evaluate remediation activities associated with the environmental remediation loan fund (IC 13-19-5-5), IDEM hereby informs the public that IDEM may issue a letter under this policy to a stakeholder ("Stakeholder") involved in redevelopment of a brownfield if, at a minimum, the Stakeholder demonstrates to IDEM's satisfaction that:

(1) no State or federal enforcement action at the brownfield is pending;
(2) no federal grant requires an enforcement action at the brownfield;
(3) no condition on the brownfield constitutes an imminent and substantial threat to human health or the environment;
(4) neither the Stakeholder nor an agent or employee of the Stakeholder caused, contributed to, or knowingly exacerbated the release or threat of release of any hazardous substance or petroleum at the brownfield; and,
(5) either the Stakeholder is eligible for an applicable exemption to liability founded in Indiana law or IDEM policy, or current levels of contaminants at the brownfield meet current cleanup criteria as established by IDEM.

Comfort Letter. If the Stakeholder can demonstrate to IDEM's satisfaction that the Stakeholder qualifies for some applicable exemption to liability found in Indiana law or IDEM policy, IDEM may issue a Comfort Letter explaining the liability exemption. If applicable, IDEM may include language that the liability exemption prohibits IDEM from pursuing the Stakeholder or subsequent owners and operators even if cleanup requirements change or if IDEM determines that a response action is necessary.

Site Status Letter. If the Stakeholder can demonstrate to IDEM's satisfaction that the current levels of contaminants at the brownfield substantially meet current cleanup criteria as established by IDEM, IDEM may issue a Site Status Letter explaining that current site conditions do not present a threat to human health or the environment and that IDEM does not plan to take a response action at the brownfield.

Conditions

(A) The Stakeholder must not have caused, contributed to, or knowingly exacerbated the release or threat of release of the hazardous substance or petroleum through an act or omission. Also, the Stakeholder must not have any ownership interest in any entity that caused, contributed to, or knowingly exacerbated the release or threat of release. For the purposes of this policy, the failure to take affirmative steps to mitigate or address contaminants will not, in the absence of exceptional circumstances, constitute an "omission" by the Stakeholder within the meaning of this condition. The Stakeholder must exercise due care with regard to the contaminants, including allowing another party to investigate and remediate the contaminants.

(B) There must be no alternative basis for the Stakeholder's liability for the contaminated property, such as liability as a disposer, generator, or transporter of the contaminants or liability as an owner or operator by reason of the existence of a new source of contaminants on the site.

(C) At the discretion of IDEM, a letter provided under this policy may be conditioned upon the Stakeholder's acceptance of recorded land use restrictions. IDEM may also require recording of the letter and/or a brief memorandum describing the environmental response activities done at the property, particularly if land use restrictions are recommended at the property.

(D) No letter issued by IDEM constitutes assurance that a property is safe or fit for a particular use. Letters issued under this policy are statements of enforcement priority based on known contaminant levels. No letter issued by IDEM can relieve a recipient of liability for contribution of costs incurred by a private party or liability for a cost recovery suit brought by the U.S. EPA. Additionally, a comfort letter does not relieve the recipient of any applicable duty under the Resource Conservation and Recovery Act (42 U.S.C. § 6901), criminal liability, or liability for natural resource damages.

(E) A letter issued under this policy may be revoked if IDEM learns that the information provided to IDEM was inaccurate. IDEM may then pursue any responsible party.

Discussion

A person or entity owning, operating, or considering the purchase or financing of contaminated property faces uncertainty about the liability for remediation of that property under State and federal environmental laws. This uncertainty leads to abandoned, dormant, or underutilized properties commonly known as "brownfields." IDEM is concerned with the unintended adverse effects of environmental laws on property owners, operators, prospective purchasers, and other parties, as well as the ability of communities to redevelop brownfields.

This policy is intended to eliminate unnecessary barriers to the transfer and redevelopment of such property while maintaining the quality of the State's environment. IDEM will seek to exempt from liability those parties who by law or public policy should not be held liable for response costs, and forgo enforcement at only those sites shown to be suitable for redevelopment. IDEM occasionally utilizes its enforcement discretion to forgo pursuit of a party potentially responsible for government response costs related to a release of petroleum or a hazardous substance. In recognition that the perception of an environmental defect on a property imposes a transaction cost upon the transfer of that property, this policy sets guidelines for IDEM personnel to consider when deciding to issue Comfort and Site Status Letters. This policy does not intend to set a legal standard and cannot lawfully do so.

These standards are based upon State and federal laws and policy statements, including:

- statutory liability provisions for hazardous substances and petroleum, and liability exemptions for innocent purchasers, political subdivisions, and fiduciaries;
- conditions of eligibility established for Indiana's Voluntary Remediation Program, Indiana's brownfields tax credit, and the brownfields revitalization zone;
- IDEM's standards of cleanup under various programs; and,
- the contaminated aquifers policies established by IDEM and the United States Environmental Protection Agency (U.S. EPA).

"Current cleanup criteria"

The legislature has authorized IDEM to establish cleanup criteria under its various remediation programs. Additionally, these programs have begun using the Risk Integrated System of Closure standards. Before issuing a Site Status Letter, IDEM will determine which set of standards is appropriate for the site. This determination is within the sole discretion of IDEM. These remediation standards are not "action levels," and property that contains contaminants below these levels should not automatically be considered free from liability.

"Applicable exemption to liability"

When deciding to issue a comfort letter under this policy, IDEM may decide that an "applicable exemption to liability" exists if the Stakeholder can demonstrate to IDEM's satisfaction that the Stakeholder is a person exempted from liability by Indiana law or an adopted IDEM policy. Examples of applicable exemptions include:

- the Stakeholder is a government entity exempted from liability under IC 13-25-4-8(e) or IC 13-11-2-151(b);
- the Stakeholder satisfies the conditions of the IDEM "Property Containing Contaminated Aquifers" nonrule policy document (OER-0008-NPD, 20 IR 1674 (March 1, 1997)), or the IDEM "Property Containing Contaminated Aquifers/Underground Storage Tanks" nonrule policy document (WASTE-0038-NPD, 23 IR 2141 (May 1, 2000))
- the Stakeholder is not the statutory owner of an underground storage tank pursuant to IC 13-11-2-150(a)(2), because the tanks were not used after November 8, 1984 and the Stakeholder was not the person who owned the tank immediately before the discontinuation of the tank's use;
- the Stakeholder is a creditor, lender, or fiduciary exempted from liability under IC 13-23-13-14, IC 13-24-1-10, IC 13-25-4-8(c), or IC 13-25-4-8.2; or
- no direct or indirect contractual relationship (as defined by the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. § 9601 and interpreted by IDEM) exists between the Stakeholder and any party that caused the contaminants.

References

Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. § 9601.
Brownfield Revitalization Zone Tax Abatement, IC 6-1.1-42.
Environmental Remediation Revolving Loan Fund IC 13-19-5.
Underground Storage Tank Corrective Actions, IC 13-23-13.
Petroleum Releases, IC 13-24-1.
Hazardous Substances Response Trust Fund, IC 13-25-4.
Indiana's Voluntary Remediation Program, IC 13-25-5.
"Property Containing Contaminated Aquifers" nonrule policy document, W0047 (formerly OER-0008-NPD), 20 IR 1674 (March 1, 1997).
"Property Containing Contaminated Aquifers/Underground Storage Tanks" nonrule policy document, WASTE-0038-NPD, 23 IR 2141 (May 1, 2000).

INDIANA STATE DEPARTMENT OF HEALTH

MONTHLY CALCULATION

March 2003

INCOME ELIGIBILITY GUIDELINES FOR THE MCH / CSHCS / HOOSIER HEALTHWISE PROGRAMS
BASED ON HEALTH AND HUMAN SERVICES POVERTY INCOME GUIDELINES

PROGRAM IMPLEMENTATION DATES LISTED BELOW

CSHCS: February 7, 2003 MCH/HOOSIER HEALTHWISE: March 31, 2003 WIC: April 1, 2003

The following information must be used by all MCH funded projects, WIC programs, CSHCS programs, and Hoosier Healthwise (HH) recorded on the appropriate enrollment forms. Guidelines for use of this form are as follows: (all calculations other than 185% are calculated from HCFA income guidelines).

MCH: The payment level for MCH Services is at the bottom of the form. It ranges from no charge at or below 100% of federal poverty guidelines to patients being charged the full cost of service (100%) at greater than 250% of federal poverty guidelines. Assignment of an MCH payment level category is based on the participant's annual family/household (economic unit) gross income and size with regard for extenuating circumstances (i.e., substantial financial debt, family members with extraordinary medical bills). The participant's payment level category must be updated annually. This payment level is for persons without insurance to cover services.

CSHCS: To be financially eligible for CSHCS, the gross household income must be less than or equal to 250% of the federal poverty income guidelines. Household means a group of related or non-related individuals who are not residents of an institution, but who are living as one economic unit. The applicant must also be medically eligible to receive services. MCH and Hoosier Healthwise and WIC define a pregnant woman as two family members. CSHCS defines a pregnant woman as one family member.

HH: For a pregnant woman and/or child 0-19, to be financially eligible for package A and B Hoosier Healthwise, the gross economic unit income must be less than or equal to 150% of the federal poverty income. Children 0-19 are eligible for Package C (required variable premium payment) up to 200% of federal poverty income guidelines.

HOUSE HOLD SIZE:	100% MONTHLY Income Starting At	HH A & B 150% MONTHLY Income Equal To Or Less Than	HH Partial Premium Package C 175% MONTHLY Income Equal To Or Less Than	HH Full Premium Package C 200% MONTHLY Income Equal To Or Less Than	CSHCS 250% MONTHLY Income Equal To Or Less Than	250%+ MONTHLY Income Greater Than
1	$748	$1,123	$1,310	$1,497	$1,871	$1,871
2	$1,010	$1,515	$1,768	$2,020	$2,525	$2,525
3	$1,272	$1,908	$2,225	$2,543	$3,179	$3,179
4	$1,533	$2,300	$2,683	$3,067	$3,833	$3,833
5	$1,795	$2,693	$3,141	$3,590	$4,488	$4,488
6	$2,057	$3,085	$3,599	$4,113	$5,142	$5,142
7	$2,318	$3,478	$4,057	$4,637	$5,796	$5,796
8	$2,580	$3,870	$4,515	$5,160	$6,450	$6,450
9	$2,842	$4,263	$4,973	$5,683	$7,104	$7,104
10	$3,103	$4,655	$5,431	$6,207	$7,758	$7,758
11	$3,365	$5,048	$5,889	$6,730	$8,413	$8,413
12	$3,627	$5,440	$6,347	$7,253	$9,067	$9,067
Each additional member add:	$262					
*MCH	0%	**1-24%	25%	50%	75%	100%

Base Poverty Level is: $8,980. Federal Register Vol. 68, No. 26, February 7, 2003

WIC cannot exceed 185% and there is no charge for WIC services.

***MCH Percentage used to calculate MCH charges. **Clinic choice 1-24% for the cost of service except those covered by HH.**

ANNUAL CALCULATION

March 2003

INCOME ELIGIBILITY GUIDELINES FOR THE WIC / MCH / CSHCS / HOOSIER HEALTHWISE PROGRAMS

BASED ON HEALTH AND HUMAN SERVICES POVERTY INCOME GUIDELINES

PROGRAM IMPLEMENTATION DATES LISTED BELOW

CSHCS: February 7, 2003 MCH/HOOSIER HEALTHWISE: March 31, 2003 WIC: April 1, 2003

The following information must be used by all MCH funded projects, WIC programs, CSHCS programs, and Hoosier Healthwise (HH) recorded on the appropriate enrollment forms. Guidelines for use of this form are as follows: (all calculations other than 185% are calculated from HCFA income guidelines).

MCH: The payment level for MCH Services is at the bottom of the form. It ranges from no charge at or below 100% of federal poverty guidelines to patients being charged the full cost of service (100%) at greater than 250% of federal poverty guidelines. Assignment of an MCH payment level category is based on the participant's annual family/household (economic unit) gross income and size with regard for extenuating circumstances (i.e., substantial financial debt, family members with extraordinary medical bills). The participant's payment level category must be updated annually. This payment level is for persons without insurance to cover services.

WIC: Please note that there is no charge for WIC services and WIC income eligibility cannot exceed 185% of the poverty income levels. Proof of income is required to receive WIC benefits. No allowances for extenuating circumstances can be made. Total household income (gross) must be used; except for self-employed persons, such as a farmer or a small business owner. For this special group use gross income less business expenses. Household consists of a group of related or non-related individuals who are not residents of an institution but who are living as one economic unit.

CSHCS: To be financially eligible for CSHCS, the gross household income must be less than or equal to 250% of the federal poverty income guidelines. Household means a group of related or non-related individuals who are not residents of an institution, but who are living as one economic unit. The applicant must also be medically eligible to receive services. MCH and Hoosier Healthwise and WIC define a pregnant woman as two family members. CSHCS defines a pregnant woman as one family member.

HH: For a pregnant woman and/or child 0-19, to be financially eligible for package A and B Hoosier Healthwise, the gross economic unit income must be less than or equal to 150% of the federal poverty income. Children 0-19 are eligible for Package C (required variable premium payment) up to 200% of federal poverty income guidelines.

HOUSE HOLD SIZE:	100% ANNUAL Income Starting At	HH A & B 150% ANNUAL Income Equal To Or Less Than	HH Partial Premium Package C 175% ANNUAL Income Equal To Or Less Than	USDA / WIC Standard 185% ANNUAL Income Equal To Or Less Than	HH Full Premium Package C 200% ANNUAL Income Equal To Or Less Than	CSHCS 250% ANNUAL Income Equal To Or Less Than	250% + ANNUAL Income Greater Than
1	$8,980	$13,470	$15,715	$16,613	$17,960	$22,450	$22,450
2	$12,120	$18,180	$21,210	$22,422	$24,240	$30,300	$30,300
3	$15,260	$22,890	$26,705	$28,231	$30,520	$38,150	$38,150
4	$18,400	$27,600	$32,200	$34,040	$36,800	$46,000	$46,000
5	$21,540	$32,310	$37,695	$39,849	$43,080	$53,850	$53,850
6	$24,680	$37,020	$43,190	$45,658	$49,360	$61,700	$61,700
7	$27,820	$41,730	$48,685	$51,467	$55,640	$69,550	$69,550
8	$30,960	$46,440	$54,180	$57,276	$61,920	$77,400	$77,400
9	$34,100	$51,150	$59,675	$63,085	$68,200	$85,250	$85,250
10	$37,240	$55,860	$65,170	$68,894	$74,480	$93,100	$93,100
11	$40,380	$60,570	$70,665	$74,703	$80,760	$100,950	$100,950
12	$43,520	$65,280	$76,160	$80,512	$87,040	$108,800	$108,800
Each additional member add:	$3,140						
*MCH	0%	**1-24%	25%	25%	50%	75%	100%

Base Poverty Level is: $8,980. Federal Register Vol. 68, No. 26, February 7, 2003
WIC cannot exceed 185% and there is no charge for WIC services.
***MCH Percentage used to calculate MCH charges. **Clinic choice 1-24% for the cost of service except those covered by HH.**

NATURAL RESOURCES COMMISSION
Information Bulletin #37
Submission and Review of Hydraulic Modeling for Permit Applications under the Flood Control Act

Background

The Flood Control Act (IC 14-28-1) prohibits the construction of residences or abodes within a floodway and requires all other construction, excavation, or filling activities within a floodway to receive the prior written approval of the Department. With regard to the Department's approval, the Act further states that the director shall issue a permit only if in the opinion of the director the applicant has clearly proven that the structure, obstruction, deposit, or excavation will not do any of the following:

1) Adversely affect the efficiency of or unduly restrict the capacity of the floodway.
2) Constitute an unreasonable hazard to the safety of life or property.
3) Result in unreasonably detrimental effects upon fish, wildlife, or botanical resources.

Additionally, in deciding whether to issue a permit, the director shall consider the cumulative effects of the structure, obstruction, deposit, or excavation when added to past, present, and reasonably foreseeable future actions.

For years, the Division of Water has provided extensive assistance to individuals and engineering consultants in developing the technical documentation needed to meet the burden of proof under the Flood Control Act. The Division of Water has conducted stream modeling, performed multiple reviews of inadequate submittals, and in many cases corrected, modified, or performed modeling to account for cumulative effects. For many reasons this level of assistance is no longer possible or appropriate.

New modeling guidelines (General Guidelines for the Hydrologic – Hydraulic Assessment of Floodplains in Indiana) have been developed, published, and placed on the Division's web site at www.in.gov/dnr/water/surface_water/pdf/fp_guidelines.pdf.

Additionally, training sessions were held in 2002 in Plymouth, Indianapolis, and Jeffersonville to assist consultants in the development of effective flood modeling submittals.

As outlined below, the Division of Water will no longer participate in project specific flood model development as part of a permit application. Division staff will only serve as reviewers. Additionally, a "Two strikes" policy will be implemented for permit application submittals with modeling errors.

Review Procedures

The procedures for the review of submitted computer modeling as part of a permit application will be as follows:

- All submitted modeling will be evaluated based on the modeling guidelines outlined in the General Guidelines for the Hydrologic – Hydraulic Assessment of Floodplains in Indiana available on the Division's website at www.in.gov/dnr/water/surface_water/pdf/fp_guidelines.pdf
- Submitted modeling should be prepared under the supervision of a professional engineer with knowledge of generally accepted modeling principles.
- Within the Division of Water, Engineering Services Center (ESC) staff will be available to meet with a consultant to discuss modeling for a project, or will answer questions that a consultant may have in the process of developing a model. ESC staff will no longer perform a preliminary review of a model before a permit application is submitted.
- A submitted model will only be reviewed when accompanied by a completed modeling checklist and project evaluation table as described in the General Guidelines for the Hydrologic – Hydraulic Assessment of Floodplains in Indiana. Failure to submit a checklist or project evaluation table does not count as a strike against the review of the model since no review has actually been completed. The applicant will, however, be notified through an abeyance letter that a completed modeling checklist and project evaluation table are required and that refusal to submit these will result in the denial of the permit application.
- ESC staff will review submitted modeling but under no circumstances will they change those models. Neither will ESC staff call or email consultants to work out explicit modeling errors. Staff will comment on the modeling using the abeyance process.
- Only explicit modeling errors will be noted and identified as deficiencies. The rationale behind any aspects of the submitted modeling that are "engineering judgment" (Manning's "n" values, coefficients, etc.) must be documented in the submitted checklist or model report. Failure to document "engineering judgment" is an explicit modeling error.
- An abeyance determination may state the comments are not inclusive. If the modeling is incomplete or contains inaccurate or outdated data, mistakes may not be apparent until the applicant clarifies the model. The submission of an incomplete model or a model that contains inaccurate or outdated data will count as a "strike" against the submitted model.
- ESC staff will be available to discuss projects before a submittal, or after an abeyance letter has been mailed. Design details are the responsibility of the applicant and the consultant, however, and ESC staff will not suggest design changes to make a project approvable.
- The "Two Strikes" policy will be applied to all permit applications with submitted modeling that do not follow the General Guidelines for the Hydrologic – Hydraulic Assessment of Floodplains in Indiana. If after two attempts the submitted computer modeling is determined to be incorrect, the permit application will be denied and the applicant advised of the opportunity to seek administrative review. In the alternative, a new permit application with revised modeling may be submitted.
- A model submittal that has a project evaluation table that shows an excessive surcharge as a result of the proposed project will not be reviewed; the applicant will, however, be notified through an abeyance letter that the project as submitted is not approvable. The submission of a model with an excessive surcharge counts as a "strike", so the applicant will not have the benefit of fixing modeling problems based on ESC staff review comments. One exception is if the surcharge is contained entirely on the applicant's property and the applicant has clearly shown this to be true, then the submitted modeling will be reviewed.
- If a project is redesigned after the abeyance letter has been mailed, the redesigned submittal, if submitted under the same application number, is considered the second submittal and subject to only one review before approval or denial. If the applicant decides to withdraw the application to redesign the project, the subsequent application submittal will be treated as an initial submittal.
- The standard abeyance period for model revisions will be 90 days. A single extension of 90 days may also be granted.
- Any testimony regarding the technical merits of the submitted modeling or project alternatives will be the responsibility of the applicant. ESC staff would provide testimony as to the circumstances of their review.

DEPARTMENT OF STATE REVENUE

02990655.LOF

LETTER OF FINDINGS NUMBER: 99-0655
Adjusted Gross Income Tax – Unitary (Combined) Filing Status
Fiscal Years 1995 and 1996

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

Authority: *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico,* 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983); IC 6-3-2-2(l); IC 6-3-2-2(p); IC 6-3-2-2(q); 35 ILCS 5/1501(a)(27); Tenn.Code Ann. § 67-4-2004(25)(B)

Taxpayer protests the Audit Division's subsequent disallowance of unitary combined filing status, for purposes of the taxpayer's combined adjusted income tax return for fiscal years 1995 and 1996, on the basis that the combined return inaccurately reported taxpayer's Indiana source income.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

Authority: IC 6-3-2-2

Taxpayer claims that if the Department finds that it does not qualify to file on a unitary basis with its parent corporation and the members of the recreational vehicle group for Indiana tax purposes, then alternatively taxpayer and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a consolidated basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns.

III. Adjusted Gross Income Tax – Consolidated Returns

Authority: None

Taxpayer claims that the Department erred in requiring taxpayer and the five additional members of the recreational vehicle group that filed Indiana tax returns to file separate tax returns.

IV. Adjusted Gross Income Tax – Throwback Sales

Authority: *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992); *Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754 (Ind. Ct. App. 1980); IC 6-3-2-2; IC 6-8.1-5-1; 45 IAC 3.1-1-64; Public Law 86-272 (15 U.S.C.A §381-385)

Taxpayer raises for the first time at hearing the following issue: whether taxpayer and the original members of the recreational group that filed Indiana tax returns erred in classifying sales to states other than Indiana as throwback sales.

STATEMENT OF FACTS

Taxpayer's parent corporation (hereinafter, "Parent") is a holding company for various companies located in the United States and Canada which manufacture recreational vehicles. By a letter dated August 25, 1995, Parent petitioned the Department of Revenue for permission to file a combined return with all fourteen of its recreational vehicle subsidiaries (hereinafter referred to collectively as the "RV Subsidiaries") based upon the premise that they formed a unitary group. In its petition, Parent maintained that the RV Subsidiaries were one hundred percent (100%) owned by Parent; that the entities are all engaged in the same line of business; that the entities share common directors and common management; and, that filing separate company returns would not fairly reflect Indiana income.

In a letter dated October 10, 1995, and based upon the information submitted by Parent, the Indiana Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. Specifically, the Department found that Parent and the five members of the RV Subsidiary that filed Indiana income tax returns met the unity requirements through their unity of ownership, centralized management, and centralized financial, administrative and operational services. (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 2). The Department further found that Parent and the five subsidiaries met the "best method for reporting adjusted gross income" test through their shared industry impact on Indiana adjusted gross income and their non-arms length transactions. *Id*. The Department determined that the remaining nine subsidiaries could not be included in the unitary group or taxed by Indiana because they did not have sufficient contacts with the state of Indiana. Although the Department granted Parent's request, in part, to file unitary, it nevertheless, reserved the right to revoke its grant of permission for unitary combined filing in the event that, *inter alia*, the facts subsequently established by the Department disclosed material error or misrepresentation of the facts set forth in Parent's original petition. (*See Department of Revenue-Tax Policy Division Letter* dated August 30, 1995, page 3).

In a letter dated March 2, 1996, Parent re-petitioned the Department for permission to file combined returns with all of the RV Subsidiaries. In its letter dated March 20, 1996, the Department denied Parent's second petition, and reiterated that permission was granted for only five of the fourteen subsidiaries. Thereafter, Parent filed unitary combined returns including the five subsidiaries beginning in the fiscal year ending July 31, 1995.

