INDIANA STATE BOARD OF ANIMAL HEALTH

Under IC 4-22-7-7, the Indiana State Board of Animal Health is publishing this notice of the following publications used to interpret, supplement, or implement agency statutes and rules governing dairy products (IC 15-2.1-24).

Number	Title	Date Originally Published	Date Revised	Other Policies Affected	Subject Matter
DNPD-01	Board of Animal Health Policy on Drug Residue Monitoring Enforcement, 2-01-96	03/01/97 21 IR 1670	Repealed 5/18/98		
DNPD-02	Methods of Making Sanitation Ratings of Milk Supplies, 1995	03/01/97 21 IR 1669			Sanitation inspections of dairy facilities.
DNPD-03	Sanitation Compliance and Enforcement Ratings of Interstate Milk Shippers, 1996	03/01/97 21 IR 1669			Interstate milk shipments sanitation ratings.
DNPD-04	Procedures governing the Cooperative State-Public Health Service/Food and Drug Administration Program for Certification of Interstate Milk Shippers, 1993	03/01/97 21 IR 1669			Joint state/U.S. Food and Drug Administration milk shipper certification procedures.
DNPD-05	Milk and Dairy Beef Residue Prevention Protocol, 1995	03/01/97 21 IR 1669			Drug residue prevention compilation.
DNPD-06	3-A Accepted Practices for the Design, Fabrication and Installation of Milk Handling Equipment	03/01/97 21 IR 1669	Repealed		
DNPD-07	FDA Guide to Inspections of Dairy Product Manufacturers, 1995	03/01/97 21 IR 1669			Milk manufacturing facility inspection guidelines.
DNPD-08	Standards for the Fabrication of Single Service containers and closures for Milk and Milk Products, 1993	03/01/97 21 IR 1670			Milk container standards.
DNPD-09	Standard Methods for the Examination of Milk Products	03/01/97 21 IR 1670			Milk evaluation procedures.
DNPD-10	Evaluation of Milk Laboratories, 1995	03/01/97 21 IR 1670			Milk laboratory evaluation procedures.
DNPD-11	2400 Series Milk Laboratory Evaluation Procedures, 1995	03/01/97 21 IR 1670	06/01/98		Milk laboratory evaluation procedures.
DNPD-12	On-site Water Supply and Wastewater Disposal for Public and Commercial Establishments (ISDH Bulletin S.E. 13)	03/01/97 21 IR 1670			Water supply and disposal system design standards.
DNPD-13	FDA Investigation Operations Manual (1996)	03/01/97 21 IR 1670			A guide for investigation procedures.
DNPD-14	FDA Compliance Policy Guides (1996)	03/01/97 21 IR 1670			Guidelines for interstate milk policy.
DNPD-15	USDA DA Instruction 918-PS; Instructions for dairy plant surveys (1997)	03/01/97 21 IR 1670			Guidelines for dairy plant survey inspections.
DNPD-16	Manufacturing Grade Dairy Plant Extended Run Qualification Guidance Document (2000)		Adopted 2000		Guidelines for compliance with 345 IAC 8-2-2.5

The following 3-A standards and 3-A accepted practices establish criteria for the sanitary construction and operation of dairy processing equipment that the Board of Animal Health may use in interpreting or establishing dairy processing requirements. The standards are published jointly by the International Association of Milk, Food and Environmental Sanitarians, Inc., and the Food and Drug Administration, Public Health Service, United States Department of Health and Human Services. The Board utilizes the latest edition of each publication.