In 1998, Parent amended its 1995 and 1996 Indiana tax returns to expand its combined filings to include all fourteen of its RV Subsidiaries. Parent based its amended returns on its position that the Department had erroneously failed to grant it permission to file combined Indiana income tax returns with the RV Subsidiaries.

<u>The "taxpayer" in the instant case is an Indiana subsidiary of Parent and one of the five RV subsidiaries originally permitted to be included in the combined filings</u>. The audit of taxpayer stems from an audit that was performed on the combined filings of Parent and its RV Subsidiaries for fiscal years 1995 through 1997 (which included the 1995 and 1996 amended returns). The disallowance of Parent's combined filings resulted in separate filing reports being generated for the subsidiaries that were originally granted permission to be included in the combined filing. The audit of taxpayer is of one such separate filing.

Pursuant to the audit performed on taxpayer, the auditor found that the expenses incurred by Parent on behalf of its subsidiary were properly reflected in the books of the subsidiary. As such, the Department determined that the Indiana income of taxpayer was more fairly reflected by filing separate company returns.

I. Adjusted Gross Income Tax – Unitary Filing Status

DISCUSSION

The taxpayer (*i.e.*, one of the RV Subsidiaries that filed Indiana income tax returns and was originally permitted to be included in the combined filings) protests the Department's determination that it may not file unitary combined returns for the fiscal years in question. Taxpayer argues that the combined reporting is the only filing method that fairly represents the flow of value from functional integration, centralized management, and economies of scale, present between taxpayer, Parent, and the remaining RV Subsidiaries.

In addressing this question, we examine: (1) whether a unitary relationship actually existed between Parent, taxpayer, and the remaining RV Subsidiaries; and (2) whether filing a combined return would more fairly represent the Parent's, taxpayer's, and remaining RV Subsidiaries' Indiana income. Hereinafter, the remaining RV Subsidiaries will be collectively referred to as the "RV Group".

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

The second criteria to be considered is common management. Common management is shown when the parent corporation provides a management role that is grounded in the parent's own operation expertise and overall operational strategy. *See, e.g.*, *Container Corp. V. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983).

Here, the taxpayer has supplied evidence which shows that Parent exercised control and influence over it and the RV Group. Parent's upper management consisted of a CEO, a Chairman and Treasurer, and a Vice President of Finance and Chief Administrative Officer. These three individuals were responsible operationally for taxpayer and the entire RV Group. Taxpayer and each one of the entities in the RV Group were required to submit to Parent's upper management for review and comment daily sales reports, monthly and annual financial reports, and operating and budget plans and goals. The CEO of Parent approved all capital expenditures in excess of one thousand dollars ($1000.00). Common management existed between Parent, taxpayer, and the RV Group.

The third test is that of common operation or use. Evidence of a common operation exists where certain functions are performed for the group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which independent companies would perform for themselves.

In the taxpayer's case, information was supplied which shows that many of the administrative, management, and financing functions for taxpayer and the RV Group were centralized. Parent's upper management employed a purchasing agent who was responsible for negotiating national supply contracts for the RV Group. Upper management selected the independent accountants, legal counsel, and insurance carriers that provided accounting, legal and insurance services to the RV Group. Parent's upper management also coordinated the administration of the employee benefits plan for the RV Group. Upper management purchased advertising space in various recreational vehicle trade magazines for the RV Group, and the entities of the RV Group often participated in joint presentations.

On the basis of these facts, it appears that taxpayer enjoyed a unitary relationship with Parent and the RV Group. There exists the elements of common ownership and management, and a modicum flow of value between the members of the business group. Using Parent's upper management to provide services for the RV Group that the taxpayer and the RV Group could have provided for themselves, resulted in common operation.

We now turn to the next point of analysis and the question of whether requiring taxpayer and the RV Group to use a standard apportionment or separate company filing method, instead of combined return filing, would result in a distortion of the income Parent reported as Indiana source income. Ultimately, this question requires us to determine whether, under all of the circumstances of the unitary relationship between Parent, taxpayer, and the RV Group, standard apportionment fulfills the statutory purpose of avoiding distortion of and realistically portraying Indiana source income. *See* IC 6-3-2-2(p).

Although IC 6-3-2-2(q) allows a parent corporation to petition the Department to file a combined return, it also incorporates by reference the restrictions imposed on alternative methods of reporting adjusted gross income by subsection (l) of that same section. Subsection (l) states in pertinent part:

> If 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 taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> ...
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The language in subsection (l) indicates that the standard apportionment and the separate accounting filing methods are the preferred methods of representing a taxpayer's income derived from Indiana sources. Other methods of income allocation and apportionment (including the combined reporting method) should only be allowed when those provided for by IC 6-3-2-2 do not fairly reflect a taxpayer's Indiana income. If the Indiana source income in the instant case can be fairly represented on the basis of standard apportionment or separate accounting, then such filing methods should be used.

Despite the finding of a unitary relationship between Parent, taxpayer, and the RV Group, and despite the relationship between the business operations of the entities, it does not appear that the operations of the businesses were so integrated to the point where the filing of separate returns would lead to a distortion of income. The evidence on file establishes that inter-company accounts existed for inter-company transactions between Parent, taxpayer, and the RV Group. Interest was paid and received by Parent on these accounts. The balance of the amounts contained in the inter-company accounts consisted of the earnings and profits of taxpayer and the members of the RV Group. Taxpayer and the members of the RV Group were required to remit to Parent at the end of each fiscal year any and all earnings and profits. If taxpayer or a member of the RV Group was unable to remit its profits for the year, Parent charged the entity interest on the unpaid amount. The delinquent entity paid an interest rate of prime plus one percent (1%).

Additionally, the evidence on file substantiates the finding that Parent was compensated for the services that it performed for taxpayer and the members of the RV Group. The expenses incurred by Parent were allocated to the appropriate entity receiving the benefit. As such, the expenses were properly reflected on each subsidiary's financial statements.

The extensive documentation presented by taxpayer does not demonstrate that the business operations of Parent, taxpayer, and the members of the RV Group were so interconnected that it becomes impossible to accurately determine the Indiana source income attributable to the respective entities.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

DISCUSSION

Taxpayer next argues that it and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a unitary basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns without a finding of some material misstatement of fact.

In a letter dated October 10, 1995, the Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. However, pursuant to an audit of Parent that resulted in the disallowance of Parent's filing on a combined basis with its subsidiaries, Parent was required to generate separate taxed returns for all of its subsidiaries, including the taxpayer and the subsidiaries with which Parent was originally granted permission to file on a unitary basis.

The statute applicable to the permission issue is found in IC 6-3-2-2 which states in pertinent part that:

IC 6-3-2-2 Corporations and nonresidents; "adjusted gross income derived from sources in state" defined...

> (l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana...
> (q)... taxpayers may petition the department... for permission to file a combined income tax return for a taxable year. The petition to file a combined income tax return must be completed and filed with the department not more than thirty (30) days after the end of the taxpayer's taxable year.

(*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 1).

The Department's grant of permission to file combined returns was a determination, based upon the facts available to the Department at the time, upon which taxpayer's parent corporation could rely. However, the Department did reserve the right to revoke the grant of permission if, *inter alia*, "the facts subsequently established by the Department disclose material error or misrepresentation to the facts set forth in this petition." (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 3). This right of revocation was clearly set forth in the letter to Parent. And, the language of the letter clearly warned Parent that should a subsequent audit reveal a misrepresentation of the facts set forth originally, permission to file combined returns would be revoked.

The evidence on file evinces that the Department granted permission to Parent to include certain subsidiaries in a combined filing based upon an assertion made by Parent in its original petition letter dated August 25, 1995. In this letter, Parent stated that, "Management fees are not paid by the subsidiaries to [Parent]. [Parent] is not a profit center; therefore, no income is recognized by [Parent] from services provided to its subsidiaries." (*See Parent's Original Petition Letter* dated August 25, 1995, page 4). Upon examination of the facts purported by Parent in its petition, and pursuant to the audit, the auditor discovered inter-company transactions (including management services) that were provided by Parent to its subsidiaries at arm's length.

Notwithstanding the foregoing, we do not believe that the Audit Division's subsequent reversal of the Department's determination that taxpayer could file combined tax returns was due to a material error or misrepresentation. The original approval letter specifically stated that combined filing status would be revoked if a material error or misrepresentation was discovered. However, through its examination of the books, records, and property of taxpayer, and its determination that separate filing best represented the taxpayer's Indiana income, Audit did not discover any material error or misrepresentation on the part of taxpayer.

Upon review of the instant case, the Department concludes that the original approval letter granting taxpayer permission to file combined tax returns is in error, but was not the result of a material error or misrepresentation on the part of taxpayer in the application process. Therefore, the appropriate remedy is for taxpayer's combined filings with the five RV subsidiaries originally permitted to be included in the combined returns for the years in question to be allowed.

FINDING

Taxpayer's protest is sustained. Taxpayer's combined returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years in question will be allowed. However, taxpayer's permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns is revoked for tax years beginning after the date of the audit report.

III. Adjusted Gross Income Tax – Consolidated Returns

DISCUSSION

Taxpayer next protests the Audit Division's determination that taxpayer and the members of the recreational vehicle group that filed Indiana tax returns were required to file separate filing reports for fiscal year ends 1995 through 1997. Taxpayer maintains that it should have been allowed to file consolidated returns with the members of the recreational vehicle group that filed Indiana tax returns for fiscal year ends 1995 through 1997, and with Parent for fiscal year ends 1996 and 1997. According to taxpayer, the filing of consolidated returns is the only way to fairly reflect taxpayer's and the subsidiaries' Indiana source income.

As we have already granted taxpayer permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years encompassed by the audit, this question is moot.

FINDING

Taxpayer's protest is denied.

IV. Adjusted Gross Income Tax – Throwback Sales

DISCUSSION

During the audit period, taxpayer and the subsidiaries that filed Indiana tax returns classified sales of recreational vehicles and parts to customers outside of Indiana (*i.e.*, recreational vehicle dealers and other subsidiaries) as throwback sales. According to taxpayer, it and the subsidiaries were under the mistaken belief that they were not subject to income tax in states other than Indiana, Ohio, and Michigan. Taxpayer believes that because it and the subsidiaries clearly had nexus activity in all the states where the recreational vehicles dealers are located (hereinafter, the "Dealers"), sales destined to those particular states should not have been classified as throwback sales.

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

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

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

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

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

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part:

A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385.

The taxpayer bears the burden to prove that an assessment by the Department is invalid. IC 6-8.1-5-1.

In *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992), the United States Supreme Court interpreted the term "solicitation" for purposes of P.L. 86-272, the federal law that generally exempts a corporation from state income tax if the company's only activity in the state is solicitation of sales of tangible personal property. Wrigley also established that a *de minimis* amount of nonsolicitation activity will not cause a corporation to lose its exemption from state taxation under P.L. 86-272. In *Wrigley*, the Court found that activities ancillary to the solicitation of orders would not result in a loss of immunity to taxation. Additionally, the Court held that as long as an activity, or activities, did not establish a nontrivial, additional connection with the taxing state it is sufficiently *de minimis* to avoid taxation. (*See also, Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754, 759 (Ind. Ct. App. 1980), where the court set out examples of activity which exceeded "mere solicitation" including "giving spot credit, accepting orders, collecting delinquent accounts and picking up returned goods within the taxing state, collecting deposits and advances on orders within the taxing state, pooling and exchanging technical personnel in a complex mutual endeavor, maintaining personal property... and associated local business activity for purposes not related to soliciting orders within the taxing state.")

The records and evidence presented to the Department lead to the conclusion that taxpayer and the Indiana subsidiaries contracted with Dealers outside of Indiana to perform warranty repair services. Periodic visits made by the employees of taxpayer and the Indiana subsidiaries to other states were to brief Dealers' on the products and the distinguishing features of the products in comparison with competitor's products, and to generate new business and to insure future sales of the products. These activities are all protected as ancillary to solicitation and would not subject taxpayer or any of the Indiana subsidiaries to taxation in other states. The few visits made by employees to brief Dealers on the products could be construed as *de minimis*. The Department concludes that taxpayer has not proven that it is subject to taxation in other states, and that the throwback of sales shipped to the other states were properly added into the numerator of the sales factor.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 99-0656
Adjusted Gross Income Tax – Unitary (Combined) Filing Status
Fiscal Years 1994 and 1995

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

ISSUES

I. Adjusted Gross Income Tax – Unitary Filing Status

Authority: *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983); IC 6-3-2-2(l); IC 6-3-2-2(p); IC 6-3-2-2(q); 35 ILCS 5/1501(a)(27); Tenn.Code Ann. § 67-4-2004(25)(B)

Taxpayer protests the Audit Division's subsequent disallowance of unitary combined filing status, for purposes of the taxpayer's combined adjusted income tax return for fiscal years 1994 and 1995, on the basis that the combined return inaccurately reported taxpayer's Indiana source income.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

Authority: IC 6-3-2-2

Taxpayer claims that if the Department finds that it does not qualify to file on a unitary basis with its parent corporation and the members of the recreational vehicle group for Indiana tax purposes, then alternatively taxpayer and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a consolidated basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns.

III. Adjusted Gross Income Tax – Consolidated Returns

Authority: None

Taxpayer claims that the Department erred in requiring taxpayer and the five additional members of the recreational vehicle group that filed Indiana tax returns to file separate tax returns.

IV. Adjusted Gross Income Tax – Throwback Sales

Authority: *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992); *Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754 (Ind. Ct. App. 1980); IC 6-3-2-2; IC 6-8.1-5-1; 45 IAC 3.1-1-64; Public Law 86-272 (15 U.S.C.A §381-385)

Taxpayer raises for the first time at hearing the following issue: whether taxpayer and the original members of the recreational group that filed Indiana tax returns erred in classifying sales to states other than Indiana as throwback sales.

STATEMENT OF FACTS

Taxpayer's parent corporation (hereinafter, "Parent") is a holding company for various companies located in the United States and Canada which manufacture recreational vehicles. By a letter dated August 25, 1995, Parent petitioned the Department of Revenue for permission to file a combined return with all fourteen of its recreational vehicle subsidiaries (hereinafter referred to collectively as the "RV Subsidiaries") based upon the premise that they formed a unitary group. In its petition, Parent maintained that the RV Subsidiaries were one hundred percent (100%) owned by Parent; that the entities are all engaged in the same line of business; that the entities share common directors and common management; and, that filing separate company returns would not fairly reflect Indiana income.

In a letter dated October 10, 1995, and based upon the information submitted by Parent, the Indiana Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. Specifically, the Department found that Parent and the five members of the RV Subsidiary that filed Indiana income tax returns met the unity requirements through their unity of ownership, centralized management, and centralized financial, administrative and operational services. (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 2). The Department further found that Parent and the five subsidiaries met the "best method for reporting adjusted gross income" test through their shared industry impact on Indiana adjusted gross income and their non-arms length transactions. *Id*. The Department determined that the remaining nine subsidiaries could not be included in the unitary group or taxed by Indiana because they did not have sufficient contacts with the state of Indiana. Although the Department granted Parent's request, in part, to file unitary, it nevertheless, reserved the right to revoke its grant of permission for unitary combined filing in the event that, *inter alia*, the facts subsequently established by the Department disclosed material error or misrepresentation of the facts set forth in Parent's original petition. (*See Department of Revenue-Tax Policy Division Letter* dated August 30, 1995, page 3).

In a letter dated March 2, 1996, Parent re-petitioned the Department for permission to file combined returns with all of the RV Subsidiaries. In its letter dated March 20, 1996, the Department denied Parent's second petition, and reiterated that permission was granted for only five of the fourteen subsidiaries. Thereafter, Parent filed unitary combined returns including the five subsidiaries beginning in the fiscal year ending July 31, 1995. In fiscal year ending July 31, 1995, Parent also included one additional company in its combined returns. The additional company is the "taxpayer" in the instant case.

In 1998, Parent amended its 1995 and 1996 Indiana tax returns to expand its combined filings to include all fourteen of its RV Subsidiaries. Parent based its amended returns on its position that the Department had erroneously failed to grant it permission to file combined Indiana income tax returns with the RV Subsidiaries.

<u>As stated above, the "taxpayer" in the instant case is an Indiana subsidiary of Parent and the additional company that Parent included in its unitary combined returns for fiscal year 1995, along with the five RV subsidiaries originally permitted to be included in the combined filings</u>. The audit of taxpayer stems from an audit that was performed on the combined filings of Parent and its RV Subsidiaries for fiscal years 1995 through 1997 (which included the 1995 and 1996 amended returns). The disallowance of Parent's combined filings resulted in separate filing reports being generated for the subsidiaries that were originally granted permission to be included in the combined filing. The audit of taxpayer is of one such separate filing.

Pursuant to the audit performed on taxpayer, the auditor found that the expenses incurred by Parent on behalf of its subsidiary were properly reflected in the books of the subsidiary. As such, the Department determined that the Indiana income of taxpayer was more fairly reflected by filing separate company returns.

I. Adjusted Gross Income Tax – Unitary Filing Status

DISCUSSION

Taxpayer protests the Department's determination that it may not file unitary combined returns for the fiscal years in question. Taxpayer argues that the combined reporting is the only filing method that fairly represents the flow of value from functional integration, centralized management, and economies of scale, present between taxpayer, Parent, and the remaining RV Subsidiaries.

In addressing this question, we examine: (1) whether a unitary relationship actually existed between Parent, taxpayer, and the remaining RV Subsidiaries; and (2) whether filing a combined return would more fairly represent the Parent's, taxpayer's, and remaining RV Subsidiaries' Indiana income. Hereinafter, the remaining RV Subsidiaries will be collectively referred to as the "RV Group".

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

The second criteria to be considered is common management. Common management is shown when the parent corporation provides a management role that is grounded in the parent's own operation expertise and overall operational strategy. *See, e.g., Container Corp. V. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983).

Here, the taxpayer has supplied evidence which shows that Parent exercised control and influence over it and the RV Group. Parent's upper management consisted of a CEO, a Chairman and Treasurer, and a Vice President of Finance and Chief Administrative Officer. These three individuals were responsible operationally for taxpayer and the entire RV Group. Taxpayer and each one of the entities in the RV Group were required to submit to Parent's upper management for review and comment daily sales reports, monthly and annual financial reports, and operating and budget plans and goals. The CEO of Parent approved all capital expenditures in excess of one thousand dollars ($1000.00). Common management existed between Parent, taxpayer, and the RV Group.

The third test is that of common operation or use. Evidence of a common operation exists where certain functions are performed for the group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which independent companies would perform for themselves.

In the taxpayer's case, information was supplied which shows that many of the administrative, management, and financing functions for taxpayer and the RV Group were centralized. Parent's upper management employed a purchasing agent who was responsible for negotiating national supply contracts for the RV Group. Upper management selected the independent accountants, legal counsel, and insurance carriers that provided accounting, legal and insurance services to the RV Group. Parent's upper management also coordinated the administration of the employee benefits plan for the RV Group. Upper management purchased advertising space in various recreational vehicle trade magazines for the RV Group, and the entities of the RV Group often participated in joint presentations.

On the basis of these facts, it appears that taxpayer enjoyed a unitary relationship with Parent and the RV Group. There exists the elements of common ownership and management, and a modicum flow of value between the members of the business group. Using Parent's upper management to provide services for the RV Group that the taxpayer and the RV Group could have provided for themselves, resulted in common operation.

We now turn to the next point of analysis and the question of whether requiring taxpayer and the RV Group to use a standard apportionment or separate company filing method, instead of combined return filing, would result in a distortion of the income Parent reported as Indiana source income. Ultimately, this question requires us to determine whether, under all of the circumstances of the unitary relationship between Parent, taxpayer, and the RV Group, standard apportionment fulfills the statutory purpose of avoiding distortion of and realistically portraying Indiana source income. *See* IC 6-3-2-2(p).

Although IC 6-3-2-2(q) allows a parent corporation to petition the Department to file a combined return, it also incorporates by reference the restrictions imposed on alternative methods of reporting adjusted gross income by subsection (l) of that same section. Subsection (l) states in pertinent part:

> If 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 taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> ...

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The language in subsection (l) indicates that the standard apportionment and the separate accounting filing methods are the preferred methods of representing a taxpayer's income derived from Indiana sources. Other methods of income allocation and apportionment (including the combined reporting method) should only be allowed when those provided for by IC 6-3-2-2 do not fairly reflect a taxpayer's Indiana income. If the Indiana source income in the instant case can be fairly represented on the basis of standard apportionment or separate accounting, then such filing methods should be used.

Despite the finding of a unitary relationship between Parent, taxpayer, and the RV Group, and despite the relationship between the business operations of the entities, it does not appear that the operations of the businesses were so integrated to the point where the filing of separate returns would lead to a distortion of income. The evidence on file establishes that inter-company accounts existed for inter-company transactions between Parent, taxpayer, and the RV Group. Interest was paid and received by Parent on these accounts. The balance of the amounts contained in the inter-company accounts consisted of the earnings and profits of taxpayer and the members of the RV Group. Taxpayer and the members of the RV Group were required to remit to Parent at the end of each fiscal year any and all earnings and profits. If taxpayer or a member of the RV Group was unable to remit its profits for the year, Parent charged the entity interest on the unpaid amount. The delinquent entity paid an interest rate of prime plus one percent (1%).

Additionally, the evidence on file substantiates the finding that Parent was compensated for the services that it performed for taxpayer and the members of the RV Group. The expenses incurred by Parent were allocated to the appropriate entity receiving the benefit. As such, the expenses were properly reflected on each subsidiary's financial statements.

The extensive documentation presented by taxpayer does not demonstrate that the business operations of Parent, taxpayer, and the members of the RV Group were so interconnected that it becomes impossible to accurately determine the Indiana source income attributable to the respective entities.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

DISCUSSION

Taxpayer next argues that it and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a unitary basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns without a finding of some material misstatement of fact.

In a letter dated October 10, 1995, the Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. However, pursuant to an audit of Parent that resulted in the disallowance of Parent's filing on a combined basis with its subsidiaries, Parent was required to generate separate taxed returns for all of its subsidiaries, including the taxpayer and the subsidiaries with which Parent was originally granted permission to file on a unitary basis.

The statute applicable to the permission issue is found in IC 6-3-2-2 which states in pertinent part that:

IC 6-3-2-2 Corporations and nonresidents; "adjusted gross income derived from sources in state" defined...

(l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana...

(q)... taxpayers may petition the department... for permission to file a combined income tax return for a taxable year. The petition to file a combined income tax return must be completed and filed with the department not more than thirty (30) days after the end of the taxpayer's taxable year.

(*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 1).

The Department's grant of permission to file combined returns was a determination, based upon the facts available to the Department at the time, upon which taxpayer's parent corporation could rely. However, the Department did reserve the right to revoke the grant of permission if, *inter alia*, "the facts subsequently established by the Department disclose material error or misrepresentation to the facts set forth in this petition." (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 3). This right of revocation was clearly set forth in the letter to Parent. And, the language of the letter clearly warned Parent that should a subsequent audit reveal a misrepresentation of the facts set forth originally, permission to file combined returns would be revoked.

The evidence on file evinces that the Department granted permission to Parent to include certain subsidiaries in a combined filing based upon an assertion made by Parent in its original petition letter dated August 25, 1995. In this letter, Parent stated that, "Management fees are not paid by the subsidiaries to [Parent]. [Parent] is not a profit center; therefore, no income is recognized by [Parent] from services provided to its subsidiaries." (*See Parent's Original Petition Letter* dated August 25, 1995, page 4). Upon examination of the facts purported by Parent in its petition, and pursuant to the audit, the auditor discovered inter-company transactions (including management services) that were provided by Parent to its subsidiaries at arm's length.

Notwithstanding the foregoing, we do not believe that the Audit Division's subsequent reversal of the Department's determination that taxpayer could file combined tax returns was due to a material error or misrepresentation. The original approval letter specifically stated that combined filing status would be revoked if a material error or misrepresentation was discovered. However, through its examination of the books, records, and property of taxpayer, and its determination that separate filing best represented the taxpayer's Indiana income, Audit did not discover any material error or misrepresentation on the part of taxpayer.

Upon review of the instant case, the Department concludes that the original approval letter granting taxpayer permission to file combined tax returns is in error, but was not the result of a material error or misrepresentation on the part of taxpayer in the application process. Therefore, the appropriate remedy is for taxpayer's combined filings with the five RV subsidiaries originally permitted to be included in the combined returns for the years in question to be allowed.

FINDING

Taxpayer's protest is sustained. Taxpayer's combined returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years in question will be allowed. However, taxpayer's permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns is revoked for tax years beginning after the date of the audit report.

III. Adjusted Gross Income Tax – Consolidated Returns

DISCUSSION

Taxpayer next protests the Audit Division's determination that taxpayer and the members of the recreational vehicle group that filed Indiana tax returns were required to file separate filing reports for fiscal year ends 1995 through 1997. Taxpayer maintains that it should have been allowed to file consolidated returns with the members of the recreational vehicle group that filed Indiana tax returns for fiscal year ends 1995 through 1997, and with Parent for fiscal year ends 1996 and 1997. According to taxpayer, the filing of consolidated returns is the only way to fairly reflect taxpayer's and the subsidiaries' Indiana source income.

As we have already granted taxpayer permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years encompassed by the audit, this question is moot.

FINDING

Taxpayer's protest of this issue is moot.

IV. Adjusted Gross Income Tax – Throwback Sales

DISCUSSION

During the audit period, taxpayer and the subsidiaries that filed Indiana tax returns classified sales of recreational vehicles and parts to customers outside of Indiana (*i.e.*, recreational vehicle dealers and other subsidiaries) as throwback sales. According to taxpayer, it and the subsidiaries were under the mistaken belief that they were not subject to income tax in states other than Indiana, Ohio, and Michigan. Taxpayer believes that because it and the subsidiaries clearly had nexus activity in all the states where the recreational vehicles dealers are located (hereinafter, the "Dealers"), sales destined to those particular states should not have been classified as throwback sales.

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

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

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

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

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

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part:

A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385.

The taxpayer bears the burden to prove that an assessment by the Department is invalid. IC 6-8.1-5-1.

In *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992), the United States Supreme Court interpreted the term "solicitation" for purposes of P.L. 86-272, the federal law that generally exempts a corporation from state income tax if the company's only activity in the state is solicitation of sales of tangible personal property. Wrigley also established that a *de minimis* amount of nonsolicitation activity will not cause a corporation to lose its exemption from state taxation under P.L. 86-272. In *Wrigley*, the Court found that activities ancillary to the solicitation of orders would not result in a loss of immunity to taxation. Additionally, the Court held that as long as an activity, or activities, did not establish a nontrivial, additional connection with the taxing state it is sufficiently *de minimis* to avoid taxation. (*See also, Indiana Dept. of State Revenue v.*

Continental Steel Corp., 399 N.E.2d 754, 759 (Ind. Ct. App. 1980), where the court set out examples of activity which exceeded "mere solicitation" including "giving spot credit, accepting orders, collecting delinquent accounts and picking up returned goods within the taxing state, collecting deposits and advances on orders within the taxing state, pooling and exchanging technical personnel in a complex mutual endeavor, maintaining personal property... and associated local business activity for purposes not related to soliciting orders within the taxing state.")

The records and evidence presented to the Department lead to the conclusion that taxpayer and the Indiana subsidiaries contracted with Dealers outside of Indiana to perform warranty repair services. Periodic visits made by the employees of taxpayer and the Indiana subsidiaries to other states were to brief Dealers' on the products and the distinguishing features of the products in comparison with competitor's products, and to generate new business and to insure future sales of the products. These activities are all protected as ancillary to solicitation and would not subject taxpayer or any of the Indiana subsidiaries to taxation in other states. The few visits made by employees to brief Dealers on the products could be construed as *de minimis*. The Department concludes that taxpayer has not proven that it is subject to taxation in other states, and that the throwback of sales shipped to the other states were properly added into the numerator of the sales factor.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02990657.LOF

LETTER OF FINDINGS NUMBER: 99-0657
Adjusted Gross Income Tax – Unitary (Combined) Filing Status
Fiscal Years 1995 through 1997

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

ISSUES

I. Adjusted Gross Income Tax – Unitary Filing Status

Authority: *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983); IC 6-3-2-2(l); IC 6-3-2-2(p); IC 6-3-2-2(q); 35 ILCS 5/1501(a)(27); Tenn.Code Ann. § 67-4-2004(25)(B)

Taxpayer protests the Audit Division's subsequent disallowance of unitary combined filing status, for purposes of the taxpayer's combined adjusted income tax return for fiscal years 1995, 1996 and 1997, on the basis that the combined return inaccurately reported taxpayer's Indiana source income.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

Authority: IC 6-3-2-2

Taxpayer claims that if the Department finds that it does not qualify to file on a unitary basis with its parent corporation and the members of the recreational vehicle group for Indiana tax purposes, then alternatively taxpayer and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a consolidated basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns.

III. Adjusted Gross Income Tax – Consolidated Returns

Authority: None

Taxpayer claims that the Department erred in requiring taxpayer and the five additional members of the recreational vehicle group that filed Indiana tax returns to file separate tax returns.

IV. Adjusted Gross Income Tax – Throwback Sales

Authority: *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992); *Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754 (Ind. Ct. App. 1980); IC 6-3-2-2; IC 6-8.1-5-1; 45 IAC 3.1-1-64; Public Law 86-272 (15 U.S.C.A §381-385)

Taxpayer raises for the first time at hearing the following issue: whether taxpayer and the original members of the recreational group that filed Indiana tax returns erred in classifying sales to states other than Indiana as throwback sales.

STATEMENT OF FACTS

Taxpayer's parent corporation (hereinafter, "Parent") is a holding company for various companies located in the United States and Canada which manufacture recreational vehicles. By a letter dated August 25, 1995, Parent petitioned the Department of Revenue for permission to file a combined return with all fourteen of its recreational vehicle subsidiaries (hereinafter referred to collectively as the "RV Subsidiaries") based upon the premise that they formed a unitary group. In its petition, Parent maintained that the RV Subsidiaries were one hundred percent (100%) owned by Parent; that the entities are all engaged in the same line of business; that the entities share common directors and common management; and, that filing separate company returns would not fairly reflect Indiana income.

In a letter dated October 10, 1995, and based upon the information submitted by Parent, the Indiana Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. Specifically, the Department found that Parent and the five members of the RV Subsidiary that filed Indiana income tax returns met the unity requirements through their unity of ownership, centralized management, and centralized financial, administrative and operational services. (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 2). The Department further found that Parent and the five subsidiaries met the "best method for reporting adjusted gross income" test through their shared industry impact on Indiana adjusted gross income and their non-arms length transactions. *Id*. The Department determined that the remaining nine subsidiaries could not be included in the unitary group or taxed by Indiana because they did not have sufficient contacts with the state of Indiana. Although the Department granted Parent's request, in part, to file unitary, it nevertheless, reserved the right to revoke its grant of permission for unitary combined filing in the event that, *inter alia*, the facts subsequently established by the Department disclosed material error or misrepresentation of the facts set forth in Parent's original petition. (*See Department of Revenue-Tax Policy Division Letter* dated August 30, 1995, page 3).

In a letter dated March 2, 1996, Parent re-petitioned the Department for permission to file combined returns with all of the RV Subsidiaries. In its letter dated March 20, 1996, the Department denied Parent's second petition, and reiterated that permission was granted for only five of the fourteen subsidiaries. Thereafter, Parent filed unitary combined returns including the five subsidiaries beginning in the fiscal year ending July 31, 1995.

In 1998, Parent amended its 1995 and 1996 Indiana tax returns to expand its combined filings to include all fourteen of its RV Subsidiaries. Parent based its amended returns on its position that the Department had erroneously failed to grant it permission to file combined Indiana income tax returns with the RV Subsidiaries.

<u>The "taxpayer" in the instant case is an Indiana subsidiary of Parent and one of the five RV subsidiaries originally permitted to be included in the combined filings</u>. The audit of taxpayer stems from an audit that was performed on the combined filings of Parent and its RV Subsidiaries for fiscal years 1995 through 1997 (which included the 1995 and 1996 amended returns). The disallowance of Parent's combined filings resulted in separate filing reports being generated for the subsidiaries that were originally granted permission to be included in the combined filing. The audit of taxpayer is of one such separate filing.

Pursuant to the audit performed on taxpayer, the auditor found that the expenses incurred by Parent on behalf of its subsidiary were properly reflected in the books of the subsidiary. As such, the Department determined that the Indiana income of taxpayer was more fairly reflected by filing separate company returns.

I. Adjusted Gross Income Tax – Unitary Filing Status

DISCUSSION

The taxpayer (*i.e.*, one of the RV Subsidiaries that filed Indiana income tax returns and was originally permitted to be included in the combined filings) protests the Department's determination that it may not file unitary combined returns for the fiscal years in question. Taxpayer argues that the combined reporting is the only filing method that fairly represents the flow of value from functional integration, centralized management, and economies of scale, present between taxpayer, Parent, and the remaining RV Subsidiaries.

In addressing this question, we examine: (1) whether a unitary relationship actually existed between Parent, taxpayer, and the remaining RV Subsidiaries; and (2) whether filing a combined return would more fairly represent the Parent's, taxpayer's, and remaining RV Subsidiaries' Indiana income. Hereinafter, the remaining RV Subsidiaries will be collectively referred to as the "RV Group".

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

The second criteria to be considered is common management. Common management is shown when the parent corporation provides a management role that is grounded in the parent's own operation expertise and overall operational strategy. *See, e.g., Container Corp. V. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983).

Here, the taxpayer has supplied evidence which shows that Parent exercised control and influence over it and the RV Group. Parent's upper management consisted of a CEO, a Chairman and Treasurer, and a Vice President of Finance and Chief Administrative Officer. These three individuals were responsible operationally for taxpayer and the entire RV Group. Taxpayer and each one of the entities in the RV Group were required to submit to Parent's upper management for review and comment daily sales reports, monthly and annual financial reports, and operating and budget plans and goals. The CEO of Parent approved all capital expenditures in excess of one thousand dollars ($1000.00). Common management existed between Parent, taxpayer, and the RV Group.

The third test is that of common operation or use. Evidence of a common operation exists where certain functions are performed for the group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which independent companies would perform for themselves.

In the taxpayer's case, information was supplied which shows that many of the administrative, management, and financing functions for taxpayer and the RV Group were centralized. Parent's upper management employed a purchasing agent who was responsible for negotiating national supply contracts for the RV Group. Upper management selected the independent accountants, legal counsel, and insurance carriers that provided accounting, legal and insurance services to the RV Group. Parent's upper management also coordinated the administration of the employee benefits plan for the RV Group. Upper management purchased advertising space in various recreational vehicle trade magazines for the RV Group, and the entities of the RV Group often participated in joint presentations.

On the basis of these facts, it appears that taxpayer enjoyed a unitary relationship with Parent and the RV Group. There exists the elements of common ownership and management, and a modicum flow of value between the members of the business group. Using Parent's upper management to provide services for the RV Group that the taxpayer and the RV Group could have provided for themselves, resulted in common operation.

We now turn to the next point of analysis and the question of whether requiring taxpayer and the RV Group to use a standard apportionment or separate company filing method, instead of combined return filing, would result in a distortion of the income Parent reported as Indiana source income. Ultimately, this question requires us to determine whether, under all of the circumstances of the unitary relationship between Parent, taxpayer, and the RV Group, standard apportionment fulfills the statutory purpose of avoiding distortion of and realistically portraying Indiana source income. *See* IC 6-3-2-2(p).

Although IC 6-3-2-2(q) allows a parent corporation to petition the Department to file a combined return, it also incorporates by reference the restrictions imposed on alternative methods of reporting adjusted gross income by subsection (l) of that same section. Subsection (l) states in pertinent part:

> If 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 taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> ...
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The language in subsection (l) indicates that the standard apportionment and the separate accounting filing methods are the preferred methods of representing a taxpayer's income derived from Indiana sources. Other methods of income allocation and apportionment (including the combined reporting method) should only be allowed when those provided for by IC 6-3-2-2 do not fairly reflect a taxpayer's Indiana income. If the Indiana source income in the instant case can be fairly represented on the basis of standard apportionment or separate accounting, then such filing methods should be used.

Despite the finding of a unitary relationship between Parent, taxpayer, and the RV Group, and despite the relationship between the business operations of the entities, it does not appear that the operations of the businesses were so integrated to the point where the filing of separate returns would lead to a distortion of income. The evidence on file establishes that inter-company accounts existed for inter-company transactions between Parent, taxpayer, and the RV Group. Interest was paid and received by Parent on these accounts. The balance of the amounts contained in the inter-company accounts consisted of the earnings and profits of taxpayer and the members of the RV Group. Taxpayer and the members of the RV Group were required to remit to Parent at the end of each fiscal year any and all earnings and profits. If taxpayer or a member of the RV Group was unable to remit its profits for the year, Parent charged the entity interest on the unpaid amount. The delinquent entity paid an interest rate of prime plus one percent (1%).

Additionally, the evidence on file substantiates the finding that Parent was compensated for the services that it performed for taxpayer and the members of the RV Group. The expenses incurred by Parent were allocated to the appropriate entity receiving the benefit. As such, the expenses were properly reflected on each subsidiary's financial statements.

The extensive documentation presented by taxpayer does not demonstrate that the business operations of Parent, taxpayer, and the members of the RV Group were so interconnected that it becomes impossible to accurately determine the Indiana source income attributable to the respective entities.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

DISCUSSION

Taxpayer next argues that it and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a unitary basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns without a finding of some material misstatement of fact.

In a letter dated October 10, 1995, the Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. However, pursuant to an audit of Parent that resulted in the disallowance of Parent's filing on a combined basis with its subsidiaries, Parent was required to generate separate taxed returns for all of its subsidiaries, including the taxpayer and the subsidiaries with which Parent was originally granted permission to file on a unitary basis.

The statute applicable to the permission issue is found in IC 6-3-2-2 which states in pertinent part that:

IC 6-3-2-2 Corporations and nonresidents; "adjusted gross income derived from sources in state" defined...

(l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana...

(q)... taxpayers may petition the department... for permission to file a combined income tax return for a taxable year. The petition to file a combined income tax return must be completed and filed with the department not more than thirty (30) days after the end of the taxpayer's taxable year.

(*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 1).

The Department's grant of permission to file combined returns was a determination, based upon the facts available to the Department at the time, upon which taxpayer's parent corporation could rely. However, the Department did reserve the right to revoke the grant of permission if, *inter alia*, "the facts subsequently established by the Department disclose material error or misrepresentation to the facts set forth in this petition." (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 3). This right of revocation was clearly set forth in the letter to Parent. And, the language of the letter clearly warned Parent that should a subsequent audit reveal a misrepresentation of the facts set forth originally, permission to file combined returns would be revoked.

The evidence on file evinces that the Department granted permission to Parent to include certain subsidiaries in a combined filing based upon an assertion made by Parent in its original petition letter dated August 25, 1995. In this letter, Parent stated that, "Management fees are not paid by the subsidiaries to [Parent]. [Parent] is not a profit center; therefore, no income is recognized by [Parent] from services provided to its subsidiaries." (*See Parent's Original Petition Letter* dated August 25, 1995, page 4). Upon examination of the facts purported by Parent in its petition, and pursuant to the audit, the auditor discovered inter-company transactions (including management services) that were provided by Parent to its subsidiaries at arm's length.

Notwithstanding the foregoing, we do not believe that the Audit Division's subsequent reversal of the Department's determination that taxpayer could file combined tax returns was due to a material error or misrepresentation. The original approval letter specifically stated that combined filing status would be revoked if a material error or misrepresentation was discovered. However, through its examination of the books, records, and property of taxpayer, and its determination that separate filing best represented the taxpayer's Indiana income, Audit did not discover any material error or misrepresentation on the part of taxpayer.

Upon review of the instant case, the Department concludes that the original approval letter granting taxpayer permission to file combined tax returns is in error, but was not the result of a material error or misrepresentation on the part of taxpayer in the application process. Therefore, the appropriate remedy is for taxpayer's combined filings with the five RV subsidiaries originally permitted to be included in the combined returns for the years in question to be allowed.

FINDING

Taxpayer's protest is sustained. Taxpayer's combined returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years in question will be allowed. However, taxpayer's permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns is revoked for tax years beginning after the date of the audit report.

III. Adjusted Gross Income Tax – Consolidated Returns

DISCUSSION

Taxpayer next protests the Audit Division's determination that taxpayer and the members of the recreational vehicle group that filed Indiana tax returns were required to file separate filing reports for fiscal year ends 1995 through 1997. Taxpayer maintains that it should have been allowed to file consolidated returns with the members of the recreational vehicle group that filed Indiana tax returns for fiscal year ends 1995 through 1997, and with Parent for fiscal year ends 1996 and 1997. According to taxpayer, the filing of consolidated returns is the only way to fairly reflect taxpayer's and the subsidiaries' Indiana source income.

As we have already granted taxpayer permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years encompassed by the audit, this question is moot.

FINDING

Taxpayer's protest is denied.

IV. Adjusted Gross Income Tax – Throwback Sales

DISCUSSION

During the audit period, taxpayer and the subsidiaries that filed Indiana tax returns classified sales of recreational vehicles and parts to customers outside of Indiana (*i.e.*, recreational vehicle dealers and other subsidiaries) as throwback sales. According to taxpayer, it and the subsidiaries were under the mistaken belief that they were not subject to income tax in states other than Indiana, Ohio, and Michigan. Taxpayer believes that because it and the subsidiaries clearly had nexus activity in all the states where the recreational vehicles dealers are located (hereinafter, the "Dealers"), sales destined to those particular states should not have been classified as throwback sales.

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

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

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

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

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

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part:

A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385.

The taxpayer bears the burden to prove that an assessment by the Department is invalid. IC 6-8.1-5-1.

In *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992), the United States Supreme Court interpreted the term "solicitation" for purposes of P.L. 86-272, the federal law that generally exempts a corporation from state income tax if the company's only activity in the state is solicitation of sales of tangible personal property. Wrigley also established that a *de minimis* amount of nonsolicitation activity will not cause a corporation to lose its exemption from state taxation under P.L. 86-272. In *Wrigley*, the Court found that activities ancillary to the solicitation of orders would not result in a loss of immunity to taxation. Additionally, the Court held that as long as an activity, or activities, did not establish a nontrivial, additional connection with the taxing state it is sufficiently *de minimis* to avoid taxation. (*See also, Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754, 759 (Ind. Ct. App. 1980), where the court set out examples of activity which exceeded "mere solicitation" including "giving spot credit, accepting orders, collecting delinquent accounts and picking up returned goods within the taxing state, collecting deposits and advances on orders within the taxing state, pooling and exchanging technical personnel in a complex mutual endeavor, maintaining personal property... and associated local business activity for purposes not related to soliciting orders within the taxing state.")

The records and evidence presented to the Department lead to the conclusion that taxpayer and the Indiana subsidiaries contracted with Dealers outside of Indiana to perform warranty repair services. Periodic visits made by the employees of taxpayer and the Indiana subsidiaries to other states were to brief Dealers' on the products and the distinguishing features of the products in comparison with competitor's products, and to generate new business and to insure future sales of the products. These activities are all protected as ancillary to solicitation and would not subject taxpayer or any of the Indiana subsidiaries to taxation in other states. The few visits made by employees to brief Dealers on the products could be construed as *de minimis*. The Department concludes that taxpayer has not proven that it is subject to taxation in other states, and that the throwback of sales shipped to the other states were properly added into the numerator of the sales factor.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02990658.LOF

LETTER OF FINDINGS NUMBER: 99-0658
Adjusted Gross Income Tax – Unitary (Combined) Filing Status
Fiscal Years 1995 through 1997

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

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

ISSUES

I. Adjusted Gross Income Tax – Unitary Filing Status

Authority: *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983); IC 6-3-2-2(l); IC 6-3-2-2(p); IC 6-3-2-2(q); 35 ILCS 5/1501(a)(27); Tenn.Code Ann. § 67-4-2004(25)(B)

Taxpayer protests the Audit Division's subsequent disallowance of unitary combined filing status, for purposes of the taxpayer's combined adjusted income tax return for fiscal years 1995, 1996 and 1997, on the basis that the combined return inaccurately reported taxpayer's Indiana source income.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

Authority: IC 6-3-2-2

Taxpayer claims that if the Department finds that it does not qualify to file on a unitary basis with its parent corporation and the members of the recreational vehicle group for Indiana tax purposes, then alternatively taxpayer and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a consolidated basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns.

III. Adjusted Gross Income Tax – Consolidated Returns

Authority: None

Taxpayer claims that the Department erred in requiring taxpayer and the five additional members of the recreational vehicle group that filed Indiana tax returns to file separate tax returns.

IV. Adjusted Gross Income Tax – Throwback Sales

Authority: *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992); *Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754 (Ind. Ct. App. 1980); IC 6-3-2-2; IC 6-8.1-5-1; 45 IAC 3.1-1-64; Public Law 86-272 (15 U.S.C.A §381-385)

Taxpayer raises for the first time at hearing the following issue: whether taxpayer and the original members of the recreational group that filed Indiana tax returns erred in classifying sales to states other than Indiana as throwback sales.

STATEMENT OF FACTS

Taxpayer's parent corporation (hereinafter, "Parent") is a holding company for various companies located in the United States and Canada which manufacture recreational vehicles. By a letter dated August 25, 1995, Parent petitioned the Department of Revenue for permission to file a combined return with all fourteen of its recreational vehicle subsidiaries (hereinafter referred to collectively as the "RV Subsidiaries") based upon the premise that they formed a unitary group. In its petition, Parent maintained that the RV Subsidiaries were one hundred percent (100%) owned by Parent; that the entities are all engaged in the same line of business; that the entities share common directors and common management; and, that filing separate company returns would not fairly reflect Indiana income.

In a letter dated October 10, 1995, and based upon the information submitted by Parent, the Indiana Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. Specifically, the Department found that Parent and the five members of the RV Subsidiary that filed Indiana income tax returns met the unity requirements through their unity of ownership, centralized management, and centralized financial, administrative and operational services. (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 2). The Department further found that Parent and the five subsidiaries met the "best method for reporting adjusted gross income" test through their shared industry impact on Indiana adjusted gross income and their non-arms length transactions. *Id*. The Department determined that the remaining nine subsidiaries could not be included in the unitary group or taxed by Indiana because they did not have sufficient contacts with the state of Indiana. Although the Department granted Parent's request, in part, to file unitary, it nevertheless, reserved the right to revoke its grant of permission for unitary combined filing in the event that, *inter alia*, the facts subsequently established by the Department disclosed material error or misrepresentation of the facts set forth in Parent's original petition. (*See Department of Revenue-Tax Policy Division Letter* dated August 30, 1995, page 3).

In a letter dated March 2, 1996, Parent re-petitioned the Department for permission to file combined returns with all of the RV Subsidiaries. In its letter dated March 20, 1996, the Department denied Parent's second petition, and reiterated that permission was granted for only five of the fourteen subsidiaries. Thereafter, Parent filed unitary combined returns including the five subsidiaries beginning in the fiscal year ending July 31, 1995.

In 1998, Parent amended its 1995 and 1996 Indiana tax returns to expand its combined filings to include all fourteen of its RV Subsidiaries. Parent based its amended returns on its position that the Department had erroneously failed to grant it permission to file combined Indiana income tax returns with the RV Subsidiaries.