Number	Title	Date Originally Published	Date Revised	Other Policies Affected	
DNPD-17	3-A Sanitary Standards for Storage Tanks for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-18	3-A Sanitary Standards for Centrifugal and Positive Rotary Pumps for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-19	3-A Sanitary Standards for Homogenizers and Pumps of the Plunger Type	03/01/97 21 IR 1670			
DNPD-20	3-A Sanitary Standards for Stainless Steel Automotive Milk and Milk Products Transportation Tanks for Bulk Delivery and/or Farm Pick-Up Service	03/01/97 21 IR 1670			
DNPD-21	3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products, as amended, Parts I and II (rev.)(Fittings and Plug Type Valves)	03/01/97 21 IR 1670			
DNPD-22	3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products, as amended, Parts I and II (rev.) (Automatic Positive Displacement Sampler.	03/01/97 21 IR 1670			
DNPD-23	3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products, as amended, Parts I and II (rev.)(Inlet and Outlet Leak-Protector Type Valves)	03/01/97 21 IR 1670			
DNPD-24	3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products, as amended, Parts I and II (rev.)(Tank Outlet Valves)	03/01/97 21 IR 1670			
DNPD-25	3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk products, as amended, Parts I and II (rev.) (Rupture Discs)	03/01/97 21 IR 1670			

DNPD-26	3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products (Thermoplastic Plug Type Valves)	03/01/97 21 IR 1670			
DNPD-27	3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products (rev.)(Steam Injection Heaters)	03/01/97 21 IR 1670			
DNPD-28	3-A Sanitary Standards for Hose Assemblies for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-29	Rescinding Amendments to 3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines conducting Milk and Milk Products, Part I and Part II (rev.)	03/01/97 21 IR 1670			
DNPD-30	Amendments to 3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products (Fittings & Plug Type Valves)	03/01/97 21 IR 1670			
DNPD-31	Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products (Compression Type Valves)	03/01/97 21 IR 1670			
DNPD-32	3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines conducting Milk and Milk Products (Diaphragm Type Valves)	03/01/97 21 IR 1670			
DNPD-33	3-A Sanitary Standards for Fittings used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products (Boot-Seal Type Valves)	03/01/97 21 IR 1670			
DNPD-34	Part One of the 3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-35	Rev. Amendments to 3-A Sanitary Standards for Fittings Used on Milk and Milk Products Equipment and Used on Sanitary Lines Conducting Milk and Milk Products, #08-20Rev.	03/01/97 21 IR 1670			
DNPD-36	3-A Sanitary Standards for Instrument Fittings and Connections Used on Milk and Milk Products Equipment, Parts I and II	03/01/97 21 IR 1670			
DNPD-37	Part One of the 3-A Sanitary Stan-	03/01/97			

	dards for Sensors and Sensor Fitting and Connections Used on Milk and Milk Products Equipment	21 IR 1670			
DNPD-38	3-A Sanitary Standards for Milk and Milk Products Filters Using Disposable Filter Media	03/01/97 21 IR 1670			
DNPD-39	3-A Sanitary Standards for Plate Type Heat Exchangers for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-40	3-A Sanitary Standards for Tubular Heat Exchangers for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-41	3-A Sanitary Standard for Farm Milk Cooling and Holding Tanks	03/01/97 21 IR 1670			
DNPD-42	3-A Sanitary Standards for Milk and Milk Products Evaporators and Vacuum Pans	03/01/97 21 IR 1670			
DNPD-43	3-A Sanitary Standards for Fillers and Sealers of Single-Service Containers for Milk and Fluid Milk Products	03/01/97 21 IR 1670			
DNPD-44	3-A Sanitary Standards for Multiple-Use Rubber and Rubber-Like Materials Used as Product Contact Surfaces in Dairy Equipment	03/01/97 21 IR 1670			
DNPD-45	3-A Sanitary Standards for Batch and Continuous Freezers for Ice Cream, Ices and Similarly Frozen Dairy Foods	03/01/97 21 IR 1670			
DNPD-46	3-A Sanitary Standards for Multiple-Use Plastic Materials Used as Product Contact Surfaces for Dairy Equipment	03/01/97 21 IR 1670			
DNPD-47	3-A Sanitary Standards for Silo-Type Storage Tanks for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-48	3-A Sanitary Standards for Equipment for Packaging Frozen Desserts, Cottage Cheese, and Similar Dairy Products	03/01/97 21 IR 1670			
DNPD-49	3-A Sanitary Standards for Non-Coil Type Batch Pasteurizers for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-50	3-A Sanitary Standards for Non-Coil Type Batch Processors for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-51	3-A Sanitary Standards for Sifters for Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-52	3-A Sanitary Standards for Equipment for Packaging Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-53	3-a Sanitary Standards for Flow Meters for Milk and Liquid Milk Products	03/01/97 21 IR 1670			
DNPD-54	3-A Sanitary Standards for Air Eliminators for Milk and Fluid Milk Products	03/01/97 21 IR 1670			
DNPD-55	3-A Sanitary Standards for Farm Milk	03/01/97			