The “taxpayer” in the instant case is an Indiana subsidiary of Parent and one of the five RV subsidiaries originally permitted to be included in the combined filings. The audit of taxpayer stems from an audit that was performed on the combined filings of Parent and its RV Subsidiaries for fiscal years 1995 through 1997 (which included the 1995 and 1996 amended returns). The disallowance of Parent’s combined filings resulted in separate filing reports being generated for the subsidiaries that were originally granted permission to be included in the combined filing. The audit of taxpayer is of one such separate filing.

Pursuant to the audit performed on taxpayer, the auditor found that the expenses incurred by Parent on behalf of its subsidiary were properly reflected in the books of the subsidiary. As such, the Department determined that the Indiana income of taxpayer was more fairly reflected by filing separate company returns.

I. Adjusted Gross Income Tax – Unitary Filing Status

DISCUSSION

The taxpayer (*i.e.*, one of the RV Subsidiaries that filed Indiana income tax returns and was originally permitted to be included in the combined filings) protests the Department’s determination that it may not file unitary combined returns for the fiscal years in question. Taxpayer argues that the combined reporting is the only filing method that fairly represents the flow of value from functional integration, centralized management, and economies of scale, present between taxpayer, Parent, and the remaining RV Subsidiaries.

In addressing this question, we examine: (1) whether a unitary relationship actually existed between Parent, taxpayer, and the remaining RV Subsidiaries; and (2) whether filing a combined return would more fairly represent the Parent’s, taxpayer’s, and remaining RV Subsidiaries’ Indiana income. Hereinafter, the remaining RV Subsidiaries will be collectively referred to as the “RV Group”.

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

The second criteria to be considered is common management. Common management is shown when the parent corporation provides a management role that is grounded in the parent’s own operation expertise and overall operational strategy. *See, e.g., Container Corp. V. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983).

Here, the taxpayer has supplied evidence which shows that Parent exercised control and influence over it and the RV Group. Parent’s upper management consisted of a CEO, a Chairman and Treasurer, and a Vice President of Finance and Chief Administrative Officer. These three individuals were responsible operationally for taxpayer and the entire RV Group. Taxpayer and each one of the entities in the RV Group were required to submit to Parent’s upper management for review and comment daily sales reports, monthly and annual financial reports, and operating and budget plans and goals. The CEO of Parent approved all capital expenditures in excess of one thousand dollars ($1000.00). Common management existed between Parent, taxpayer, and the RV Group.

The third test is that of common operation or use. Evidence of a common operation exists where certain functions are performed for the group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which independent companies would perform for themselves.

In the taxpayer’s case, information was supplied which shows that many of the administrative, management, and financing functions for taxpayer and the RV Group were centralized. Parent’s upper management employed a purchasing agent who was responsible for negotiating national supply contracts for the RV Group. Upper management selected the independent accountants, legal counsel, and insurance carriers that provided accounting, legal and insurance services to the RV Group. Parent’s upper management also coordinated the administration of the employee benefits plan for the RV Group. Upper management purchased advertising space in various recreational vehicle trade magazines for the RV Group, and the entities of the RV Group often participated in joint presentations.

On the basis of these facts, it appears that taxpayer enjoyed a unitary relationship with Parent and the RV Group. There exists the elements of common ownership and management, and a modicum flow of value between the members of the business group. Using Parent’s upper management to provide services for the RV Group that the taxpayer and the RV Group could have provided for themselves, resulted in common operation.

We now turn to the next point of analysis and the question of whether requiring taxpayer and the RV Group to use a standard apportionment or separate company filing method, instead of combined return filing, would result in a distortion of the income Parent reported as Indiana source income. Ultimately, this question requires us to determine whether, under all of the circumstances of the unitary relationship between Parent, taxpayer, and the RV Group, standard apportionment fulfills the statutory purpose of avoiding distortion of and realistically portraying Indiana source income. *See* IC 6-3-2-2(p).

Although IC 6-3-2-2(q) allows a parent corporation to petition the Department to file a combined return, it also incorporates by reference the restrictions imposed on alternative methods of reporting adjusted gross income by subsection (l) of that same section. Subsection (l) states in pertinent part:

> If 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 taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> ...
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The language in subsection (l) indicates that the standard apportionment and the separate accounting filing methods are the preferred methods of representing a taxpayer's income derived from Indiana sources. Other methods of income allocation and apportionment (including the combined reporting method) should only be allowed when those provided for by IC 6-3-2-2 do not fairly reflect a taxpayer's Indiana income. If the Indiana source income in the instant case can be fairly represented on the basis of standard apportionment or separate accounting, then such filing methods should be used.

Despite the finding of a unitary relationship between Parent, taxpayer, and the RV Group, and despite the relationship between the business operations of the entities, it does not appear that the operations of the businesses were so integrated to the point where the filing of separate returns would lead to a distortion of income. The evidence on file establishes that inter-company accounts existed for inter-company transactions between Parent, taxpayer, and the RV Group. Interest was paid and received by Parent on these accounts. The balance of the amounts contained in the inter-company accounts consisted of the earnings and profits of taxpayer and the members of the RV Group. Taxpayer and the members of the RV Group were required to remit to Parent at the end of each fiscal year any and all earnings and profits. If taxpayer or a member of the RV Group was unable to remit its profits for the year, Parent charged the entity interest on the unpaid amount. The delinquent entity paid an interest rate of prime plus one percent (1%).

Additionally, the evidence on file substantiates the finding that Parent was compensated for the services that it performed for taxpayer and the members of the RV Group. The expenses incurred by Parent were allocated to the appropriate entity receiving the benefit. As such, the expenses were properly reflected on each subsidiary's financial statements.

The extensive documentation presented by taxpayer does not demonstrate that the business operations of Parent, taxpayer, and the members of the RV Group were so interconnected that it becomes impossible to accurately determine the Indiana source income attributable to the respective entities.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

DISCUSSION

Taxpayer next argues that it and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a unitary basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns without a finding of some material misstatement of fact.

In a letter dated October 10, 1995, the Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. However, pursuant to an audit of Parent that resulted in the disallowance of Parent's filing on a combined basis with its subsidiaries, Parent was required to generate separate taxed returns for all of its subsidiaries, including the taxpayer and the subsidiaries with which Parent was originally granted permission to file on a unitary basis.

The statute applicable to the permission issue is found in IC 6-3-2-2 which states in pertinent part that:

> IC 6-3-2-2 Corporations and nonresidents; "adjusted gross income derived from sources in state" defined...
>
> (l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana...
>
> (q)... taxpayers may petition the department... for permission to file a combined income tax return for a taxable year. The petition to file a combined income tax return must be completed and filed with the department not more than thirty (30) days after the end of the taxpayer's taxable year.
>
> (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 1).

The Department's grant of permission to file combined returns was a determination, based upon the facts available to the Department at the time, upon which taxpayer's parent corporation could rely. However, the Department did reserve the right to revoke the grant of permission if, *inter alia*, "the facts subsequently established by the Department disclose material error or misrepresentation to the facts set forth in this petition." (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 3). This right of revocation was clearly set forth in the letter to Parent. And, the language of the letter clearly warned Parent that should a subsequent audit reveal a misrepresentation of the facts set forth originally, permission to file combined returns would be revoked.

The evidence on file evinces that the Department granted permission to Parent to include certain subsidiaries in a combined filing based upon an assertion made by Parent in its original petition letter dated August 25, 1995. In this letter, Parent stated that, "Management fees are not paid by the subsidiaries to [Parent]. [Parent] is not a profit center; therefore, no income is recognized by [Parent] from services provided to its subsidiaries." (*See Parent's Original Petition Letter* dated August 25, 1995, page 4). Upon examination of the facts purported by Parent in its petition, and pursuant to the audit, the auditor discovered inter-company transactions (including management services) that were provided by Parent to its subsidiaries at arm's length.

Notwithstanding the foregoing, we do not believe that the Audit Division's subsequent reversal of the Department's determination that taxpayer could file combined tax returns was due to a material error or misrepresentation. The original approval letter specifically stated that combined filing status would be revoked if a material error or misrepresentation was discovered. However, through its examination of the books, records, and property of taxpayer, and its determination that separate filing best represented the taxpayer's Indiana income, Audit did not discover any material error or misrepresentation on the part of taxpayer.

Upon review of the instant case, the Department concludes that the original approval letter granting taxpayer permission to file combined tax returns is in error, but was not the result of a material error or misrepresentation on the part of taxpayer in the application process. Therefore, the appropriate remedy is for taxpayer's combined filings with the five RV subsidiaries originally permitted to be included in the combined returns for the years in question to be allowed.

FINDING

Taxpayer's protest is sustained. Taxpayer's combined returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years in question will be allowed. However, taxpayer's permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns is revoked for tax years beginning after the date of the audit report.

III. Adjusted Gross Income Tax – Consolidated Returns

DISCUSSION

Taxpayer next protests the Audit Division's determination that taxpayer and the members of the recreational vehicle group that filed Indiana tax returns were required to file separate filing reports for fiscal year ends 1995 through 1997. Taxpayer maintains that it should have been allowed to file consolidated returns with the members of the recreational vehicle group that filed Indiana tax returns for fiscal year ends 1995 through 1997, and with Parent for fiscal year ends 1996 and 1997. According to taxpayer, the filing of consolidated returns is the only way to fairly reflect taxpayer's and the subsidiaries' Indiana source income.

As we have already granted taxpayer permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years encompassed by the audit, this question is moot.

FINDING

Taxpayer's protest is denied.

IV. Adjusted Gross Income Tax – Throwback Sales

DISCUSSION

During the audit period, taxpayer and the subsidiaries that filed Indiana tax returns classified sales of recreational vehicles and parts to customers outside of Indiana (*i.e.*, recreational vehicle dealers and other subsidiaries) as throwback sales. According to taxpayer, it and the subsidiaries were under the mistaken belief that they were not subject to income tax in states other than Indiana, Ohio, and Michigan. Taxpayer believes that because it and the subsidiaries clearly had nexus activity in all the states where the recreational vehicles dealers are located (hereinafter, the "Dealers"), sales destined to those particular states should not have been classified as throwback sales.

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

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

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

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

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

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part:

A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385.

The taxpayer bears the burden to prove that an assessment by the Department is invalid. IC 6-8.1-5-1.

In *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992), the United States Supreme Court interpreted the term "solicitation" for purposes of P.L. 86-272, the federal law that generally exempts a corporation from state income tax if the company's only activity in the state is solicitation of sales of tangible personal property. Wrigley also established that a *de minimis* amount of nonsolicitation activity will not cause a corporation to lose its exemption from state taxation under P.L. 86-272. In *Wrigley*, the Court found that activities ancillary to the solicitation of orders would not result in a loss of immunity to taxation. Additionally, the Court held that as long as an activity, or activities, did not establish a nontrivial, additional connection with the taxing state it is sufficiently *de minimis* to avoid taxation. (*See also, Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754, 759 (Ind. Ct. App. 1980), where the court set out examples of activity which exceeded "mere solicitation" including "giving spot credit, accepting orders, collecting delinquent accounts and picking up returned goods within the taxing state, collecting deposits and advances on orders within the taxing state, pooling and exchanging technical personnel in a complex mutual endeavor, maintaining personal property... and associated local business activity for purposes not related to soliciting orders within the taxing state.")

The records and evidence presented to the Department lead to the conclusion that taxpayer and the Indiana subsidiaries contracted with Dealers outside of Indiana to perform warranty repair services. Periodic visits made by the employees of taxpayer and the Indiana subsidiaries to other states were to brief Dealers' on the products and the distinguishing features of the products in comparison with competitor's products, and to generate new business and to insure future sales of the products. These activities are all protected as ancillary to solicitation and would not subject taxpayer or any of the Indiana subsidiaries to taxation in other states. The few visits made by employees to brief Dealers on the products could be construed as *de minimis*. The Department concludes that taxpayer has not proven that it is subject to taxation in other states, and that the throwback of sales shipped to the other states were properly added into the numerator of the sales factor.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02990659.LOF

LETTER OF FINDINGS NUMBER: 99-0659
Adjusted Gross Income Tax – Unitary (Combined) Filing Status
Fiscal Years 1995 through 1997

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

ISSUES

I. Adjusted Gross Income Tax – Unitary Filing Status

Authority: *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223 (1980); *Exxon Corp. v. Department of Revenue of Wisconsin*, 447 U.S. 207, 100 S.Ct. 2109 (1980); *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307, 102 S.Ct. 3103 (1982); *F.W. Woolworth v. Taxation and Revenue Department of New Mexico*, 458 U.S. 354, 102 S.Ct. 3128 (1982); *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983); IC 6-3-2-2(l); IC 6-3-2-2(p); IC 6-3-2-2(q); 35 ILCS 5/1501(a)(27); Tenn.Code Ann. § 67-4-2004(25)(B)

Taxpayer protests the Audit Division's subsequent disallowance of unitary combined filing status, for purposes of the taxpayer's combined adjusted income tax return for fiscal years 1995, 1996 and 1997, on the basis that the combined return inaccurately reported taxpayer's Indiana source income.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

Authority: IC 6-3-2-2

Taxpayer claims that if the Department finds that it does not qualify to file on a unitary basis with its parent corporation and the members of the recreational vehicle group for Indiana tax purposes, then alternatively taxpayer and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a consolidated basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns.

III. Adjusted Gross Income Tax – Consolidated Returns

Authority: None

Taxpayer claims that the Department erred in requiring taxpayer and the five additional members of the recreational vehicle group that filed Indiana tax returns to file separate tax returns.

IV. Adjusted Gross Income Tax – Throwback Sales

Authority: *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992); *Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754 (Ind. Ct. App. 1980); IC 6-3-2-2; IC 6-8.1-5-1; 45 IAC 3.1-1-64; Public Law 86-272 (15 U.S.C.A §381-385)

Taxpayer raises for the first time at hearing the following issue: whether taxpayer and the original members of the recreational group that filed Indiana tax returns erred in classifying sales to states other than Indiana as throwback sales.

STATEMENT OF FACTS

Taxpayer's parent corporation (hereinafter, "Parent") is a holding company for various companies located in the United States and Canada which manufacture recreational vehicles. By a letter dated August 25, 1995, Parent petitioned the Department of Revenue for permission to file a combined return with all fourteen of its recreational vehicle subsidiaries (hereinafter referred to collectively as the "RV Subsidiaries") based upon the premise that they formed a unitary group. In its petition, Parent maintained that the RV Subsidiaries were one hundred percent (100%) owned by Parent; that the entities are all engaged in the same line of business; that the entities share common directors and common management; and, that filing separate company returns would not fairly reflect Indiana income.

In a letter dated October 10, 1995, and based upon the information submitted by Parent, the Indiana Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. Specifically, the Department found that Parent and the five members of the RV Subsidiary that filed Indiana income tax returns met the unity requirements through their unity of ownership, centralized management, and centralized financial, administrative and operational services. (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 2). The Department further found that Parent and the five subsidiaries met the "best method for reporting adjusted gross income" test through their shared industry impact on Indiana adjusted gross income and their non-arms length transactions. *Id*. The Department determined that the remaining nine subsidiaries could not be included in the unitary group or taxed by Indiana because they did not have sufficient contacts with the state of Indiana. Although the Department granted Parent's request, in part, to file unitary, it nevertheless, reserved the right to revoke its grant of permission for unitary combined filing in the event that, *inter alia*, the facts subsequently established by the Department disclosed material error or misrepresentation of the facts set forth in Parent's original petition. (*See Department of Revenue-Tax Policy Division Letter* dated August 30, 1995, page 3).

In a letter dated March 2, 1996, Parent re-petitioned the Department for permission to file combined returns with all of the RV Subsidiaries. In its letter dated March 20, 1996, the Department denied Parent's second petition, and reiterated that permission was granted for only five of the fourteen subsidiaries. Thereafter, Parent filed unitary combined returns including the five subsidiaries beginning in the fiscal year ending July 31, 1995.

In 1998, Parent amended its 1995 and 1996 Indiana tax returns to expand its combined filings to include all fourteen of its RV Subsidiaries. Parent based its amended returns on its position that the Department had erroneously failed to grant it permission to file combined Indiana income tax returns with the RV Subsidiaries.

<u>The "taxpayer" in the instant case is an Indiana subsidiary of Parent and one of the five RV subsidiaries originally permitted to be included in the combined filings</u>. The audit of taxpayer stems from an audit that was performed on the combined filings of Parent and its RV Subsidiaries for fiscal years 1995 through 1997 (which included the 1995 and 1996 amended returns). The disallowance of Parent's combined filings resulted in separate filing reports being generated for the subsidiaries that were originally granted permission to be included in the combined filing. The audit of taxpayer is of one such separate filing.

Pursuant to the audit performed on taxpayer, the auditor found that the expenses incurred by Parent on behalf of its subsidiary were properly reflected in the books of the subsidiary. As such, the Department determined that the Indiana income of taxpayer was more fairly reflected by filing separate company returns.

I. Adjusted Gross Income Tax – Unitary Filing Status

DISCUSSION

The taxpayer (*i.e.*, one of the RV Subsidiaries that filed Indiana income tax returns and was originally permitted to be included in the combined filings) protests the Department's determination that it may not file unitary combined returns for the fiscal years in question. Taxpayer argues that the combined reporting is the only filing method that fairly represents the flow of value from functional integration, centralized management, and economies of scale, present between taxpayer, Parent, and the remaining RV Subsidiaries.

In addressing this question, we examine: (1) whether a unitary relationship actually existed between Parent, taxpayer, and the remaining RV Subsidiaries; and (2) whether filing a combined return would more fairly represent the Parent's, taxpayer's, and remaining RV Subsidiaries' Indiana income. Hereinafter, the remaining RV Subsidiaries will be collectively referred to as the "RV Group".

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

The second criteria to be considered is common management. Common management is shown when the parent corporation provides a management role that is grounded in the parent's own operation expertise and overall operational strategy. *See, e.g., Container Corp. V. Franchise Tax Board*, 463 U.S. 159, 180, n. 19, 103 S.Ct. 2933, 2948, n. 19 (1983).

Here, the taxpayer has supplied evidence which shows that Parent exercised control and influence over it and the RV Group. Parent's upper management consisted of a CEO, a Chairman and Treasurer, and a Vice President of Finance and Chief Administrative Officer. These three individuals were responsible operationally for taxpayer and the entire RV Group. Taxpayer and each one of the entities in the RV Group were required to submit to Parent's upper management for review and comment daily sales reports, monthly and annual financial reports, and operating and budget plans and goals. The CEO of Parent approved all capital expenditures in excess of one thousand dollars ($1000.00). Common management existed between Parent, taxpayer, and the RV Group.

The third test is that of common operation or use. Evidence of a common operation exists where certain functions are performed for the group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which independent companies would perform for themselves.

In the taxpayer's case, information was supplied which shows that many of the administrative, management, and financing functions for taxpayer and the RV Group were centralized. Parent's upper management employed a purchasing agent who was responsible for negotiating national supply contracts for the RV Group. Upper management selected the independent accountants, legal counsel, and insurance carriers that provided accounting, legal and insurance services to the RV Group. Parent's upper management also coordinated the administration of the employee benefits plan for the RV Group. Upper management purchased advertising space in various recreational vehicle trade magazines for the RV Group, and the entities of the RV Group often participated in joint presentations.

On the basis of these facts, it appears that taxpayer enjoyed a unitary relationship with Parent and the RV Group. There exists the elements of common ownership and management, and a modicum flow of value between the members of the business group. Using Parent's upper management to provide services for the RV Group that the taxpayer and the RV Group could have provided for themselves, resulted in common operation.

We now turn to the next point of analysis and the question of whether requiring taxpayer and the RV Group to use a standard apportionment or separate company filing method, instead of combined return filing, would result in a distortion of the income Parent reported as Indiana source income. Ultimately, this question requires us to determine whether, under all of the circumstances of the unitary relationship between Parent, taxpayer, and the RV Group, standard apportionment fulfills the statutory purpose of avoiding distortion of and realistically portraying Indiana source income. *See* IC 6-3-2-2(p).

Although IC 6-3-2-2(q) allows a parent corporation to petition the Department to file a combined return, it also incorporates by reference the restrictions imposed on alternative methods of reporting adjusted gross income by subsection (l) of that same section. Subsection (l) states in pertinent part:

> If 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 taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> ...
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The language in subsection (l) indicates that the standard apportionment and the separate accounting filing methods are the preferred methods of representing a taxpayer's income derived from Indiana sources. Other methods of income allocation and apportionment (including the combined reporting method) should only be allowed when those provided for by IC 6-3-2-2 do not fairly reflect a taxpayer's Indiana income. If the Indiana source income in the instant case can be fairly represented on the basis of standard apportionment or separate accounting, then such filing methods should be used.

Despite the finding of a unitary relationship between Parent, taxpayer, and the RV Group, and despite the relationship between the business operations of the entities, it does not appear that the operations of the businesses were so integrated to the point where the filing of separate returns would lead to a distortion of income. The evidence on file establishes that inter-company accounts existed for inter-company transactions between Parent, taxpayer, and the RV Group. Interest was paid and received by Parent on these accounts. The balance of the amounts contained in the inter-company accounts consisted of the earnings and profits of taxpayer and the members of the RV Group. Taxpayer and the members of the RV Group were required to remit to Parent at the end of each fiscal year any and all earnings and profits. If taxpayer or a member of the RV Group was unable to remit its profits for the year, Parent charged the entity interest on the unpaid amount. The delinquent entity paid an interest rate of prime plus one percent (1%).

Additionally, the evidence on file substantiates the finding that Parent was compensated for the services that it performed for taxpayer and the members of the RV Group. The expenses incurred by Parent were allocated to the appropriate entity receiving the benefit. As such, the expenses were properly reflected on each subsidiary's financial statements.

The extensive documentation presented by taxpayer does not demonstrate that the business operations of Parent, taxpayer, and the members of the RV Group were so interconnected that it becomes impossible to accurately determine the Indiana source income attributable to the respective entities.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax – Unitary Filing Status – Retroactive Withdrawal of Permission to File Unitary

DISCUSSION

Taxpayer next argues that it and the original members of the recreational vehicle group that filed Indiana tax returns for the tax years in question should have been allowed to file on a unitary basis with the parent corporation. As such, taxpayer protests the Audit Division's retroactive withdrawal of its grant of permission to allow taxpayer and the original members of the recreational group that filed Indiana tax returns to file unitary combined returns without a finding of some material misstatement of fact.

In a letter dated October 10, 1995, the Department of Revenue granted Parent's petition to file unitary combined returns as a unitary group with five of the fourteen RV Subsidiaries for fiscal year 1995 forward. However, pursuant to an audit of Parent that resulted in the disallowance of Parent's filing on a combined basis with its subsidiaries, Parent was required to generate separate taxed returns for all of its subsidiaries, including the taxpayer and the subsidiaries with which Parent was originally granted permission to file on a unitary basis.

The statute applicable to the permission issue is found in IC 6-3-2-2 which states in pertinent part that:

IC 6-3-2-2 Corporations and nonresidents; "adjusted gross income derived from sources in state" defined...

(l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana...

(q)... taxpayers may petition the department... for permission to file a combined income tax return for a taxable year. The petition to file a combined income tax return must be completed and filed with the department not more than thirty (30) days after the end of the taxpayer's taxable year.

(*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 1).

The Department's grant of permission to file combined returns was a determination, based upon the facts available to the Department at the time, upon which taxpayer's parent corporation could rely. However, the Department did reserve the right to revoke the grant of permission if, *inter alia*, "the facts subsequently established by the Department disclose material error or misrepresentation to the facts set forth in this petition." (*See Department of Revenue-Tax Policy Division Letter* dated October 10, 1995, page 3). This right of revocation was clearly set forth in the letter to Parent. And, the language of the letter clearly warned Parent that should a subsequent audit reveal a misrepresentation of the facts set forth originally, permission to file combined returns would be revoked.

The evidence on file evinces that the Department granted permission to Parent to include certain subsidiaries in a combined filing based upon an assertion made by Parent in its original petition letter dated August 25, 1995. In this letter, Parent stated that, "Management fees are not paid by the subsidiaries to [Parent]. [Parent] is not a profit center; therefore, no income is recognized by [Parent] from services provided to its subsidiaries." (*See Parent's Original Petition Letter* dated August 25, 1995, page 4). Upon examination of the facts purported by Parent in its petition, and pursuant to the audit, the auditor discovered inter-company transactions (including management services) that were provided by Parent to its subsidiaries at arm's length.

Notwithstanding the foregoing, we do not believe that the Audit Division's subsequent reversal of the Department's determination that taxpayer could file combined tax returns was due to a material error or misrepresentation. The original approval letter specifically stated that combined filing status would be revoked if a material error or misrepresentation was discovered. However, through its examination of the books, records, and property of taxpayer, and its determination that separate filing best represented the taxpayer's Indiana income, Audit did not discover any material error or misrepresentation on the part of taxpayer.

Upon review of the instant case, the Department concludes that the original approval letter granting taxpayer permission to file combined tax returns is in error, but was not the result of a material error or misrepresentation on the part of taxpayer in the application process. Therefore, the appropriate remedy is for taxpayer's combined filings with the five RV subsidiaries originally permitted to be included in the combined returns for the years in question to be allowed.

FINDING

Taxpayer's protest is sustained. Taxpayer's combined returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years in question will be allowed. However, taxpayer's permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns is revoked for tax years beginning after the date of the audit report.

III. Adjusted Gross Income Tax – Consolidated Returns

DISCUSSION

Taxpayer next protests the Audit Division's determination that taxpayer and the members of the recreational vehicle group that filed Indiana tax returns were required to file separate filing reports for fiscal year ends 1995 through 1997. Taxpayer maintains that it should have been allowed to file consolidated returns with the members of the recreational vehicle group that filed Indiana tax returns for fiscal year ends 1995 through 1997, and with Parent for fiscal year ends 1996 and 1997. According to taxpayer, the filing of consolidated returns is the only way to fairly reflect taxpayer's and the subsidiaries' Indiana source income.

As we have already granted taxpayer permission to file combined tax returns with the five RV subsidiaries originally permitted to be included in the combined returns for the tax years encompassed by the audit, this question is moot.

FINDING

Taxpayer's protest is denied.

IV. Adjusted Gross Income Tax – Throwback Sales

DISCUSSION

During the audit period, taxpayer and the subsidiaries that filed Indiana tax returns classified sales of recreational vehicles and parts to customers outside of Indiana (*i.e.*, recreational vehicle dealers and other subsidiaries) as throwback sales. According to taxpayer, it and the subsidiaries were under the mistaken belief that they were not subject to income tax in states other than Indiana, Ohio, and Michigan. Taxpayer believes that because it and the subsidiaries clearly had nexus activity in all the states where the recreational vehicles dealers are located (hereinafter, the "Dealers"), sales destined to those particular states should not have been classified as throwback sales.

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

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

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

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

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

Indiana's regulatory language further defines "taxable in another state." 45 IAC 3.1-1-64 states in part:

A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it [the corporation] to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385.

The taxpayer bears the burden to prove that an assessment by the Department is invalid. IC 6-8.1-5-1.

In *Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992), the United States Supreme Court interpreted the term "solicitation" for purposes of P.L. 86-272, the federal law that generally exempts a corporation from state income tax if the company's only activity in the state is solicitation of sales of tangible personal property. Wrigley also established that a *de minimis* amount of nonsolicitation activity will not cause a corporation to lose its exemption from state taxation under P.L. 86-272. In *Wrigley*, the Court found that activities ancillary to the solicitation of orders would not result in a loss of immunity to taxation. Additionally, the Court held that as long as an activity, or activities, did not establish a nontrivial, additional connection with the taxing state it is sufficiently *de minimis* to avoid taxation. (*See also, Indiana Dept. of State Revenue v. Continental Steel Corp.*, 399 N.E.2d 754, 759 (Ind. Ct. App. 1980), where the court set out examples of activity which exceeded "mere solicitation" including "giving spot credit, accepting orders, collecting delinquent accounts and picking up returned goods within the taxing state, collecting deposits and advances on orders within the taxing state, pooling and exchanging technical personnel in a complex mutual endeavor, maintaining personal property... and associated local business activity for purposes not related to soliciting orders within the taxing state.")

The records and evidence presented to the Department lead to the conclusion that taxpayer and the Indiana subsidiaries contracted with Dealers outside of Indiana to perform warranty repair services. Periodic visits made by the employees of taxpayer and the Indiana subsidiaries to other states were to brief Dealers' on the products and the distinguishing features of the products in comparison with competitor's products, and to generate new business and to insure future sales of the products. These activities are all protected as ancillary to solicitation and would not subject taxpayer or any of the Indiana subsidiaries to taxation in other states. The few visits made by employees to brief Dealers on the products could be construed as *de minimis*. The Department concludes that taxpayer has not proven that it is subject to taxation in other states, and that the throwback of sales shipped to the other states were properly added into the numerator of the sales factor.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

1820000159.LOF

LETTER OF FINDINGS NUMBER: 00-0159
Financial Institutions Tax
For Tax Periods: 1993 through 1996

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

ISSUE

Financial Institutions Tax – Unitary Filing

Authority: IC 6-5.5-5-1, IC 6-5.5-2-1, IC 6-5.5-1-18, IC 6-8.1-5-1(b)

The taxpayer protests the exclusion of certain affiliates from the unitary group.

STATEMENT OF FACTS

The taxpayer is a bank holding company based in the state of New York. Several of its subsidiaries conduct the business of a financial institution in Indiana. The Indiana Department of Revenue, hereinafter referred to as the "department," audited the taxpayer for the tax years 1993-1996. Prior to the audit, the taxpayer's subsidiaries filed returns as separate entities. The department calculated the taxpayer's financial institutions tax liability on a unitary basis. The taxpayer protested this assessment contending that additional affiliates should be included in the unitary group. A hearing was held to determine which affiliates should be included in the unitary group.

Financial Institutions Tax – Unitary Filing

DISCUSSION

IC 6-5.5-2-1 imposes a franchise tax on the income of financial institutions. The department determined the taxpayer's financial institutions tax liability on a unitary basis following the provisions of IC 6-5.5-5-1 as follows:

> ... a unitary group consisting of at least two (2) taxpayers shall file a combined return covering the operations of the unitary business and including all of the members of the unitary business.

A unitary group is defined at IC 6-5.5-1-18 as follows:

> ... unitary business means business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution... Unity is presumed whenever there is unity of ownership, operation, and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting, or other controlled interaction among entities...

The department included the members of the taxpayer's federal consolidated filing group and its direct and indirectly owned subsidiaries in the unitary group upon which tax was assessed. The taxpayer contends that the unitary group should also have included the additional members historically filing on a combined basis in the states of California and Illinois. The issue to be determined is which business activities and operations should be considered members of the taxpayer's unitary group.

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b). The taxpayer failed to provide any documentary evidence in either its original letter of protest or after the hearing that the department's determination of the entities to be included in the unitary group was incorrect. Therefore, the taxpayer did not sustain its burden of proof that the department did not include the proper business activities and operations in the taxpayer's unitary group.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000345.LOF

LETTER OF FINDINGS NUMBER: 00-0345
Sales/Use Tax
For the Tax Period: 1997

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

ISSUES

I. Use Tax – Imposition

Authority: IC 6-2.5-3-1 through IC 6-2.5-3-6

Taxpayer protests the assessment of tax on an aircraft.

STATEMENT OF FACTS

Taxpayer was a full year resident of Indiana in 1997. Taxpayer registered its aircraft, which was based at the White County airport, with the FAA on November 7, 1997. The department issued its proposed tax assessment on November 19, 1999 for the year 1997. The "Aviation Locator" indicates the aircraft was registered to WSCI from February 1, 1991 through February 19, 1997. Taxpayer states he does not have a sales/use tax liability since the aircraft purchase was out of state by an out of state resident and the aircraft was maintained out of state. Taxpayer further states that he remained an out of state resident for approximately three years following the purchase. The Department received notification that the taxpayer was the owner of the subject aircraft and found that the aircraft was not properly registered with the State of Indiana. On September 26, 1997, the taxpayer was informed that the aircraft was not registered and a proposed assessment would be issued if he did not reply within ten days of that letter. The department issued a proposed assessment based upon an average retail value for the type and year of the aircraft on November 19, 1999.

I. Use Tax – Imposition

DISCUSSION

In numerous arguments, taxpayer states he does not owe sales/use tax on the purchase of his plane. He argues that he purchased the aircraft while an out of state resident in 1988.

FAA records, however, indicate the taxpayer was not the registered owner of said aircraft until 1997. IC 6-2.5-3-6 requires the owner to pay the sales/use tax to the registering agency when the person **registers** (emphasis added) the aircraft.

"The notice of proposed assessment is *prima facie evidence* that the department's claim for unpaid tax is valid, and the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1 (emphasis added). Taxpayer has not submitted any evidence or documentation to rebut the validity of the tax imposed on said aircraft. Therefore, the Department finds that the assessment is valid.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120010175.LOF

LETTER OF FINDINGS NUMBER: 01-0175
Individual Income Tax
For the Tax Year 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. "S" Corporation's Vehicle / Advertising Expense Deduction

Authority: 45 IAC 3.1-1-66; I.R.C. § 179

Taxpayer argues that the audit erred in disallowing the purchase price of a vehicle as a business expense.

II. Disallowance of "S" Corporation Business Gift

Authority: I.R.C. § 162(a); I.R.C. § 274(b)(1); I.R.C. § 2503(b)

Taxpayer maintains that the audit improperly disallowed, as a business expense, the value of a computer which had been given to a family member as a gift.

III. Home Office Expenses for "S" Corporation

Authority: I.R.C. § 162(a); I.R.C. § 280A

Taxpayer argues that the S-Corporation is entitled to claim home office expenses as a business deduction.

STATEMENT OF FACTS

There are two independent players involved in this protest; the individual taxpayer and the taxpayer's business (*Hereinafter* "S-Corporation"). The business is qualified to file as an "S" corporation and did so for a number of years. However, in 1998 and 1999, the taxpayer filed incomplete tax returns for the S-Corporation. For 1998, taxpayer – on behalf of the S-Corporation – submitted the appropriate federal S corporation (1120S) return but did not submit or prepare the state S corporation return (IT-20S). In 1999, taxpayer prepared neither the state or federal S corporation returns. However, on taxpayer's own individual 1040 return, taxpayer attached a "Schedule C" (Profit or Loss From Business – Sole Partnership). On that Schedule C attachment, taxpayer claimed certain business expenses attributed to the S-Corporation.

Both the taxpayer and the S-Corporation were audited. Because the taxpayer failed to file Indiana S corporation returns for 1998 and 1999, those particular returns were completed on behalf of the S-Corporation. The audit prepared two S corporation returns based upon the existing 1998 S corporation federal return and the information contained within the taxpayer's individual 1999 Schedule C. The audit made certain adjustments and disallowed certain business expenses claimed on the 1999 Schedule C. It is those particular adjustments which form the basis for the protest which follows.

No tax was assessed against the S-Corporation. However, the disallowance of the S-Corporation's 1999 expenses resulted in additional income which flowed through to the taxpayer as – apparently – the sole shareholder of the S-Corporation. Therefore, although the protest stems from the assessment of *individual* income taxes, because of the relationship between taxpayer and the S-Corporation, the resolution of the issues raised by that assessment requires consideration of both S corporation and individual income tax questions.

Taxpayer – acting for both himself and the S-Corporation – challenged the assessment of the additional 1999 individual income taxes, an administrative hearing was held, and this Letter of Findings follows.

DISCUSSION

I. "S" Corporation's Vehicle / Advertising Expense Deduction

An S corporation normally does not pay income tax. 45 IAC 3.1-1-66, states that, "Corporations electing Subchapter S status under Internal Revenue Code § 1372... are exempt from adjusted gross and supplemental net income tax on all income except capital gains...." Rather than taxing the income at the business level, the S corporation's income is passed through to the shareholders. The shareholders then must report the income on their own income tax return. 45 IAC 3.1-1-66 states that, "Subchapter S corporation shareholders are taxed on their distributive shares of income at the individual income tax rate." This is the dilemma in which taxpayer finds himself; because certain of the S-Corporation's deductions were disallowed, additional taxable income flowed through to the taxpayer as the S-Corporation's shareholder. It was this additional flow-through income which led to the imposition of additional, individual income taxes.

The S-Corporation purchased a vehicle in 1999 for approximately $5,800. Taxpayer – on behalf of the S-Corporation – argues that the S-Corporation was entitled to deduct immediately the total purchase price of the vehicle under I.R.C. § 179. Taxpayer – again on behalf of the S-Corporation – maintains that the vehicle is not a "vehicle" for purposes of state or federal income tax. According to taxpayer, the vehicle is "used as advertising in front of the [S-Corporation's] retail store. Therefore, the taxpayer maintains that the purchase of the "vehicle" was more akin to the acquisition of a stationary, permanent, advertising display.

The audit disagreed with the taxpayer's argument. Instead of treating the purchase of the vehicle as an ordinary business expense under I.R.C. § 179, the audit – under I.R.C. § 280F – "depreciated" the entire vehicle cost over a five-year period because the vehicle was used exclusively for business purposes. That is, rather than allowing the entire $5,800 as a wholesale business expense deduction, the audit allowed the S-Corporation to claim a $1,160 deduction on the S-Corporation's 1999 tax return. Presumably, the same "straight line" deduction will be available to the S-Corporation in 2000, 2001, 2002, and 2003.

Taxpayer states that the vehicle is permanently parked in front of the S-Corporation's retail site and that such an arrangement is necessary in order to attract attention to the site's location. In addition, taxpayer indicates that– at least temporarily – the vehicle is immobile because the battery has been removed. However, it should also be noted that the audit report indicated that the vehicle had certain "mileage" during the tax period.

This does not seem to be an instance in which a vehicle has been purchased, reconditioned, immobilized, and permanently adopted as a fixed advertising structure. However necessary it may be that the vehicle remain parked in front of the S-Corporation's business location, the vehicle remains a "vehicle." The audit did not err in requiring that the original purchase price be depreciated over the five-year period.

FINDING

Taxpayer's protest is respectfully denied.

II. Disallowance of "S" Corporation Business Gift

The S-Corporation gave a disused computer to taxpayer's daughter. The computer was assigned a value of $650 and was claimed by the S-Corporation as a business expense in 1999. The gift may have been a sensible way in which to dispose of a computer which had become obsolete for purposes of the S-Corporation; however, taxpayer fails to explain in what manner the S-Corporation is entitled to claim the gift as a "business expense." Taxpayer claims that the S-Corporation is entitled to give up to $10,000 in gifts. Insofar as it relates to the S-Corporation's state income tax liability, taxpayer is mistaken. Under I.R.C. § 274(b)(1), the S-Corporation is limited to claiming a deduction for business gifts, made either directly or indirectly, up to $25 per recipient each year.

Taxpayer's assertion – that the S-Corporation is entitled to make an annual gift of up to $10,000 per year – may be a reference to the gift tax exclusion which the donor of a gift is entitled to claim under I.R.C. § 2503(b). Under that provision, the first $10,000 of gifts made by a donor to any recipient is not included in the total amount of the donor's taxable gifts during that year. However taxpayer – or more accurately, the S-Corporation – is seeking relief from an assessment of additional income taxes. Whether or not the S-Corporation is entitled to the $10,000 gift tax exclusion is irrelevant; the issue is whether or not the S-Corporation may claim the $650 as a "business expense." On this question, taxpayer's protest fails because there is no indication that the cost of giving away a computer is an "ordinary and necessary business expense...." I.R.C. § 162(a). Taxpayer's relief is limited to the extent that the S-Corporation is entitled to claim the $25 business gift deduction provided under I.R.C. § 274(b)(1).

FINDING

Taxpayer's protest is respectfully denied.

III. Home Office Expenses for "S" Corporation

Taxpayer – on behalf of the S-Corporation – argues that the S-Corporation was entitled to claim a deduction for business expenses based upon the taxpayer's own individual home office deduction. Simply stated, taxpayer – as an individual and shareholder – performed the necessary calculations and determined that he was entitled to claim an approximately $3,000 "home office" deduction on his individual 1999 federal income tax return. Consequently, according to taxpayer, the S-Corporation is entitled to claim an identical amount as one of S-Corporation's ordinary business expenses.

Taxpayer is correct in his assertion that he may be individually entitled to claim a deduction for home office expenses under I.R.C. § 280A. The Department does not challenge the taxpayer's claim to a home office deduction on his individual income tax return for 1999.

The S-Corporation – as a separate entity – is entitled to claim under I.R.C. § 162(a) a deduction for "all the ordinary and necessary expenses paid or incurred... in carrying on any trade or business." However, the S-Corporation and the taxpayer cannot have it both ways. If, under I.R.C. § 280A, taxpayer individually incurred expenses attributable to operating the business from his home, then taxpayer was entitled to deduct the general "home office" deduction on his individual federal income tax returns. If the S-Corporation incurs particularized "ordinary and necessary business expenses," then the S-Corporation was entitled to claim those *particular* expenses as a deduction under I.R.C. § 162(a). It is immaterial whether the S-Corporations business expenses are attributable to its retail location or to the business activities conducted at the taxpayer's own home. However, taxpayer mistakenly regards his own expenses and the expenses of the S-Corporation as two sides of the same coin. The taxpayer may be entitled to claim home office expenses on his individual tax return. The S-Corporation may be able to demonstrate that it incurred its own "ordinary and necessary expenses." Nevertheless, an individual employee's home office expenses and a corporation's "ordinary and necessary expenses" are not the same; the two sets of expenses are incurred by two distinct entities, the two are computed differently, and they are attributable to entirely different taxpayers.

Taxpayer makes much of the fact that the nature of the S-Corporation requires it to have two federal licenses. However, whether the S-Corporation has two or twenty licenses is unconnected with the question of whether the S-Corporation did not or did not incur "ordinary and necessary expenses." In this instance, taxpayer may be legitimately entitled to claim the home office deduction on his personal federal income tax return. However, the S-Corporation – as a separate taxable entity – must search elsewhere in order to locate and specifically identify its own "ordinary and business expenses."

Taxpayer is entitled to organize his business as an S corporation under federal and state law and to obtain the distinct advantages attributable to such an arrangement. However, having done so, taxpayer is required to distinguish between those expenses he incurred and those expenses the S-Corporation incurred.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420010292.LOF

LETTER OF FINDINGS NUMBER: 01–0292
Gross Retail and Use Tax – Adequate Documentation
Tax Administration – Penalty
For Tax Years 1998-1999

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ISSUES

I. Gross Retail and Use Tax – Adequate Documentation

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

Taxpayer protests the proposed assessments of Indiana's gross retail and use taxes.

II. Tax Administration – Penalty

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

Taxpayer protests the proposed assessment of the negligence penalty.

STATEMENT OF FACTS

Taxpayer sells used medical equipment, primarily ultra sound machines. In August of 2000, the Audit Division notified taxpayer he had been selected for auditing and that certain records should be available to complete the audit in a timely fashion. *See*, discussion, *infra*. Because taxpayer and his representative were uncooperative in providing the required documentation, the Audit Division assessed gross retail and use tax based on the best information available to the auditor. Taxpayer and his representative then filed a protest, claiming the documents were then available; taxpayer and his representative then cancelled two meetings with the auditor. The file came to the Legal Division for resolution. Thereafter, the auditor was able to examine documentation made available pursuant to an agreement between the Department and taxpayer's representative.

Taxpayer protests the proposed assessment of Indiana's gross retail and use taxes based on the best information available to the auditor at the time of the audit. Because there was little information available at the time of the original audit, a projection was used to determine gross retail tax liability for 1998. The auditor also assessed use tax on a variety of expense item purchases, using a projection for 1999 because of the same lack of available information. Finally, the 10% negligence penalty was imposed. The auditor returned to taxpayer's representative's office to examine thoroughly additional documentation made available after a protest hearing was held. The auditor was unable to determine taxpayer's liability based on the new documentation and again relied on the projections used in the original audit exam, concluding the review in December of 2002. Additional facts will be added as necessary.

I. Gross Retail and Use Tax – Adequate Documentation

DISCUSSION

Taxpayer protests the proposed assessments of Indiana's gross retail and use taxes. Because of taxpayer's and his representative's reluctance to timely provide the proper documents to the auditor, and their continuing failure to cooperate with the Department, a hearing was set before one of the Legal Division's Hearing Officers. At the hearing, taxpayer's representative stated that records for tax year 1998 were now ready for inspection. Since the proposed assessment for 1998 was based on a projection backward from tax year 1999, the availability of 1998's records would have presented a more accurate basis for a proposed assessment. Therefore, a supplemental audit was performed pursuant to IC § 6-8.1-5-1 and 45 IAC 15-5-4. However, the auditor, after thoroughly reviewing the new documentation, determined that there were numerous invoices that were needed, but not provided, for his inspection. Further, there were numerous problems with the documents actually provided. In short, taxpayer, after being given numerous opportunities to provide appropriately reliable documentation in support of his protest, failed to provide what was needed in order to refute the Department's projection method.

As just one example from the many listed in the auditor's supplemental examination memorandum, the auditor noted that taxpayer should have been able to provide a 1998 Sales Journal "clearly showing Indiana and non-Indiana sales" and 1998 Sales invoices with "ship to" information on it. Instead, taxpayer only provided "deal jackets" for 1998, some of which were sequentially missing and showed no Indiana buyers. Taxpayer's income tax return did not have any apportionment, and all sales were shown as Indiana sales.

FINDING

Taxpayer's protest concerning the proposed assessments of Indiana's gross retail and use taxes is denied.

II. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due. Taxpayer's representative stated at the hearing that there was no intent to defraud the state, and that taxpayer's failure to pay the proper amount of tax was due to faulty corporate financial structuring and failure to keep proper records in a form and place readily accessible.

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 taxes held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. Indiana Administrative Code, Title 45, Rule 15, section 11-2 defines negligence as the failure to use reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by Indiana's tax statutes and administrative regulations.

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

Taxpayer has failed to set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. It is undisputed that taxpayer failed to keep proper records. Given the totality of the circumstances, waiver of the penalty is inappropriate in this instance because taxpayer was negligent in keeping proper corporate records of its business transactions.

FINDING

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

DEPARTMENT OF STATE REVENUE

0420010302.LOF

LETTER OF FINDINGS NUMBER: 01-0302
Use Tax
For Tax 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.

ISSUES

I. Use Tax – Volvo Loader

Authority: <u>Mechanics Laundry & Supply, Inc. v. Indiana Department of State Revenue</u>, 650 N.E.2d 1223 (Ind. Tax 1995); IC 6-2.5-5-3; 45 IAC 2.2-3-13; 45 IAC 2.2-5-61

Taxpayer protests the imposition of use tax on its purchase of a Volvo loader.

STATEMENT OF FACTS

Taxpayer operates a trucking company, which hauls stone, dirt, sand, and other materials for hire. As the result of an audit, the Indiana Department of Revenue ("Department") issued a proposed use tax assessment. Taxpayer protests that a Volvo loader taxed by the Department is exempt from sales and use tax. Further facts will be supplied as necessary.

I. Use Tax – Volvo Loader

DISCUSSION

Taxpayer protests the imposition of use tax on a Volvo loader. The Department issued a proposed use tax assessment on the loader based on its finding that the loader is not used exclusively for the mining of sand and public transportation, and that taxpayer's use of the loader does not constitute a mining operation, but rather is a service provided by taxpayer to its customers. The Department refers to 45 IAC 2.2-3-13, which states:

Tangible personal property, purchased in Indiana or elsewhere in a retail transaction from a retail merchant, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax measured by the gross retail income received from such property, unless the Indiana gross retail tax has been collected at the point of purchase.