	Storage Tanks	21 IR 1670			
DNPD-56	3-A Sanitary Standards for Scraped Surface Heat Exchangers	03/01/97 21 IR 1670			
DNPD-57	3-A Sanitary Standards for Uninsulated Tanks for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-58	3-A Sanitary Standards for Polished Metal Tubing for Dairy Products	03/01/97 21 IR 1670			
DNPD-59	3-A Sanitary Standards for Portable Bins for Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-60	3-A Sanitary Standards for Continuous Blenders	03/01/97 21 IR 1670			
DNPD-61	3-A Sanitary Standards for Colloid Mills	03/01/97 21 IR 1670			
DNPD-62	3-A Sanitary Standards for Pressure and Level Sensing Devices	03/01/97 21 IR 1670			
DNPD-63	3-A Sanitary Standards for Cottage Cheese Vats	03/01/97 21 IR 1670			
DNPD-64	3-A Sanitary Standards for Pneumatic Conveyors for Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-65	3-A Sanitary Standards for Bag Collectors for Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-66	3-A Sanitary Standards for Mechanical Conveyors for Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-67	3-A Sanitary Standards for In-Line Strainers for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-68	3-A Sanitary Standards for Wet Collectors for Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-69	3-A Sanitary Standards for Air Driven Diaphragm Pumps for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-70	3-A Sanitary Standards for Crossflow Membrane Modules	03/01/97 21 IR 1670			
DNPD-71	3-A Sanitary Standards for Refractometers and Energy Absorbing Optical Sensors for Milk and Milk Products	03/01/97 21 IR 1670			
DNPD-72	3-A Sanitary Standards for Air Driven Sonic Horns For Dry Milk Products	03/01/97 21 IR 1670			
DNPD-73	3-a Sanitary Standards for Level Sensing Devices for Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-74	3-A Accepted Practices for the Sanitary Construction, Installation, Testing and Operation of High-Temperature Short-Time and Higher Heat Shorter Time Pasteurizer Systems	03/01/97 21 IR 1670			
DNPD-75	3-A Accepted Practices for Supplying Air Under Pressure in Contact With Milk, Milk Products and Product Contact Surfaces	03/01/97 21 IR 1670			

DNPD-76	3-A Accepted Practices for Permanently Installed Product and Solution Pipelines and Cleaning Systems Used in Milk and Milk Product Processing Plants	03/01/97 21 IR 1670			
DNPD-77	3-A Accepted Practices for the Design, Fabrication and Installation of Milking and Milk Handling Equipment	03/01/97 21 IR 1670			
DNPD-78	3-A Accepted Practices for Milk and Milk Products Spray Drying Systems	03/01/97 21 IR 1670			
DNPD-79	3-A Accepted Practices for Instantizing Systems for Dry Milk and Dry Milk Products	03/01/97 21 IR 1670			
DNPD-80	3-A Accepted Practices for a Method of Producing Steam of Culinary Quality	03/01/97 21 IR 1670			
DNPD-81	3-A Accepted Practices for the Sanitary Construction, Installation and Cleaning of Crossflow Membrane Processing Systems for Milk and Milk Products	03/01/97 21 IR 1670			

INDIANA STATE BOARD OF ANIMAL HEALTH

Under IC 4-22-7-7, the Indiana State Board of Animal Health publishes this notice of the following publications used to interpret, supplement, or implement agency statutes and rules governing meat and poultry products (IC 15-2.1-24).