Taxpayer protests that it uses the loader to extract sand from a pit owned by its customer and load it onto trucks it owns for transport to its customer's locations. The relevant statute is IC 6-2.5-5-3(b), which states:

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 production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or furnishing of other tangible personal property.

In support of its protest, taxpayer supplied documentation establishing that it did extract and then transport sand for its customers.

While it is true that taxpayer extracted the sand for its customer from the customer's pit, the Indiana Tax Court explained in <u>Mechanics Laundry</u>:

In the case of the equipment exemption, our supreme court has held that the terms used are not separate and distinct. *Indiana Department of State Revenue v. Cave Stone, Inc. (1983), N.E.2d 520*. Indeed, the supreme court stated that the terms used "are not mutually exclusive;…[rather, they] overlap and at times encompass each other." *Id. at 524*.

<u>Mechanics Laundry & Supply, Inc. v. Indiana Department of State Revenue</u>, 650 N.E.2d 1223, 1228 (Ind. Tax 1995)

Therefore, in order to qualify for the exemption provided in IC 6-2.5-5-3(b), a purchaser must use the equipment in the production of tangible personal property. In the instant case, taxpayer did not own the sand when it was in the ground, on its trucks, or at any other time. Taxpayer was not extracting and producing sand for sale, but rather was extracting and transporting sand as a service for its customer. Since taxpayer was not producing sand for sale, the exemption provided in IC 6-2.5-5-3(b) does not apply here.

Taxpayer also argues that the loader is used in public transportation. The relevant regulation is 45 IAC 2.2-5-61. 45 IAC 2.2-5-61(a) states:

> 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.
>
> 45 IAC 2.2-5-61(f) states in relevant part:
>
> The purchase, storage, or use of tangible personal property used for activities prior to or subsequent to the rendition of public transportation is subject to tax. For purposes of this regulation *[45 IAC 2.2]*, transportation means the movement, transporting, or carrying of persons or property from one place to another and includes loading and unloading of persons or property into or from transportation vehicles.

Since the loader is used in the loading of property (sand) into transportation vehicles, it is involved in public transportation, and so is exempt under 45 IAC 2.2-5-61.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420020021.LOF

LETTER OF FINDINGS NUMBER: 02-0021
State Gross Retail Tax
For Tax Years 1999 through 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.

ISSUES

I. State Gross Retail Tax – Manufacturing Exemption

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

Taxpayer protests the Department's determination that certain items of equipment did not qualify for the manufacturing exemption from sales tax because they lacked an essential and integral relationship with the taxpayer's manufacturing process.

II. Tax Administration – Abatement of Penalty

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

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

STATEMENT OF FACTS

Taxpayer is a manufacturer of dies and molds. At issue are the Department's proposed assessments of sales and use tax on taxpayer's equipment. Additional facts are discussed below.

I. State Gross Retail Tax – Manufacturing Exemption

DISCUSSION

Taxpayer protests the Department's determination that certain items of equipment do not qualify for exemption from sales tax, under the manufacturing exemption set forth in 45 IAC 2.2-5-8, because the equipment does not have an essential and integral relationship with taxpayer's manufacturing process. These items include an air dryer and a 3D scanning machine.

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

<u>AIR DRYER</u>

Taxpayer argues that its air dryer is exempt from the state's retail tax because it is an item of equipment having a direct and immediate effect on the production of taxpayer's mold and die products. According to taxpayer, many of its production machines (*e.g.*, airlift tables, air clutches, air brakes, air logic controls/valves, and air clamps) are operated by an air compressor system that requires clean and dry air to operate. Specifically, the air dryer acts as a filter that filters condensation out of the system and prevents moisture from penetrating the manufacturing lines. Although it is not attached directly to the air compressor, the air dryer works with the air compressor. Should water penetrate the manufacturing lines, rust would be created and the manufacturing process would be seriously, adversely affected.

Here, taxpayer has demonstrated that many of the machines used within the production process are operated by an interconnected production process comprised of an air compressor and an air dryer. The most closely analogous regulatory example is found at 45 IAC 2.2-5-8(g)(3) which states that:

> The manufacture of certain extruded rubber products uses an interconnected production process of an air compressor, and air dryer, and injection molding machines which work together to force rubber through dies in order to form the desired shapes. The component parts of the production process are exempt since the production process has an immediate effect upon the article being produced.

3D SCANNING MACHINE

Taxpayer also argues that the purchase of its 3D scanning machine is exempt from the state's gross retail tax. Taxpayer maintains that it uses the machine within the production process.

Taxpayer's scanning machine is a PC-based system used primarily for "reverse engineering". Taxpayer's customers routinely send to taxpayer dies and molds that are in need of repair, replacement blocks, or engineering changes. Typically, taxpayer receives the dies and molds without computer aided design (CAD) data, and without the tool drawings with which they were originally built. Taxpayer's scanning machine is therefore used to measure the size of the work piece, any hole locations, and the 3-D contoured surfaces.

As the scanning machine scans the surface of the work piece, the information is sent to a computer (attached to the 3D scanning machine) and eventually recorded on a disc. The information recorded on the disc is then reprogrammed (using computer aided manufacturing (CAM)) into a language that taxpayer's vertical machining center (VMC) understands. The VMC is the machine that cuts the metal into the specific die or mold.

Once the information has been reprogrammed, the machinist removes the disc from the scanning machine's computer and places it into the VMC's operating system (*i.e.*, the computer numerical control or CNC). The operating system feeds the information recorded on the disc to the VMC; and, the VMC begins to produce the die or mold. Once the new piece is completed, taxpayer uses the 3D scanning machine to re-scan the piece and verify that the shape and size are correct. According to taxpayer, a piece cannot be produced without first using the 3D scanning machine to determine the surface data of the piece.

The Department's regulations at 45 IAC 2.2-5-8(g)(6) state that "[c]omputers which are interconnected with and control other production machinery or are used to make tapes which control computerized production machinery are exempt from tax." However, 45 IAC 2.2-5-8(g)(7) states that "[c]omputers which produce designs which are not sold as products are not exempt." Here, taxpayer's scanning machine is a PC-based system used to capture data regarding the work pieces taxpayer is hired to produce. The data collected by the scanning machine is recorded on a disc. The recorded information is then transferred to a VMC which machines the particular work piece desired. The evidence of file establishes that the scanning machine performs a computer aided design function; and, the designs captured by the machine are not sold as products. As such, taxpayer's scanning machine is not exempt from tax.

FINDING

Taxpayer's protest regarding the retail tax exemption of the air dryer is sustained; however, taxpayer's protest regarding the retail tax exemption of the 3D scanning machine is denied.

II. Tax Administration – Abatement of Penalty

DISCUSSION

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

IC 6-8.1-10-2.1(d) states that if a person subject to the negligence penalty imposed under said 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. 45 IAC 15-11-2 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 the Indiana Code or Department regulations.

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

In the instant case, the Department finds that taxpayer has failed to established "reasonable cause" sufficient to warrant abating the ten percent negligence penalty.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220020304.LOF

LETTER OF FINDINGS NUMBER: 02-0304
Indiana Corporate Income Tax
For the Tax Years 1996, 1997, and 1998

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

ISSUES

I. Excess-Value Reinsurance Premiums – Adjusted Gross Income Tax

Authority: IC 6-3-2-2(l); Gregory v. Helvering, 293 U.S. 465 (1935); Horn v. Commissioner of Internal Revenue, 968 F.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Bethlehem Steel Corp. v. Ind. Dept. of State Revenue, 597 N.E.2d 1327 (Ind. Tax Ct. 1992)

Taxpayer challenges the audit's decision to adjust its Indiana tax returns to include, as taxpayer's own income, reinsurance premiums received from its customers and ultimately paid over to a foreign insurance company directly or indirectly associated with the taxpayer.

II. Combined Water's Edge Unitary Return

Authority: IC 6-3-2-2(o); IC 6-3-2-2(q); IC 6-3-2-2.4; Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax Ct. 1998); Ind. Dept. of Rev. Tax Policy Directive No. 6 (1992)

Taxpayer maintains that the audit erred in denying it permission to report its business activities on a "world-wide" unitary basis and the audit's consequent exclusion of net income attributable to taxpayer's foreign subsidiaries.

III. Unitary Partnerships – Adjusted Gross Income Tax

Authority: Allied-Signal Inc. v. Dir., Div. of Taxation, 504 U.S. 768 (1992); Container Corp. v. Franchise Tax Board, 463 U.S. 159 (1983). F.W. Woolworth v. Taxation and Revenue Dep't of New Mexico, 458 U.S. 354 (1982); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); Exxon Corp. v. Dep't of Revenue of Wisconsin, 447 U.S. 207 (1980); Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. 425 (1980); 45 IAC 3.1-1-153(a), (b)

Taxpayer contests the audit's determination that five partnership entities were "unitary" with the taxpayer.

IV. Abatement of the Ten Percent Negligence Penalty

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

Taxpayer argues that the ten percent negligence should not have been imposed and that the Department should exercise its discretion to entirely abate the penalty.

STATEMENT OF FACTS

Taxpayer is in the business of shipping packages and is the primary operating subsidiary of the parent company. The taxpayer filed Indiana tax returns which included its various domestic and foreign affiliates. The Department of Revenue (Department) conducted an audit of taxpayer's business records and tax returns spanning the years 1996, 1997, and 1998. The audit made a number of adjustments certain of which resulted in the assessment of additional Indiana corporate income taxes. Taxpayer submitted a protest challenging a number of the audit's determinations, an administrative hearing was held, and this Letter of Findings follows.

DISCUSSION

I. Excess-Value Reinsurance Premiums – Adjusted Gross Income Tax

Taxpayer earns money by shipping packages. If one of a customer's packages is lost or damaged during shipping, taxpayer will automatically pay the customer up to $100 of the package's declared value. If the customer wishes to insure a package worth more than $100, taxpayer will do so and charge an additional amount for each additional $100 in declared value. This additional amount is called an "excess value charge." The amount taxpayer is entitled to charge for excess value insurance is governed by various federal and state tariffs.

At one time, taxpayer simply retained these excess value charges and paid for any losses out of its corporate pocket. The difference between what the taxpayer charged as excess value charges and the amount it paid as losses was simply retained as one portion of the taxpayer's profit.

Taxpayer rearranged its business organization to minimize the potential tax effect on profits derived from insuring its customers' packages. It did so by forming and capitalizing a Bermuda corporation. Thereafter, the Bermuda corporation's shares were distributed to taxpayer's own shareholders; the Bermuda corporation's shareholders were essentially identical to taxpayer's own shareholders.

Subsequently, taxpayer purchased an insurance policy – on behalf of the excess value insureds – from a domestic insurance company. The domestic insurance company assumed the risk of damage or loss to excess value packages. However, taxpayer agreed to administer the day-to-day claims submitted by taxpayer's insured customers.

The domestic insurance company then entered into a reinsurance treaty with the Bermuda corporation. The Bermuda corporation agreed to assume the entire amount of risk borne by domestic insurance company and owed to taxpayer.

Under this new arrangement, taxpayer collected the customer's excess value insurance payments, investigated any insurance claims, settled for any verified claims, and then paid over the remaining premium amounts to the domestic insurance company. The difference between the amount of money taxpayer received from its customers and the amount of money taxpayer paid for losses to excess value packages, constituted the premiums on the policy with the domestic insurance company. Therefore, depending on the amount of claims paid to its customers, the premium amount paid over to the domestic insurer would vary from month to month.

The domestic insurer collected the premiums, retained a portion of the premiums for its own fees, commission, and taxes and forwarded the remainder of the premiums to the Bermuda corporation as consideration for the reinsurance agreement. In practical application, the domestic insurer paid approximately 95 percent of the premiums received from the taxpayer over to the Bermuda corporation.

Taxpayer did not report on its federal return the amount of excess value insurance premiums it received from its shipping customers. The Internal Revenue Service disagreed with this decision and determined a deficiency equal of the value of the excess value charges taxpayer collected. The Internal Revenue Service found that the value of the excess value charges should be treated as taxpayer's own gross income. Taxpayer appealed the IRS finding. In a 1999 Tax Court Memo, the United States Tax Court agreed with the IRS determination and concluded that taxpayer's insurance arrangement was a "sham." Subsequently, taxpayer appealed the Tax Court's decision to the federal court of appeals. In 2001, the court of appeals reversed the Tax Court's decision and remanded the issue to the Tax Court in order to allow it to address the IRS's contentions challenging the reinsurance arrangement under I.R.C. §§ 482, 845(a).

The total amount of excess value charges was reported on the taxpayer's 1998 federal tax return. During the state's own audit of taxpayer 1996, 1997, and 1998 state returns, the amount of excess value charges reported on the federal return was included as one of the state adjustments on the 1998 Indiana return. In addition, the audit included "projected amounts" of these premiums for the 1996 and 1997 in those amounts to be apportioned to the state.

Taxpayer challenges the audit's determination as both inappropriate and premature. According to taxpayer, following remand to the Tax Court, taxpayer entered into discussions with the IRS in order to achieve a compromise settlement. Taxpayer urges the Department to hold the assessment of additional taxes – based upon the income received from excess value premiums – in abeyance until the compromise settlement with the IRS has been finalized.

The "sham transaction" doctrine is well established both in state and federal tax jurisprudence dating back to Gregory v. Helvering 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert denied*, 338 U.S. 955 (1950). "[t]ransactions 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). In determining whether a business transaction was an economic sham, two factors can be considered; "(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" Id. at 1337.

In applying these standards to the particular insurance arrangement taxpayer entered into with the domestic insurer and the Bermuda corporation, the Department concludes that the arrangement comes within the definition of the sham transaction doctrine. It is apparent that the reinsurance arrangements were entered into for no independent purpose other than obtaining the tax benefits attendant upon those arrangements and that it is the taxpayer who is earning this money and not the domestic insurer and not the Bermuda corporation.

Under the reinsurance agreements, taxpayer collects the excess value premiums from its customers, deposits the premiums into its own accounts, receives and processes the claims, pays for losses incurred as the result of damaged or missing excess value packages, and pays the amount remaining to the domestic insurer as "premiums." The domestic insurer thereafter – after retaining approximately 5 percent of the amount – passes the premiums over to the Bermuda corporation which is entirely owned by taxpayer's own shareholders. As between taxpayer and its shipping customers, the insurance agreement is entirely transparent.

The domestic insurer's only risk exposure is in the event of the sort of catastrophic loss for which taxpayer provides no material evidence or historical experience. In any event, this negligible risk of catastrophic loss is simply shifted from taxpayer, to the domestic insurer, to the Bermuda corporation and – ultimately – the Bermuda corporation's shareholders. By the terms of this roundabout insurance arrangement, the risk of catastrophic loss finds its way back to the same shareholders who bore it in the first place. Taxpayer is paying substantial amounts of money for little discernible benefit and its arguments – that the reinsurance arrangement has a purpose other than obtaining tax benefits – are insubstantial, inconsequential, or speculative.

Under such circumstances, the Department is entitled to ignore the effect of the reinsurance arrangements and require that the taxpayer report the entirety of the excess value premiums as taxpayer's own income because the taxpayer's reinsurance agreements have no substantive economic substance or business purpose. The plain language of the law 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." IC 6-3-2-2(l) (*Emphasis added*). The Department is not required to accept the assertion that taxpayer divested itself of a large portion of the highly profitable excess value charges when the divestiture had no economic impact on the taxpayer other than the accompanying tax benefits.

Taxpayer is, of course, entitled to organize its package transport business in any manner its sees fit and to vigorously pursue any tax advantage attendant upon such an arrangement. However, in determining the nature of any business transaction and the resultant tax consequences, the Department is required to look at "the substance rather than the form of the transaction." <u>Bethlehem Steel Corp. v. Ind. Dept. of State Revenue</u>, 597 N.E.2d 1327, 1331 (Ind. Tax Ct. 1992).

FINDING

Taxpayer's protest is respectfully denied.

II. Combined Water's Edge Unitary Return

The audit report – completed in 2001 – accepted taxpayer's combined unitary tax returns. However, the audit rejected the taxpayer's decision to file the unitary returns using a worldwide reporting method. As a result, the audit excluded income received from foreign sources because, under a "water's edge" basis, that net income should not have been included on the Indiana returns.

Taxpayer takes exception to the audit's decision rejecting the worldwide method of reporting its income. Taxpayer argues that it has consistently filed its corporate income tax returns on a worldwide basis since 1983 and that this method of reporting has been accepted by the Department during previous audit cycles. In addition, taxpayer maintains that, "there is nothing in the statutes or regulations that requires or permits the Department to reject a worldwide return that is voluntarily filed by the taxpayer and which fairly reflects Indiana income." According to taxpayer, having accepted taxpayer's past worldwide returns, the Department may not now reject the 1996, 1997, and 1998 returns filed on a world-wide basis.

IC 6-3-2-2(q) permits a taxpayer to petition the Department for permission to file a combined return. Specifically, the rule states that, "Notwithstanding subsections (o) and (p), one (1) or more taxpayers may petition the department under subsection (l) for permission to file a combined income tax return for a taxable year." "The basic premise in filing combined/unitary returns is that all activities carried on by separate entitles are part of a single unitary business (one taxpayer)." Ind. Dept. of Rev. Tax Policy Directive No. 6 (1992).

However, IC 6-3-2-2(o) contains a "water's edge" provision directed at the Department. "Notwithstanding subsections (l) and (m), the department may not, under any circumstances, require that income, deductions, and credits attributable to a taxpayer and another entity be reported in a combined income tax return for any taxable year, if the other entity is: (1) a foreign corporation...." IC 6-3-2-2(o).

The rule is then that the Department may never require a taxpayer to file a "worldwide" return although a taxpayer may request permission to do so. IC 6-3-2-2(o), (q).

There is nothing to indicate that taxpayer has either sought or received permission to file a worldwide return as required under IC 6-3-2-2(q). There is nothing to indicate that even if taxpayer had sought permission to file a worldwide return, the Department would have found it appropriate to deviate from the unambiguous statutory aversion to employing the worldwide reporting methodology. IC 6-3-2-2(o) ("The department may not, *under any circumstances require* that income" of a foreign corporation "be reported in a combined income tax return for any taxable year...." (*Emphasis added*). There is nothing substantive to establish that even if taxpayer had sought permission to file worldwide returns, the Department would have determined that the standard apportionment methods – employing a "water's edge" formulation – did not fairly reflect the taxpayer's Indiana income. *See* IC 6-3-2-2(o), (q); IC 6-3-2-2.4. The taxpayer's assertion, that the foreign companies are owned and managed by taxpayer and that "nothing could be more unitary," does not establish that the "water's edge" reporting method fails to fairly reflect taxpayer's Indiana income.

Nonetheless, the plain fact is that the Department has permitted taxpayer to file worldwide returns during previous audit cycles. According to taxpayer, this past acquiescence to the worldwide reporting method – in and of itself – requires the Department to consent to the worldwide reporting method on the 1996, 1997, and 1998 returns. Taxpayer's argument fails because – again – there is no indication taxpayer ever *sought* the requisite permission to file worldwide returns, that the Department ever *granted* taxpayer permission to file on a worldwide basis, or that such a proposed reporting methodology would *more fairly reflect* taxpayer's Indiana income.

In addition, taxpayer is not entitled to prospective treatment of the determination reached within this Letter of Findings because there is no indication that the audit report, completed in 2001, "reinterpreted" taxpayer's then current tax liability. *See* Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122, 1129 (Ind. Tax Ct. 1998). To the contrary, information contained within a previous audit report – stemming from a review taxpayer's 1990, 1991, and 1994 returns – specifically noted that taxpayer was incorrectly reporting on a worldwide basis and that this method of reporting was unwarranted. Although the audit did not require the elimination of the foreign income during that particular reporting period, the report noted that "taxpayer has been notified that no future filings with Indiana will be allowed on a [worldwide] unitary basis." There is no indication that there was a statutory basis for permitting worldwide reporting during the previous audit cycles. Taxpayer was placed on notice by at least August 1994 that it would not be permitted to file on a worldwide basis in the future. Taxpayer may not now be heard to complain that it is entitled to prospective treatment of a decision regarding the appropriateness of the worldwide reporting method reached in 2003.

FINDING

Taxpayer's protest is respectfully denied.

III. Unitary Partnerships – Adjusted Gross Income Tax

Taxpayer filed unitary returns. The audit determined that five partnerships, in which the taxpayer had made investments, should be considered "unitary" with the taxpayer. The audit arrived at this conclusion because of the partnership's "relationship to parcel shipping or by virtue of the fact that the [t]axpayer exercises control of these [five] partnerships." After arriving at this conclusion, the audit made adjustments to taxpayer's non-business income and to the various components of the apportionment factor.

Taxpayer challenges this decision. Taxpayer argues that the partnerships are simply hands-off business arrangements entered into for the purpose of investing excess cash. According to taxpayer, the five partnerships are managed by unaffiliated companies; all major and minor operational and policy decisions are made by unaffiliated management companies; and that taxpayer's own personnel are not involved in any aspect of the five partnership businesses.

In support of the argument that the five partnerships did not have a unitary relationship with taxpayer, taxpayer cites to 45 IAC 3.1-1-153. The rules states, in relevant part, as follows:

> A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income (b) If the corporate partner's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by [the] three (3) factor formula. 45 IAC 3.1-1-153(a), (b).

The Supreme Court has set out a three-part test to determine whether a unitary relationship exists. The three-part test consists of: common ownership; common management; and common use or operation. *See* Allied-Signal Inc. v. Dir., Div. of Taxation, 504 U.S. 768 (1992); F.W. Woolworth v. Taxation and Revenue Dep't of New Mexico, 458 U.S. 354 (1982); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); Exxon Corp. v. Dep't of Revenue of Wisconsin, 447 U.S. 207 (1980); Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. 425 (1980).

The first issue to be determined is the question of "common ownership." In this instance, taxpayer owned between 70 to 80 percent of the five partnerships. According to taxpayer, this degree of ownership interest was significant in the audit's determination because the audit excluded two partnerships in which taxpayer owned less than a 50 percent ownership. 45 IAC 3.1-1-153(b) provides no specific guidance as to the degree of common ownership necessary to establish a "unitary relationship." However, taxpayer owns between 70 to 80 percent of the five partnerships and this evidence is sufficient to establish that taxpayer and the five partnerships share "common ownership."

The second element considered in establishing a unitary relationship is common management. Common management is demonstrated when the parent company provides a management role that is "grounded in [the parent company's] own operational expertise and its overall operational Strategy." Container Corp. v. Franchise Tax Board, 463 U.S. 159, 180 n.19 (1983). In determining this second element, the audit report provides no specific information as to the degree of operational control taxpayer exercises over the five partnership interests.

The five partnerships are involved in various business enterprises including satellite ownership, aircraft leasing, oil drilling operations, office leasing, and hotel investments. According to taxpayer, the aircraft owned by the partnership interest are not leased for use in taxpayer's own package shipping business but are leased to commercial airlines for use in providing passenger service. Given the disparity between taxpayer's business and the five partnership's businesses and the absence of any information that taxpayer exercises any managerial control over the five partnerships, it is reasonable to conclude that the second element – common management – is absent.

The third element is that of common operation or use. Evidence of a "common operation" exists where certain functions are performed for the outside group by the parent (such as purchasing, financing, advertising, marketing, research, tax compliance, insurance, and pension plan management) which entirely independent companies would otherwise perform for themselves.

There is no information that taxpayer and the five partnerships share in any degree of "common operation." Given the information provided by taxpayer – that the relationship between itself and the five partnerships is entirely "hands-off" and that the five partnerships are simply investment vehicles for taxpayer's excess cash reserves – it is reasonable to conclude that the third element, common operation or use, is lacking.

Although the taxpayer possesses a substantial degree of ownership in the five partnerships, because the elements of common management and common operation are entirely absent, the taxpayer is correct in its assertion that, under 45 IAC 3.1-1-153(a), it did not have a unitary relationship with the five partnerships.

FINDING

Taxpayer's protest is sustained.

IV. Abatement of the Ten Percent Negligence Penalty

Taxpayer maintains that its "Indiana returns were substantially correct as filed" and that "no penalties should be assessed in this matter."

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..."

Despite additional assessments determined at the time of the original audit and the issues raised within taxpayer's protest, under the facts and circumstances as indicated in the record, taxpayer has demonstrated that it "exercised ordinary business care" and is therefore entitled to abatement of the ten percent negligence penalty.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420020395.LOF

LETTER OF FINDINGS NUMBER: 02-0395
Use Tax
Calendar Years 1999 and 2000

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

ISSUE

I. Use Tax – Computerized Golf Booth

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

The taxpayer protests the assessment of use tax on its golf booth.

II. Tax Administration – Penalty

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

The taxpayer protests the penalty.

III. Tax Administration – Interest

Authority: IC 6-8.1-10.1

The taxpayer protests the interest.

STATEMENT OF FACTS

Upon audit, it was discovered that the taxpayer failed to remit Use Tax on a computerized golf booth, cameras, signs, stone, baskets, and rubber tees. Taxpayer had no use tax accrual system in place.

I. Use Tax – Computerized Golf Booth

DISCUSSION

The taxpayer protests the Department's assessment of use tax on its computerized golf booth.

Taxpayer states that the company from whom it purchased the golf booth is out of business and it could not get a copy of the invoice. Taxpayer states that the company is out of state and has no way of checking to see if sales tax was charged.

The hearing officer explained that a company must be registered with the Indiana Department of Revenue to collect the sales tax and offered to check with the Department. Since the company from whom the taxpayer purchased the golf booth is not registered with the Indiana Department of Revenue, Indiana sales tax could not have been remitted. Use tax is due from the taxpayer.

FINDINGS

The taxpayer's protest is denied.

II. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and has not provided reasons.

Taxpayer had no use tax accrual system in place. The ST-103 clearly has a line for use tax for items that had no sales tax assessed. The Indiana Code and Regulations are clear regarding the payment of use tax.

FINDINGS

Taxpayer's protest is denied.

III. Tax Administration – Interest

DISCUSSION

Taxpayer protests the interest assessed. The Department has no authority to waive interest.

FINDINGS

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is denied for issues I, II, and III.

DEPARTMENT OF STATE REVENUE

0120020537.LOF

LETTER OF FINDINGS NUMBER: 02-0537
Individual Income Tax
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. Taxpayer's Indiana Income Tax Exemptions

Authority: IC 6-3-1-3.5(a)(3) and (4); IC 6-3-1-3.5(a)(5)(A); IC 6-8.1-3-3(a); Johnson County Farm Bureau v. Dep't of Revenue, 568N.E.2d 578 (Ind. Tax Ct. 1991); 45 IAC 3.1-1-5(b)(4)

Taxpayer protests the disallowance of an exemption for a dependent child.

STATEMENT OF FACTS

Taxpayer filed a joint 1040 federal return reporting income received during 1999. Taxpayer submitted a divorce decree where she could claim the federal exemption for one child and her ex husband claims the other. Taxpayer claimed both dependent children for Indiana State Tax purposes because both children live with her in Indiana.

On July 30, 2002, the Department issued taxpayer a notice of "Proposed Assessment". The assessment of additional taxes was based upon the inconsistency between taxpayer's federal and state returns.

I. Taxpayer's Indiana Income Tax Exemptions

DISCUSSION

Taxpayer claimed herself, her husband, and two dependent children as exemptions on the state tax return. The Department issued its proposed assessment because the federal return did not agree with the exemptions reported on the state return. In the divorce decree, the taxpayer was allowed the right for income tax purposes to claim the dependency exemption for one child.

Taxpayer argues that she was legitimately entitled to claim all four exemptions on her state return. Taxpayer maintains that both children lived with her in Indiana.

Insofar as relevant to taxpayer's "Line 8" deductions, IC 6-3-1-3.5(a)(3) and (4) state that the Indiana taxpayer is to "Subtract one thousand dollars ($1,000), or in the case of a joint return filed by a husband and wife, subtract for each spouse one thousand dollars ($1,000). Subtract one thousand dollars ($1,000) for each of the exemptions provided by Section 151(c) of the Internal Revenue Code. Insofar as relevant to taxpayer's "Line 9" deductions, IC 6-3-1-3.5(a)(5)(A) permits an Indiana taxpayer to "subtract one thousand ($1,500) for each of the exemptions allowed under Section 151(c)(1)(B) of the Internal Revenue Code for taxable years beginning after December 31, 1996."

The statutory formula is straightforward; an Indiana taxpayer may claim a $1,000 exemption on line 8 of its Indiana return if that exemption is allowed under I.R.C. 151(c). The Indiana taxpayer may claim a $1,500 deduction on line 9 of her Indiana return if that exemption is allowed under I.R.C. 151(c)(1)(B).

The explanatory language on the 1999 IT-40 return is equally straightforward; line eight on the form states that the taxpayer is to report the "[n]umber of exemptions claimed on your federal return." The IT-40 also states that the taxpayer is entitled to claim an [a]dditional exemption for certain dependent children" and to report that number on line nine.

Relevant to line eight, the Department's accompanying instructional booklet states that "You are allowed a $1,000 exemption on your Indiana tax return for each exemption *you claim on your federal return." (Emphasis added).* Relevant to line nine, the booklet states that, "An additional exemption, which has been increased to $1,500, is allowed for certain dependent children."

The instructions printed on the Indiana tax form, the accompanying instructional booklet, and the Department's regulation preclude an Indiana taxpayer from claiming an exemption unless the exemption has also been claimed on the corresponding federal return. The tax form, the instructional booklet, and accompanying regulation have interpreted the applicable statutes as being consistent with federal requirements for claiming dependent exemptions.

The legislature has delegated to the Department the authority to interpret and apply the tax statutes. IC 6-8.1-3-3(a) states that "The department shall adopt, under IC 4-22-2, rules governing: (1) the administration, collection, and enforcement of the listed taxes; (2) the interpretation of the statutes governing the listed taxes; (3) the procedures relating to the listed taxes; and (4) the methods of valuing the items subject to the listed taxes."

There is nothing to indicate that the Department acted beyond its authority in promulgating a regulation mandating that Indiana taxpayers first claim the exemption on their federal returns before claiming the exemption on the corresponding Indiana return. Specifically, there is nothing to indicate that the Department acted beyond the scope of its authority in noting the discrepancy between taxpayer's federal and state 1999 returns and rendering an additional assessment based upon that discrepancy. "A rule issued by an agency pursuant to its statutory authority to implement the statute has the force of law." Johnson County Farm Bureau v. Dep't of Revenue, 568 N.E.2d 578, 584 (Ind. Tax Ct. 1991).

Taxpayer argues that "Indiana law allows exemptions where they are qualified and [does not] intend to deprive taxpayers of receiving an exemption." Taxpayer makes an argument – based on general principles of equity and fairness – that the Department circumvent the regulation and permit taxpayer to maximize the tax advantages attendant on her decision to claim four exemptions on her 1999 state return. The Department has no such equitable authority and must decline taxpayer's request.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0320020561P.LOF

LETTER OF FINDINGS NUMBER: 02-0561P
Withholding Tax
Month Ending 04/30/01

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 for the month of April 2001. In a letter dated November 20, 2002, taxpayer requests a waiver because its accountant and attorney each thought that the other was filing for its tax accounts. Taxpayer states that it wasn't until June that it was determined that nothing had been filed. Taxpayer registered on June 15, 2001. Taxpayer prepared its own payroll in February, March, and three weeks in April before turning it over it an agent.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer failed to remit its withholding tax timely and was assessed a late payment penalty. Taxpayer states that it believed either the accountant or its attorney was filing for its tax accounts.

Taxpayer's failure to remit the tax timely was not the result of reasonable cause. Taxpayer should have assured itself that either the accountant or attorney was following through with its duty to properly register with the Department. Payment for February, March, and April were clearly late and the Taxpayer has failed to substantiate reasonable cause for a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120020612.LOF

LETTER OF FINDINGS NUMBER: 02-0612
Individual Income Tax
For the Tax Period: 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. Individual Income Tax – Exemptions

Authority: IC 6-3-1-3.5, IC 6-8.1-3-3, IC 6-8.1-5-1, 45 IAC 3.1-1-5, *Johnson County Farm Bureau v. Dep't of* Revenue, 568 N.E.2d 578 (Ind. Tax Ct. 1991), 1999 *IT-40 Instruction Booklet*

Taxpayer argues that the Department erred in its assessment of additional income taxes on the ground that Taxpayer overstated the number of exemptions claimed on his 1999 Indiana individual income tax return.

II. Tax Administration – Penalty

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

The Taxpayer protests the Department's assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer was assessed individual income tax after an adjustment was made to his 1999 IT-40 Indiana Full-Year Resident Individual Income Tax Return.

Taxpayer claimed two exemptions on line 6 on his federal Form 1040 consisting of himself and one dependent child. Thereafter, Taxpayer filed a single IT-40 state return reporting income received during 1999. On the IT-40 return, Taxpayer claimed two exemptions on line 8 (exemptions claimed on your federal return) plus three (additional exemptions for dependant children) on line 9.

On September 27, 2000, the Department issued Taxpayer a Form PFC disallowing all the exemptions claimed on Line 9 with the reason of "[e]xtra exemptions claimed". On July 23, 2001, the Department issued a notice of "Proposed Assessment".

On August 10, 2001, the "Proposed Assessment" was canceled. Subsequently, a second "Proposed Assessment" was issued on August 26, 2002 for the adjustments made to the 1999 IT-40. More facts supplied as necessary.

I. Individual Income Tax – Exemptions

DISCUSSION

On his federal return, Taxpayer claimed himself and one of his dependent children as exemptions. Taxpayer chose not to claim two dependent children on the federal return. Taxpayer argues that he was entitled to claim all three exemptions on his state return even though he chose to claim only one on the corresponding federal return. Taxpayer maintains that his decision, not to claim two of his three dependent children on the federal return, did not preclude him from claiming them as "Additional Exemptions" on the state return.

Taxpayer argues the IT-40 instruction booklet does not state that the he is required to limit the exemptions claimed on "Line 9" to either what was claimed on the federal return or what he reported on "Line 8". Rather, he states he is entitled to claim those exemptions in which he was eligible to take on the federal return. Specifically, he points to the 1999 IT-40 instruction booklet which states: "If any dependent(s) you are eligible to claim on your federal return also meet the *Dependent Child Definition* above, enter that number in the box on line 9". He states that since the three dependents claimed on Line 9 meet the "Dependent Child Definition", the Department erred when it adjusted his return.

In understanding whether Taxpayer is allowed to claim the three "Additional Exemptions" on Line 9 of the Indiana IT-40, we must also look to Line 8. Insofar as relevant to Taxpayer's "Line 8" deductions, IC 6-3-1-3.5(a)(3), (4) states that the Indiana taxpayer is to "Subtract one thousand dollars ($1,000), or in the case of a joint return filed by a husband and wife, subtract for each spouse one thousand dollars ($1,000). Subtract one thousand dollars ($1,000) for each of the exemptions provided by Section 151(c) of the Internal Revenue Code. Insofar as relevant to Taxpayer's "Line 9" deductions, IC 6-3-1-3.5(a)(5)(A) permits an Indiana taxpayer to "subtract one thousand five hundred dollars ($1,500) for each of the exemptions allowed under Section 151 (c)(1)(B) of the Internal Revenue Code for taxable years beginning after December 31, 1996."

The statutory formula is straightforward; an Indiana taxpayer may claim a $1,000 exemption on Line 8 of his Indiana return if that exemption is allowed under I.R.C. § 151(c). The Indiana taxpayer may claim a $1,500 deduction on "Line 9" of his Indiana return if that exemption is allowed under I.R.C. §151(c)(1)(B). There is nothing apparent in the statute which requires –as a condition precedent to claiming those Indiana exemptions – that Taxpayer first claim the identical exemptions on his federal return. The explanatory language on the 1999 IT-40 return is equally straightforward; Line 8 on the form states that the taxpayer is to report the "[n]umber of exemptions claimed on your federal return." In this case, Taxpayer claimed two exemptions which is what he claimed on his federal return.

The IT-40 also states that the taxpayer is entitled to claim an [a]dditional exemption for certain dependent children" and to report that number on Line 9. The instruction booklet states that, "An additional exemption, which has been increased to $1,500, is allowed for certain dependent children".

Taxpayer contends that the number that may be "eligible" to be taken on the federal return is distinguishable from the number that was actually taken on the federal return. However, Taxpayer misinterprets the instructions for Line 9 to include exemptions for additional dependents to those exemptions claimed on Line 8, when in fact, Taxpayer is allowed an additional exemption for certain dependents claimed on Line 8. This is clarified in the instructions which state in relevant part:

> Line 9 – *Additional Exemption* for Dependent Child
>
> An *additional exemption*, which has been increased to $1,500, is allowed for certain dependent children….
>
> If any dependent(s) you are eligible to claim on your federal return also meet the *Dependent Child Definition* above, enter that number in the box on line 9.
>
> *Example* – John and Lisa *claimed* their 12 year old daughter Sarah as an *exemption on their federal return*. Since Sarah is their daughter, is under the age of 19 and *was claimed as an exemption on her parent's federal tax return*, John and Lisa will claim one (1) exemption on line 9 for a total of $1,500. (*Emphasis added*)
>
> Note: Not all dependent children eligible to be claimed as exemptions on the federal tax return will be eligible for this additional exemption. For instance, if you claimed a grandson or nephew as an exemption on your federal tax return, you should also claim an exemption for them on line 8. However, since he doesn't meet the *Dependent Child Definition* above, you won't be able to claim the additional exemption on line 9.
>
> *1999 IT-40 Instruction Booklet*, pg. 15.

Nevertheless, 45 IAC 3.1-1-5(B)(4) directs Taxpayer to "[s]ubtract $1000 for each exemption taken on the Federal return for taxpayer or spouse aged 65 or above…" and to subtract "$500 [now $1,500] for each exemption *taken on the Federal return* for a qualified dependent". (*Emphasis added*).

The legislature has delegated to the Department the authority to interpret and apply the tax statutes. IC 6-8.1-3-3(a) states the "The department shall adopt, under IC 4-22-1, rules governing: (1) the administration, collection, and enforcement of the listed taxes; (2) the interpretation of the statutes governing the listed taxes; (3) the procedures relating to the listed taxes; and (4) the methods of valuing the items subject to the listed taxes."

There is nothing to indicate that the Department acted beyond its authority in promulgating a regulation mandating that Indiana taxpayers first claim the exemption on their federal returns before claiming the exemption on the corresponding Indiana return. "A rule issued by an agency pursuant to its statutory authority to implement the statute has the force of law." *Johnson County Farm Bureau v. Dep't of Revenue*, 568 N.E.2d 578, 584 (Ind. Tax Ct. 1991).

Consequently, The Department correctly denied two of the three exemptions. However, Taxpayer is entitled to one exemption on Line 9 for a dependent he claimed on Line 8.

Taxpayer also argues that since the original "Proposed Assessment" was canceled on August 10, 2001, the Department cannot create an assessment for the same adjustment. Pursuant to IC 6-8.1-5-1(a), "If the Department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment on the amount of the unpaid tax on the basis of the best information available to the department." Here, the first assessment was canceled in error. The Department reasonably believed that Taxpayer incorrectly reported the amount of tax due and correctly issued the second "Proposed Assessment".

FINDING

The Taxpayer's protest is denied in part and sustained in part. The Department correctly denied two exemptions which were not claimed on Line 8 of his 1999 IT-40. However, Taxpayer is entitled to claim one exemption on Line 9.

II. Tax Administration – Penalty

IC 6-8.1-10-2.1(d) allows a penalty to be waived upon a showing that the failure to pay the deficiency was due to reasonable cause. Also, 45 IAC 15-11-2(c) requires that in order to establish reasonable cause, the taxpayers must show that they exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. The Department finds that Taxpayer demonstrated reasonable cause for their failure to pay tax.

FINDING

The Taxpayer's protest of the penalty is sustained.

DEPARTMENT OF STATE REVENUE

4220030005.LOF

LETTER OF FINDINGS NUMBER: 03-0005
International Fuel Tax Agreement (IFTA)
For the Year 2000

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

ISSUES

I. IFTA – Sufficiency of documentation

Authority: IFTA.VII.R700; IFTA A550; IFTA P510; IFTA.R 540

The taxpayer protested the auditor's rejection of new fuel tax records prepared and submitted by taxpayer after an IFTA audit assessment was made based on taxpayer's original invoices.

STATEMENT OF FACTS

The taxpayer is a private carrier using vehicles for hauling. An IFTA fuel audit was conducted and taxpayer did not provide complete records for the audit review. The audit found that the origins and destinations listed on the taxpayer's pay records were coded into a computer system and the codes were not explained, nor was a key provided to the auditor. The mileage records did not include jurisdictional miles, routes, or odometer readings. The taxpayer also failed to maintain monthly and/or quarterly vehicle mileage summaries. The taxpayer failed to maintain all the fuel purchase receipts, instead the taxpayer divided the reported total miles by a predetermined MPG factor of 6.75 to determine the reported total gallons. The taxpayer also failed to maintain monthly and/or quarterly vehicle fuel summaries. The audit reviewed what records were available with an assessment resulting; taxpayer is protesting said assessment. Taxpayer's failed to appear for the scheduled hearing and this letter of finding was prepared based on information within the file.

I. IFTA – Sufficiency of documentation

DISCUSSION

The department, pursuant to an IFTA audit, requested taxpayer records pursuant to IFTA.Article VII, R700 requirements. After the assessment, taxpayer submitted a protest to the audit findings and assessment outlining three arguments against the assessment.

Taxpayer argues that by its calculations the fuel consumption used in the audit determination was incorrect. IFTA article A550 requires that in the absence of adequate records, a standard 4.00 MPG rate can be used to compute total fuel consumption. Given the absence of records to establish mileage and fuel consumption this was an appropriate method of calculation by the audit.

Taxpayer then argues that another entity was using, or leasing, the vehicles at issue. Taxpayer maintains that in the event of a lease arrangement that is silent as to tax duty, lessee, not taxpayer, is responsible for the taxes. Taxpayer does not reconcile this position with the requirements in IFTA P510:

> Every licensee shall preserve the records for a period of four years from the due date of the return or the date filed, whichever is later. Such records shall be made available upon request by any member jurisdiction.

And IFTA R 540:

> No member jurisdiction shall require the filing of such leases, but such leases shall be made available upon request of any member jurisdiction.

While IFTA does not address the tax burden in the event of a silent lease, taxpayer is explicitly directed within the code section cited to make copies of such leases "available upon request." Taxpayer did not provide any record related to the alleged lessees. Given the incomplete proof of the leasing arrangements and the requirement to document such arrangements imposed by IFTA on taxpayer, taxpayer fails to shift the responsibility for these taxes to the entities it identifies as lessees.

Finally, taxpayer argues that the audit calculations are based upon presumptions that are at variance with industry norms. Taxpayer does not cite any IFTA provisions- nor explain- taxpayer's protest based on "industry standards, " and Department will note that a logical inference that industry standards would require compliance with IFTA record keeping requirements can be drawn.

Taxpayer arguments and evidence fail to provide proof that the assessment was either erroneous or excessive.

FINDINGS

Taxpayer's appeal is denied.

DEPARTMENT OF STATE REVENUE

4220030006.LOF

LETTER OF FINDINGS NUMBER: 03-0006
International Fuel Tax Agreement (IFTA)
For the Year 1999 and 2000

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I. IFTA – Sufficiency of documentation

DISCUSSION

The department, pursuant to an IFTA audit, requested taxpayer records pursuant to IFTA.Article VII, R700 requirements. After the assessment, taxpayer submitted a protest to the audit findings and assessment outlining three arguments against the assessment.

Taxpayer argues that by its calculations the fuel consumption used in the audit determination was incorrect. IFTA article A550 requires that in the absence of adequate records, a standard 4.00 MPG rate can be used to compute total fuel consumption. Given the absence of records to establish mileage and fuel consumption this was an appropriate method of calculation by the audit.

Taxpayer then argues that another entity was using, or leasing, the vehicles at issue. Taxpayer maintains that in the event of a lease arrangement that is silent as to tax duty, lessee, not taxpayer, is responsible for the taxes. Taxpayer does not reconcile this position with the requirements in IFTA P510:

> Every licensee shall preserve the records for a period of four years from the due date of the return or the date filed, whichever is later. Such records shall be made available upon request by any member jurisdiction.

And IFTA R 540:

> No member jurisdiction shall require the filing of such leases, but such leases shall be made available upon request of any member jurisdiction.

While IFTA does not address the tax burden in the event of a silent lease, taxpayer is explicitly directed within the code section cited to make copies of such leases "available upon request." Taxpayer did not provide any record related to the alleged lessees. Given the incomplete proof of the leasing arrangements and the requirement to document such arrangements imposed by IFTA on taxpayer, taxpayer fails to shift the responsibility for these taxes to the entities it identifies as lessees.

Finally, taxpayer argues that the audit calculations are based upon presumptions that are at variance with industry norms. Taxpayer does not cite any IFTA provisions- nor explain- taxpayer's protest based on "industry standards, " and Department will note that a logical inference that industry standards would require compliance with IFTA record keeping requirements can be drawn.

Taxpayer arguments and evidence fail to provide proof that the assessment was either erroneous or excessive.

FINDINGS

Taxpayer's appeal is denied.

DEPARTMENT OF STATE REVENUE

0220030007P.LOF

LETTER OF FINDINGS NUMBER: 03-0007P
Gross Income Tax
For Calendar Years 1998, 1999, and 2000

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

At audit it was determined that the taxpayer failed to report gross receipts for Indiana. Taxpayer receives income from a subsidiary for services provided under a management agreement. Adjustments were also necessary for Adjusted Gross Income under the apportionment schedules for Indiana sales that had no effect for AGI as the taxpayer had considerable losses.

Taxpayer filed a penalty protest dated November 21, 2002 stating that it did not willfully underpay taxes to the state of Indiana and has filed all subsequent returns in compliance with Indiana statutes.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states it did not willfully underpay taxes to the state of Indiana. Taxpayer states that as a result of the audit, it filed its 2001 return under the same guidelines prescribed by the audit.

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 failed to report Indiana income although it had rented property and payrolls in the state. Taxpayer did not make itself aware of the Indiana tax laws when doing business in this state and has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

1020030008P.LOF

LETTER OF FINDINGS NUMBER: 03-0008P
Food and Beverage Tax
For the Month Ended May 31, 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 filed its return with payment on July 15, 2002 and was assessed a late penalty. The original due date of the return was July 1, 2002.

Taxpayer filed a penalty protest dated December 9, 2002. Taxpayer states that an oversight and not intentional disregard caused the late remittance.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that it was late due to an administrative oversight. Taxpayer further states that it has a punctual remittance history for the past three years.

Taxpayer failed to remit its tax timely and has not provided reasonable cause to allow the department to waive the penalty. An oversight is not reasonable cause.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030009P.LOF

LETTER OF FINDINGS NUMBER: 03-0009P
Sales Tax
For the Month ended October 31, 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 filed its return with payment late and was assessed a penalty.

Taxpayer filed a penalty protest dated December 11, 2002. Taxpayer states that it was late by one day and states that the error was unintentional and due solely to human error.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that it was late due to human error. Taxpayer further states that it has always paid its taxes in full and timely.