ID Number	Title	Date Originally Published	Date Revised	Other Policies Repealed or Amended
MNPD-01	Meat and Poultry Inspection Manual, July 1, 1997	09/01/97 21 IR 3524	No longer used	
MNPD-02	Labeling Policy Book	09/01/97 21 IR 3524		
MNPD-03	Meat and Poultry Sanitation Handbook	09/01/97 21 IR 3524	No longer used	
MNPD-04	FSIS Directive 7220.1, Standards and Labeling Policy Memoranda	09/01/97 21 IR 3524		
MNPD-05	SBOAH Meat and Poultry Division, MPI Bulletins; USDA - FSIS Directives	09/01/97 21 IR 3524		
MNPD-06	Indiana Red Meat Slaughtering and/or Processing Plants, Indiana Red Meat Processing Plants, and Indiana Poultry Slaughtering and/or Processing Plants - A Guide to Construction, Operations, and Sanitation	09/01/97 21 IR 3524		
MNPD-07	Ratitae Slaughter Inspection Training Guide	09/01/97 21 IR 3524		
MNPD-08	Performance Based Inspection System - Reference Guide	09/01/97 21 IR 3524		
MNPD-09	9 CFR 352 Exotic Animals; Voluntary Inspection	09/01/97 21 IR 3524		
MNPD-10	USDA - FSIS List of Proprietary Substances and Nonfood Compounds (Publication No. 1419)	09/01/97 21 IR 3524	No longer used.	

INDIANA DEPARTMENT OF INSURANCE
July 29, 2003
Bulletin 118
Filing of Proof of Financial Responsibility with and
Payment of Surcharge to the Indiana Patient's Compensation Fund

This bulletin is addressed to all insurers, risk managers and surplus lines agents that collect and remit surcharge payments under Indiana's Medical Malpractice Act (Act) to the Patient's Compensation Fund (PCF). The Commissioner of the Indiana Department of Insurance is charged with administering the provisions of the Act. It has come to the Commissioner's attention that there is some confusion concerning penalties applicable to delinquent surcharge payments. This Bulletin is intended to clarify existing standards that are already in effect.

Pursuant to IC 34-18-5-3, the insurer, risk manager or surplus lines agent (hereinafter collectively referred to as "insurer") shall collect the surcharge due to the PCF. The surcharge is due to the PCF within thirty (30) days after the premium for the insurance coverage has been received by the insurer. In reviewing this issue the Department will presume that premium was received by the insurer no later than the effective date of the policy. If the surcharge is remitted to the PCF more than thirty (30) days after receipt by the insurer, the insurer is liable for a penalty equal to ten percent (10%) of the amount of surcharge.

A health care provider's status as a qualified health care provider may begin on the first date of coverage under the insurance policy if the PCF receives proof of financial responsibility and the surcharge not later than ninety (90) days after the effective date of the policy. If these items are received by the PCF more than ninety (90) days but not later than one hundred eighty (180) days after the policy effective date, the health care provider's qualification may begin on the effective date of the policy only if the insurer demonstrates to the satisfaction of the Commissioner that the surcharge was timely paid to the insurer and the insurer erred in not forwarding the surcharge to the PCF within ninety (90) days of the policy's effective date. *See* IC 34-18-3-5. In such instances the insurer must submit a request in writing to the Commissioner for an affirmative exercise of this discretion. Such request should be accompanied by documentation indicating the date the insurer received the surcharge payment from the health care provider.