Taxpayer failed to remit its tax timely and has not provided reasonable cause to allow the department to waive the penalty. An oversight is not reasonable cause.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030011P.LOF

LETTER OF FINDINGS NUMBER: 03-0011P
Gross and Adjusted Gross Income Tax
Calendar Years 1997, 1998, 1999, and 2000

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

STATEMENT OF FACTS

Taxpayer manufactures abrasive products used in industry and by consumers to cut, grind, shape, sharpen, or finish metal, glass, ceramic, plastic and wood. Taxpayer sells the products throughout the United States and in several foreign countries. The taxpayer had a sales office and distribution center in Indiana. Upon audit it was discovered that the taxpayer failed to report a significant portion of its Indiana sales for gross income tax. All sales were the result of the efforts of salesmen's activities conducted from the Indiana sales office.

Taxpayer's audit revealed that it failed to report Indiana destination sales shipped from out of state to Indiana customers that were serviced from the Indiana sales office.

To address the penalty issues, reference is made to taxpayer's letter dated December 5, 2002 that objects to the ten percent (10%) penalty for under payment of tax paid with its return and an additional ten percent (10%) penalty for the underpayment of its estimated payments.

Taxpayer states that its tax department did everything that responsible people could have been expected to do in order to comply with the tax laws of Indiana. Its estimates were based on the best information it had at the time the payments were made. Taxpayer further states that it has always filed its estimates and returns in a timely fashion and for those reasons feels that the penalties assessed are unreasonable.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer was assessed a penalty at audit for calendar years 1997 through 2000 for failing to report Indiana destination sales in gross income. The underreporting was for over ninety percent of the gross income tax for all years at audit.

Taxpayer also received underpayment penalty assessments for the IT-20's it filed.

Taxpayer, in a letter dated December 5, 2002 protests the penalties assessed because it did everything possible in order to comply with the tax laws of Indiana. Taxpayer further states that its estimates were based on the best information it had at the time the payments were made and has always filed its estimates and returns in a timely fashion. Taxpayer requests a refund of the penalties.

Taxpayer, however, failed to report more than ninety percent (90%) of its gross income tax for all years at audit. Taxpayer has not provided reasonable cause for its failure to report all of its income.

The Underpayment Penalty for failing to correctly estimate and pay the quarterly estimated taxes was assessed concurrently with the audit.

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 provide reasonable cause to allow a penalty waiver.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030024P.LOF

LETTER OF FINDINGS NUMBER: 03-0024P
Sales Tax
For Calendar Years 1996, 1997, 1998, 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 1996 through 2001. The auditor's review of taxpayer's business activity revealed that the taxpayer had been conducting business in Indiana since its incorporation in 1996. The taxpayer sells, delivers, installs, and repairs lubrication equipment. The examination revealed that the taxpayer was not registered with the Department of Revenue to collect Indiana Gross Retail Sales Tax and tax returns had not been filed. Sales of equipment and parts delivered or shipped to Indiana customers without valid exemption certificates are included in the audit report.

Taxpayer requests abatement of the penalty because it was not aware that sales tax should be paid to Indiana.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that it was unaware that sales tax is due to the state of Indiana.

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 sold, delivered, and installed lubrication equipment in Indiana. Taxpayer has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030025P.LOF

LETTER OF FINDINGS NUMBER: 03-0025P
Use Tax
For Calendar Years 1999 and 2000

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

ISSUE(S)

Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer's audit was completed on September 6, 2002. Taxpayer in a written protest requests an abatement of the penalty. Taxpayer's audit revealed that it failed to self-assess and remit use tax on clearly taxable items such as copier maintenance items, office supplies, maintenance repairs, advertising items, office equipment parts, first aid supplies, and other miscellaneous items. Taxpayer was audited previously with the same issues.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that the amount of tax assessed during the tax audit was not a result of negligence but high turnover in the accounting department. Taxpayer states the procedures relating to the accrual of use tax have been put in place and should help correct any future use tax issues.

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 failed to remit use tax on clearly taxable items, has had a prior audit with the same issues, and was aware of the consequences of not paying use tax due. Taxpayer has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030026P.LOF

LETTER OF FINDINGS NUMBER: 03-0026P
Sales and Use Tax
For the Period October 1, 2000 through 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

Upon audit it was discovered that the taxpayer failed to remit use tax on clearly taxable items such as uniforms, office supplies, maintenance and janitorial supplies, and other miscellaneous items. Taxpayer also failed to obtain an exemption certificate from one of its customers and was given the opportunity to obtain the *Special Sales/Use Tax Exemption Certificate*, Form AD-70.

Taxpayer requests abatement of the penalty because it took immediate steps to correct the issues and has an excellent compliance history.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that it has "instated" a use tax system for future capital purchases and has taken steps to correct the issues that led to the assessment.

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 was previously audited and failed to remit use tax due on clearly taxable items, primarily fixed assets, and has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer’s protest is denied.

DEPARTMENT OF STATE REVENUE

0420030044P.LOF

LETTER OF FINDINGS NUMBER: 03-0044P
Sales and 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 self-assess use tax on similar items as in a prior audit which consists of a company vehicle, product scanners, materials for equipment movement, maintenance items, and other miscellaneous purchases.

Taxpayer requests abatement of the penalty because it does not feel it was negligent in any of the instances in which tax was due on a purchase. In addition the majority of the items were capital assets that taxpayer believes are part of its production process.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer was audited for calendar years 1999, 2000, and 2001. Upon audit, it was discovered that the taxpayer failed to self assess use tax on clearly taxable items which were also issues in a prior audit.

Taxpayer states that the majority of the items considered taxable are capital assets that it feels are part of its production process and should be exempt. However, upon subsequent research by the auditor, taxpayer agreed that the auditor had a stronger case on treating these assets as “one step away from the production process.”

The hearing officer, in reviewing the audit, found many items that are not a part of the production process. These include items such as a company automobile, computer software licenses, forklifts to move equipment, outdoor lighting, product code scanners, and other miscellaneous items classified as fixed assets.

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 was previously audited and failed to remit use tax on clearly taxable items. Taxpayer failed to remit 40.43%, 49.40%, and 17.88% in use tax due for calendar years 1999, 2000, and 2001, respectively, and has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer’s protest is denied.

DEPARTMENT OF STATE REVENUE

0420030046P.LOF

LETTER OF FINDINGS NUMBER: 03-0046P
Use Tax
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, a retail merchant and commercial printer, produces and sells marketing materials, envelopes, cards, and other types of printed materials.

At audit it was determined that the taxpayer purchased cleaning supplies such as towels, mops, mats, soap, and other miscellaneous items and failed to self assess use tax even though it had a prior Letter of Findings denying the same issue. Taxpayer also failed to pay tax on publications and computer hardware.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that it does not agree with the Department's definition of the "printing production process and taxpayer maintains that cleaning supplies are an integral part of the printing process. The cleaning and maintaining of printing equipment was clearly a taxable issue in Taxpayer's Letter of Findings Number 04-970542.

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."

The taxpayer failed to remit tax on an issue that was previously denied and has not provided reasonable cause to allow a penalty waiver.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030047P.LOF

LETTER OF FINDINGS NUMBER: 03-0047P
Adjusted Gross Income Tax
For Calendar Ended December 31, 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 late payment of its income tax. The due date of the return was April 15, 2000. Taxpayer filed its return late with payment of forty-eight percent of its tax liability. The Department issued its late payment assessment on June 26, 2002.

Taxpayer filed a penalty and interest protest letter dated July 16, 2002 and states that it could not reasonably estimate its tax due to various prior acquisitions.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty and interest assessed and states that it was unable to reasonably estimate its Indiana apportionment factor at the initial due date of the return because of prior acquisitions.

Taxpayer did not make payment by the original due date of the return nor attempt to make a partial payment when it had property and payroll in the state of Indiana. Taxpayer had income from Indiana sources and failed to remit approximately forty-eight percent (48%) of its tax by the original due date of the return.

Taxpayer has not provided reasonable cause to allow the Department to waive the penalty and has no authority to waive interest.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030053P.LOF

LETTER OF FINDINGS NUMBER: 03-0053P
Income Tax
For Fiscal Ended August 31, 2000

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

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the proposed penalty assessments for the underpayment of estimated income tax and the late payment thereof. The due date of the return was December 15, 2000. Taxpayer filed its return late with payment of one hundred (100%) percent of its tax liability. The Department issued its late payment assessments on December 9, 2002.

Taxpayer's representative filed a penalty protest letter dated January 24, 2003 and states that it could not ascertain the facts that resulted in the penalty being imposed. Taxpayer is also unable to determine if those facts would constitute "reasonable cause" for abatement of the penalty but asks the Department to consider the new parent's history.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalties assessed and states that it could not ascertain the facts that resulted in the penalties being imposed.

Taxpayer did not make payment by the original due date which resulted in the late payment penalty. Payment for one hundred percent of the tax was made after the due date of the return on May 15, 2001.

Taxpayer also failed to make quarterly estimated payments although it had done so in prior years.

The penalties assessed are "pre-acquisition" penalties, therefore, irrelevant to the new parent's history.

Taxpayer has not provided reasonable cause to allow the Department to waive the penalties.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030059P.L0F

LETTER OF FINDINGS NUMBER: 03-0059P
Gross Income Tax
Fiscal Year Ended 09-30-2000

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

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

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was assessed a late payment penalty and a penalty for failing to remit estimated taxes. Taxpayer had a tax liability of $11, 339.84. Taxpayer requests an abatement of the penalties.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer states it changed its mailing address twice and went though an acquisition that involved significant changes in recordkeeping, as well as changes in personnel. As a result of those circumstances, and other factors, the company was not able to estimate its Indiana State tax liability until the 2000 year tax return was filed. Taxpayer paid the tax liability in full with the return and paid the interest on August 14, 2002. Taxpayer requests a penalty waiver on its account.

Taxpayer was assessed a penalty for the late payment of its income taxes which it remitted on September 17, 2001. The due date was January 15, 2001. Taxpayer has not provided reasonable cause to allow the waiver.

Taxpayer was also assessed a penalty for the underpayment of quarterly estimated taxes. Taxpayer made no attempt to pay quarterly taxes. The only payment on record is a carryover from a previous year that amounted to eight percent (8%) of the total 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 penalty waivers.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030060P.LOF

LETTER OF FINDINGS NUMBER: 03-0060P

Use Tax

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 previously audited and an agreement was signed that utilized a "Formulary Use Tax Treatment on Applicable Purchases". At audit, it was determined that the taxpayer failed to self assess and remit use tax for several accounts that were previously agreed upon to be included in calculating use tax due.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and contends that it acted in good faith, without negligence and with no intent to defraud the state. Taxpayer further states that it made every effort to be in compliance with Indiana sales and use tax laws which had been filed and paid timely.

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."

The taxpayer failed to remit use tax upon items that were clearly listed in an agreement between the taxpayer and the Indiana Department of Revenue. Taxpayer has not provided reasonable cause for the failure to allow the department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030061P.L0F

LETTER OF FINDINGS NUMBER: 03-0061P
Gross and Adjusted Gross Income Tax
Calendar Years 1997, 1998, and 1999

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

ISSUE(S)

I. Tax Administration – Penalty

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

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was audited and found to have placed its service income into low rate gross income that amounted to more than seventy-five percent (75%) of its gross income tax liability. Taxpayer requests an abatement of the penalty.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer states that it believed the low rate should be utilized to determine income tax due on the gross receipts because income derived from its business would be considered "selling at retail", pursuant to the requirements of 45 IAC 1-1-13.

Taxpayer provides educational programming to its customers via satellite or videotape formats. A set fee is paid for the training. Taxpayer's customer has its own equipment on its premises and receives the service by satellite.

Taxpayer misread 45 IAC 1-1-13 because he must meet all of the four standards. Information contained in the audit indicates the taxpayer's customer owns the equipment. Taxpayer charges a fee for its services and the income it received should have been reported at the high rate of tax.

Taxpayer was also assessed a penalty for the underpayment of quarterly estimated taxes. Taxpayer states that it overpaid quarterly estimate taxes in the beginning of that year. Taxpayer provided a copy of its Schedule IT-2220. The 2220, however, is for the return as filed, and not the audited figures. The audited figures indicate the taxpayer remitted less than ninety percent of the tax due.

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 failed to correctly tax its gross income at the high rate of tax. Taxpayer failed to assure that the tax returns were correctly filed and apparently failed to verify the tax rates, which is clearly negligent. The taxpayer has not provided reasonable cause to allow penalty waivers.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02970043.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0043SLOF
Indiana Corporation Income Tax
For the Tax Periods: 1990 through 1992

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

ISSUES

I. Indiana Gross Income Tax – Inter-company Sales

Authority: IC 6-2.1-2-2, IC 6-2.1-5-5, IC 6-2.1-4-6, IC 6-8.1-5-4

Taxpayer protests the Department's inclusion of inter-company sales in gross income.

II. Indiana Gross Income Tax – Proceeds from Asset Sales

Authority: I.R.C. § 338, I.R.C § 351, IC 6-2.1-2-2, IC 6-2.1-1-2, 45IAC 1-1-58, 45 IAC 1.1-6-2

Taxpayer protests the Department's inclusion of proceeds from asset sales in gross income.

III. Indiana Adjusted Gross Income Tax – State Income Tax

Taxpayer protests the amounts of state income tax used to calculate gross income tax.

IV. Indiana Adjusted Gross Income Tax – Federal Taxable Income Adjustment

Taxpayer protests the Department's federal taxable income adjustment.

V. Indiana Adjusted Gross Income Tax – Payments

Taxpayer protests certain payments that were not refunded.

VI. Indiana Gross Income Tax – Out-of-State Sales

Authority: IC 6-2.1-2-2, IC 6-2.1-3-3, 45 IAC 1-1-120

Taxpayer protests the Department's inclusion of certain wholesale sales in gross income.

STATEMENT OF FACTS

Taxpayer is an international corporation engaged in the production and distribution of computers and computer equipment. A re-hearing was granted to resolve several issues relating to a 1990 to 1992 corporate income tax audit. Taxpayer has provided the Department with additional information pertaining to the issues. This Letter of Findings is based upon the Department's discussion with taxpayer at hearings, the information contained in the file, taxpayer's written brief, and the auditor's extensive notes in response to issues raised in taxpayer's original protest. More facts will be supplied as necessary.

I. Indiana Gross Income Tax – Inter-company Sales

DISCUSSION

The auditor disallowed the deduction of unsubstantiated inter-company receipts for the audit years. Taxpayer states that certain receipts represented inter-company sales.

"An income tax, known as the gross income tax, is imposed upon the receipt of…the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2. Also, IC 6-2.1-5-5 states in relevant part:

(a) Corporations are affiliated if a least eighty percent (80%) of the voting stock of one (1) corporation (exclusive of directors' qualifying shares) is owned by the other corporation. Every corporation affiliated with another corporation is affiliated with every corporation that is affiliated with such other corporation. All corporations so affiliated constitute an affiliated group.

(b) Corporate members of an affiliated group that are incorporated in the state of Indiana or are authorized to do business in the state of Indiana may file a consolidated gross income tax return.

IC 6-2.1-4-6 states:

(a) Except as provided in subsections (b) and (c), each taxable year an affiliated group or corporations filing a consolidated return pursuant to IC 6-2.1-5-5 is entitled to a deduction from the gross income reported on such a return. The amount of the deduction equals the total amount of gross income received during the taxable year from transactions between members of the group that are incorporated or authorized to do business in Indiana.

(b) The deduction provided by this section does not apply to gross income received by a member of an affiliated group and derived from sources outside Indiana.

(c) The deduction provided by this section does not apply to gross income that is received by a member of an affiliated group in a distribution in connection with the dissolution of any other member of the affiliated group.

Also, IC 6-8.1-5-4(a) states that "[e]very person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records."

Taxpayer provided a spreadsheet to demonstrate where the figures they used for the returns originated. However, the deduction was disallowed because the figures were unsubstantiated. Taxpayer has not provided any documentation to verify the amounts used on the spreadsheet are correct.

FINDING

Taxpayer's protest is denied.

II. Indiana Gross Income Tax – Proceeds from Asset Sales

DISCUSSION

During the audit, the auditor picked up additional receipts from the sale of fixed assets for 1991. The total adjustment is made up of two items: A drop-down of assets to a subsidiary corporation and an Indiana apportioned gain from an I.R.C. § 338(h)(10) disposition gain on fixed assets.

Gross income tax is imposed on the taxable gross income of a non-domiciliary or non-resident of Indiana if the income is derived from activities or sources within Indiana. IC 6-2.1-2-2. Gross income is defined in IC 6-2.1-1-2(a)(3) as gross receipts received "from the sale, transfer, or exchange of property, real or personal, tangible or intangible…."

First, Taxpayer contends that the auditor incorrectly included contributions of capital in receipts from a drop-down of assets to a subsidiary corporation. 45 IAC 1-1-58 states: "Contributions of capital to a corporation, joint venture or partnership are exempt from gross income tax. No gross receipts result to the recipient of the capital and none result to the donee upon his receipt of stock in exchange for the capital." Taxpayer notes this section is consistent with I.R.C. § 351 and contends that only a percentage of the gain which is in excess of the property exchanged for the stock is taxable. I.R.C. § 351 states in relevant part:

(a) General Rule.- No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation.

(b) Receipt of Property. – If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock permitted to be received under subsection (a). other property or money, than-

(1) gain (if any) to such recipient shall be recognized, but not in excess of-

(A) the amount of money received, plus

(B) the fair market value of such other property received; and

(2) no loss to such recipient shall be recognized.

….

Based on the information used to make the adjustment, sixty two percent (62%) of the realized gain was taxable pursuant to I.R.C. § 351(b). Consequently, this reduces the apportioned gross proceeds taxable by Indiana.

Second, Taxpayer asserts that the auditor included proceeds relating to an I.R.C. § 338(h)(10) transaction. I.R.C. § 338 states in relevant parts:

(a) GENERAL RULE. – For purposes of this subtitle, if a purchasing corporation makes an election under this section (or is treated under subsection (e) as having made such an election), then, in the case of any qualified stock purchase, the target corporation—

(1) shall be treated as having sold all of its assets at the close of the acquisition date at fair market value in a single transaction, and

(2) shall be treated as a new corporation which purchased all of the assets referred to in paragraph (1) as of the beginning of the day after the acquisition date.

…

(h) ELECTIVE RECOGNITION OF GAIN OR LOSS BY TARGET CORPORATION, TOGETHER WITH NONRECOGNITION OF GAIN OR LOSS ON STOCK SOLD BY SELLING CONSOLIDATED GROUP.

(A) IN GENERAL.- Under regulations prescribed by the Secretary, an election may be made under which if-

(i) the target corporation was, before the transaction, a member of the selling consolidated group, and

(ii) the target corporation recognizes gain or loss with respect to the transaction as if it sold all of its assets in a single transaction,

then the target corporation shall be treated as a member of the selling consolidated group with respect to such sale, and (to the extent provided in regulations) no gain or loss will be recognized on stock sold or exchanged in the transaction by members of the selling consolidated group….

However, in accordance with IC 6-2.1-1-2, the transaction is taxed as a stock sale. Nevertheless, 45 IAC 1.1-6-2(*formerly* 45 IAC 1-1-51) states in part:

(c) Receipts derived from an intangible are not included in gross income under the following situations:

(1) The intangible forms an integral part of:

(A) a trade or business situated and regularly carried on at a business situs outside Indiana; or

(B) activities incident to such trade or business.

(2) The intangible does not form an integral part of a trade or business situated and regularly carried on at a business situs in Indiana, and the taxpayer's commercial domicile is located outside Indiana.

(3) The receipts from the intangible or otherwise excluded from gross income under IC 6-2.1-1-2 or 45 IAC 1.1-3-3(c)(7).

(d) In determining whether an intangible forms an integral part of a trade or business or activities incident thereto under subsection (c), it is the connection of the intangible itself to such trade or business or activities incident thereto under subsection (c), it is the connection of the intangible itself to such trade or business or activities incident thereto that is the controlling factor. The physical location of the evidence of the intangible (share of stock, bond, etc.) is not a controlling factor. Also, any activities related to the sale of an intangible occur after the fact and are never determinative….

The stock does not form an integral part of trade or business regularly carried on at a business situs in Indiana. As such, it is not subject to the Indiana gross income tax.

FINDING

Taxpayer's protest is sustained.

III. Indiana Adjusted Gross Income Tax – State Income Tax

DISCUSSION

Taxpayer protests the Department's addback of certain state taxes during the audit. Taxpayer argues that certain tax amounts were added back that were not based on income. Taxpayer subsequently provided documentation dated January 10, 1997 which providing a description on the amounts to be used for the addback. Therefore, the audit should be adjusted to reflect these figures upon verification.

FINDING

Taxpayer's protest is sustained subject to audit verification.

IV. Indiana Adjusted Gross Income Tax – Federal Taxable Income Adjustment

DISCUSSION

Taxpayer protests an adjustment made to federal taxable income on its consolidated federal tax return. Taxpayer disputes the figure the auditor determined to be Taxpayer's 1992 Adjusted Federal Taxable income. The original adjustment was based on information supplied by Taxpayer during the audit. Taxpayer subsequently submitted a schedule that reconciled the variance in income between the federal schedules and that reported to Indiana. Taxpayer's protest is sustained.

FINDING

Taxpayer's protest is sustained.

V. Indiana Adjusted Gross Income Tax – Payments

DISCUSSION

Taxpayer protests a payment that was not credited toward its Indiana Corporate Income Tax. During the audit, the auditor relied on departmental records in calculating the credits. Although workpapers attached to the original return indicate Taxpayer was entitled to a refund, the Department has no record of the refund ever being sent to Taxpayer. Consequently, Taxpayer should receive credit.

FINDING

Taxpayer's protest is sustained.

VI. Indiana Gross Income Tax – Out-of-State Sales

DISCUSSION

Taxpayer is an out-of-state corporation who maintains sales offices and a repair facility in Indiana. Taxpayer sold personal computers and related hardware and software to Company A, an out-of-state corporation, who maintained a warehouse in Indiana. Taxpayer shipped these computers from an out-of-state location to Company A's Indiana warehouse. The auditor disallowed Taxpayer's exemption for these sales because Taxpayer did not provide sufficient information to show that these sales were in fact exempt.

Gross income tax is imposed upon "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a)(2). If the gross income is derived from business commerce between Indiana and another state, it is exempt from the gross income tax to the extent Indiana is prohibited from taxing that income by the United States Constitution. IC 6-2.1-3-3. Consequently, gross income "is not subject to the Indiana income tax unless the seller was engaged in business activity within the State and such activity was connected with or facilitated the sales". 45 IAC 1-1-120.

45 IAC 1-1-120(1)(b) describes a nontaxable in-shipment as:

> Sales made by a nonresident who has a business situs or business activities within the State, but the situs or activities are not significantly associated with the sales, and the goods are shipped directly to the buyer upon receipt of a prior order... This situation arises most frequently…where a seller's home office, which is located outside Indiana, handles the accounts of some Indiana customers as "house accounts", instead of having such customers served by its in-state employees. For the sales to be considered as nontaxable under this rule, they must be initiated, negotiated and serviced by out-of-state personnel, and contact with the Indiana business situs or with employees operating within the state must be no more than incidental.

Taxpayer has provided evidence that these sales were not connected with or facilitated by their Indiana business activity. Rather, they claim that the sales were handled as a "house account" by one of Taxpayer's out-of-state offices dealing directly with Company A's out-of-state office. Also, payments to Taxpayer were not paid by Company A from Indiana and were not received at Taxpayer's Indiana offices. Contracts executing the sale of products were executed out-of-state. Taxpayer's out-of-state office maintained a team of six to eight people who were responsible for all sales, marketing programs and inventory management for Company A. Taxpayer established that all products sold to Company A were manufactured and stored out-of-state. Consequently, Taxpayer's protest with regards to this issue is sustained.

FINDING

Taxpayer's protest is sustained.