If the Commissioner is satisfied that the conditions have been met for qualification to begin on the effective date of the policy, a progressive penalty for late payment is assessed. For a surcharge that is remitted ninety-one (91) to one hundred twenty (120) days after the policy's effective date a penalty in the amount of ten percent (10%) of the surcharge is owed to the PCF; a twenty percent (20%) penalty is due to the PCF if the surcharge is remitted after one hundred twenty (120) days but before one hundred fifty (150) days; and a penalty of fifty percent (50%) is due to the PCF for surcharge remitted from one hundred fifty (150) days to one hundred eighty (180) days after the policy effective date. If surcharge is received later than one hundred eighty (180) days after the policy effective date, the health care provider begins his/her status as qualified under the Act on the date the surcharge is received by the PCF.

The penalties discussed above are independent of one another. There may be instances where an insurer owes one or both of these penalties. Neither penalty may be used to offset, abate or mitigate the other penalty. The penalties are assessed against the insurer and may not be passed on to the health care provider.

The following are two illustrations:

(1) An insurer receives the surcharge from a health care provider and does not remit the surcharge to the PCF for forty-five (45) days. The insurer shall remit to the PCF the surcharge as well as a penalty of ten percent (10%) of the surcharge amount. The health care provider is qualified under the Act beginning the first day of the insurance policy.

(2) An insurer receives surcharge from a health care provider and does not remit the premium for one hundred (100) days. The insurer has jeopardized the health care provider's ability to coordinate its status as a qualified health care provider with its primary insurance coverage. If the insurer can show that the health care provider paid surcharge to the insurer in a timely fashion and that it was the insurer that failed to remit the surcharge to the PCF, the Commissioner has the discretion to find the surcharge to be timely and may begin the health care provider's status as a qualified health care provider on the effective date of the insurance policy rather than the date the surcharge was received. However, the insurer must remit the surcharge as well as a penalty in the amount of ten percent (10%) of the surcharge amount under IC 34-18-3-5(c). In addition, the insurer owes an additional penalty of ten percent (10%) of the surcharge amount under IC 34-18-5-3(b) for failing to forward the surcharge to the PCF within thirty (30) days of receipt.

The Commissioner is hereby directing all insurers that collect and remit surcharge payments to the PCF to review coverage for health care providers with effective dates of July 1, 2002, through the present. If any insurer failed to pay the appropriate penalties for untimely payment of surcharge the insurer shall file by October 1, 2003, a report detailing the instances where a penalty should have been remitted and was not. The report shall include the provider's name, the amount of the provider's surcharge, the policy number and the penalty amount and shall be accompanied by payment of the amounts in arrears. Any insurer that complies with this reporting and payment requirement by October 1, 2003, will not be subject to enforcement action by the Department of Insurance. An insurer that does not make payment by October 1, 2003, and is found to have failed to remit the penalties required by IC 34-18-3-5(b) or IC 34-18-5-3(c) may be subject to enforcement action.

INDIANA DEPARTMENT OF INSURANCE
Sally McCarty, Commissioner

INDIANA DEPARTMENT OF INSURANCE
July 29, 2003
Bulletin 119
Indiana Patient's Compensation Fund – Filings

This bulletin is directed to all insurers that provide coverage to health care providers under Indiana's Medical Malpractice Act. Bulletin 30 and Bulletin 68 are hereby withdrawn and replaced by this Bulletin 119.

Pursuant to IC 34-18-3-2 a health care provider may qualify under the Indiana Medical Malpractice Act by filing with the Department of Insurance proof of financial responsibility and payment of a surcharge to the Indiana Patient's Compensation Fund. Attached to this Bulletin as Exhibit A is the certificate that shall be used when filing proof of financial responsibility with the Patient's Compensation Fund.

IC 34-18-9 contains reporting requirements that currently are not being completed by insurers. These reports are necessary for the successful protection, defense and operation of the Patient's Compensation Fund.

IC 34-18-9-2 requires the health care provider's insurer to provide written notice, within thirty (30) days, of the filing of an action under IC 34-18-8-6 (action seeking payment for damages not greater than $15,000) and the final disposition of the action.

IC 34-18-9-3(a) states that the health care provider's insurer shall notify the Insurance Commissioner of any malpractice case upon which the insurer has placed a reserve of at least fifty thousand dollars ($50,000) for occurrences of malpractice before July 1, 1999, or one hundred twenty-five thousand dollars ($125,000) for occurrences of malpractice on or after July 1, 1999. Attached to this Bulletin as Exhibit B is the form to be used for reporting this information to the Patient's Compensation Fund.

IC 34-18-9-3(b) requires the health care provider's insurer or risk manager to report to the department all claims settled or adjudicated to final judgment against the health care provider. The report shall be made within sixty (60) days after the final disposition and shall include the following:

(1) The nature of the claim;
(2) The damages asserted and the alleged injury;
(3) The attorney's fees and expenses incurred in connection with the claim or defense; and
(4) The amount of the settlement or judgment.

Attached to this Bulletin as Exhibit C is the form to be used for reporting this information to the Patient's Compensation Fund.

INDIANA DEPARTMENT OF INSURANCE
Sally McCarty, Commissioner

EXHIBIT A
CERTIFICATE OF INSURANCE

			Surcharge	Effective Date
TO: INDIANA PATIENT'S COMPENSATION FUND				
MEDICAL MALPRACTICE DIVISION	Cancellation:	☐	$________	______________
311 W. WASHINGTON ST. STE.300	Return/Additional Surcharge	☐	$________	______________
INDIANAPOLIS, IN 46204-2787	Credit	☐	_______%	______________

Policy No.:	Occurrence Claims Made Reporting Endors.	☐ ☐ ☐	 Retro Date _______________ Retro Date _______________
Health Care Provider: Medical License No.:	Including employees ☐	Excluding employees ☐	
Address (Street, City, State, Zip):	County:		

<table>
<tr><td colspan="2">Coverage Dates:

From: _______________ To: ________________</td><td>Classification Number:</td></tr>
<tr><td>Limits of Liability

$________________ per occurrence</td><td>

$________________annual aggregate</td><td>Premium Amount:

Surcharge Amount:

Penalty Amount:</td></tr>
<tr><td colspan="3">The undersigned Insurance Company hereby certifies limits of liability on behalf of the above referenced Health Care Provider two hundred fifty thousand ($250,000) dollars for each occurrence and with an annual aggregate of seven hundred fifty thousand ($750,000) dollars as required, unless otherwise mandated by statute, for claims against said Health Care Provider as a result of Medical Malpractice, or allegation thereof, within the State of Indiana, and further that said policy of insurance complies in all respects with the provisions of the Indiana Medical Malpractice Act, Indiana Code 34-18-1-1 et seq.

It is further certified that the surcharge for the above referenced coverage for the period specified in this policy is at the appropriate Class rate for the named specialty, is based upon the published calculation for a hospital, or is one hundred percent (100%) of the premium for non-physician or non-hospital providers. Said Company also agrees to collect and remit the rated surcharge or a minimum surcharge of one hundred ($100.00) dollars, whichever is larger, for each year of the period of coverage to the Department of Insurance, Patient's Compensation Fund, State of Indiana, within thirty (30) days and not more than ninety (90) days from the effective date of said policy.

It is further acknowledged that in the event of termination of the policy herein certified, or any reduction of liability limit, such termination or change shall not be effective unless notice of same has been delivered to the Department of Insurance, State of Indiana, not less than thirty (30) days prior to such change. Notice shall be considered to have been given upon placing same in the United States Mail by First Class Certified Mail, a copy of which shall have been mailed to the health care provider.

Dated this ____ day of _________________, 20___ at the insurance office of ____________________________________

Signed by: _____________________________________
Authorized Signature
Printed: _______________________________________
Title: ____</td></tr>
</table>

EXHIBIT B
Indiana Patients' Compensation Fund
RESERVE NOTIFICATION
IC 34-18-9-3(a)
(Notice of cases with reserves of $50,000 or more through July 1, 1999, and cases with reserves of $125,000 July 1, 1999, forward)

Policy #	Date of Loss	Insured	Plaintiff's Name	Reserve

EXHIBIT C
Indiana Patients' Compensation Fund
SETTLEMENT NOTIFICATION
IC 34-18-9-3(b)

Policy #	Date of Loss	Insured	Plaintiff's Name	Damages Asserted and Alleged Injury	Settlement	Nature of Claim	Attorney Fees & Expenses

INDIANA DEPARTMENT OF INSURANCE
August 8, 2003
Bulletin 120
PATIENT'S COMPENSATION FUND – SURCHARGE RATES FOR HOSPITALS AND PHYSICIANS

This bulletin is directed to all health care providers electing to be qualified under Indiana's Medical Malpractice Act (IC 34-18-1-1 et seq.) and to insurers that provide coverage to those health care providers. Bulletin 91 and Bulletin 101 are withdrawn and replaced by this Bulletin 120.

Pursuant to IC 34-18-5-2, the Commissioner of the Department of Insurance in her capacity as administrator of the Patient's Compensation Fund hereby notifies physicians and hospitals of the following surcharge for qualification under the Medical Malpractice Act. The rates are the result of a detailed actuarial review and are effective for coverage beginning **August 15, 2003**. While these increases are significant, the surcharge rates have not been increased since July 1, 1999, and the Commissioner feels it is necessary to implement these new rates on August 15, 2003. Directions for implementing the surcharge on the effective date will appear on the Department's website (www.in.gov/idoi) beginning August 11, 2003.

PHYSICIANS

The percentage increase to the physician rates is the same for each specialty class. A complete list of physician specialty class codes is published at 760 IAC 1-60.

CLASS	ANNUAL RATE
0	$2,334
1	3,112
2	4,357
3	5,602
4	7,002
5	9,336
6	14,004
7	21,784
8	26,452

HOSPITALS

The surcharge for a hospital is calculated using the attached worksheet. The completed worksheet shall be submitted to the Department along with the surcharge payment.

INDIANA DEPARTMENT OF INSURANCE
Sally McCarty, Commissioner

HOSPITAL EXPOSURE WORKSHEET FOR SURCHARGE CALCULATION

Name of Hospital:
License No:

List all facilities and/or services operated under the hospital license (as identified on the Department of Health Application for License to Operate a Hospital):

CATEGORY	EXPOSURE	MANUAL	TOTAL
Provide # of Beds			Category x Manual = Total
	Hospital (Acute care and Intensive Care)	523.00	
	Mental Health/Rehabilitation	262.00	
	Extended Care/Intermediate Care/Residential	26.00	
	Nursing Home/Critical Extended Care	262.00	
	Health Institution/Assisted Living/Other	105.00	
	Bassinets	523.00	
# of Visits (in 100s)			
	Emergency Room	52.30	
	Clinics/Others	26.15	
	Mental Health/Rehabilitation	13.08	
	Health Institution	10.46	
	Home Health Care	26.15	
Provide # of Surgeries/Births (in 100s)			
	Births	2,092.00	
	Outpatient Surgeries	52.30	
	Inpatient Surgeries	1,046.00	
Employed Physicians Sharing Limits	50% of Specialty Class Code		
		SUB-TOTAL	
	Lack of Risk Management Program	10% Penalty x sub-total	
	Hospital with > 500 beds	3% multiplier of subtotal	
		TOTAL DUE	

DEPARTMENT OF STATE REVENUE

49-98000001.LOF

LETTER OF FINDINGS NUMBER: 98-000001
Indiana Solid Waste Disposal Fee
For the Period 1994-1995

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. Solid Waste Disposal Fee – Estoppel

Authority: 45 IAC 15-3-2; West Pub. Co. v. Indiana Department of Revenue, 524 N.E.2d 1329 (Ind.Tax 1988); Video Tape Exchange v. Ind. Dept. of State Revenue, 533 N.E.2d 1302 (Ind.Tax 1989); Walgreen Co. v. Gross Income Tax Division, 75 N.E.2d 784 (Ind. 1947).

Taxpayer protests the Department's assessment of the solid waste disposal fee.

II. Tax Administration – Penalty and Interest

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2; IC 6-8.1-10-1

The taxpayer protests the assessment of a negligence penalty and interest.

STATEMENT OF FACTS

The taxpayer was the operator of a solid waste landfill (when necessary, hereinafter referred to as City of X Sanitary Landfill). The landfill was owned by an Indiana city (hereinafter referred to as "City X").

I. Solid Waste Disposal Fee – Estoppel

DISCUSSION

The taxpayer states that it operated the landfill at the "specific request of and as a favor to the then Mayor of [City X] … from November 1994 until December 1995." The taxpayer further states the following:

- Taxpayer was requested by the Mayor to operate the landfill "due to emergency circumstances resulting from the indictment of the prior operator on various criminal charges related to the operation" of the landfill (thus leaving the landfill without an operator);
- That given the "immediate need of covering up the waste" and "other immediate actions," the taxpayer was "immediately behind in the various tasks necessary to properly operate" the landfill;

The taxpayer has two arguments regarding the solid waste disposal fee: (A) that the taxpayer relied on the alleged oral statements of a Department of Revenue employee (hereinafter John Doe) and therefore, per the taxpayer, the "Department should be estopped from recovering the assessments"; and (B) that the taxpayer "operated the landfill at the complete discretion of and direction of the Mayor, the assessments, if the same are found to stand, and any penalties, if not waived, and interest should be properly collected from the [City of X]…."

With regard to (A) above, the taxpayer states that it was erroneously instructed on how to fill out the SW-100 by John Doe. The taxpayer describes the timeline of events as follows. In January 1995 a letter (dated January 20, 1995, from John Doe, Special Tax Division of the Department of Revenue, and addressed to the City of X Sanitary Landfill) was received by the taxpayer. The letter stated that all solid waste final disposal facilities in Indiana had to file a SW-100 form by the tenth of each month. The letter noted that no SW-100 for November 1994 had been received by the Department. At this point, in order to explicate the taxpayer's argument, the following extensive quotations will be necessary:

> This was a new and unique issue for [the Taxpayer] since [Taxpayer] had just organized to operate the [City of X Sanitary Landfill]. In order to comply with the request in the letter from [John Doe], [Taxpayer's office manager] called [John Doe], on February 10, 1995, to explain that [Taxpayer] was just setting up a method of operation, that the Form SW-100 would be submitted soon and to obtain instruction on the completion of the Form SW-100 in anticipation of becoming fully compliant.

And:

> In a direct conversation with [Doe] on February 10, 1995, [Taxpayer's office manager] learned how to complete the Form SW-100 after [Doe] went through the Form SW-100, line-by-line ….

And further:

> …because of what seemed like odd wording in Line 1 of the Form SW-100, [Taxpayer's office manager] asked [Doe] whether Line 1 required an entry by tons or by units. [Doe] specifically advised [Taxpayer's office manager] that Line 1 of the Form SW-100 did not need to be completed and that only Line 2 needed completion since every vehicle coming in and out of the Landfill was weighed on a qualified scale by [Taxpayer], regardless of weight.

Finally, the taxpayer states that it—

> began reporting exactly as it was instructed by [Doe] and continued to report each month in good faith in the same manner until [the Mayor of City X] abruptly forced [Taxpayer] out of the [City of X Sanitary Landfill] when [Taxpayer] refused to accept a partner in the Landfill."

To buttress its case that the Department should be estopped, the taxpayer provides an affidavit by the office manager, and also telephone records that purport to establish that the office manager spoke with John Doe.

Before unpacking the elements of estoppel, it is worth noting that the alleged conversations between the office manager and John Doe were *oral*. That fact is salient because the Department's regulations state in part:

> *Oral* opinions or advice will *not* be binding upon the department. However, taxpayers may inquire as to whether or not the department will make a ruling or determination based on the facts presented by the taxpayer. If the taxpayer wishes a ruling by the department, the formal request must be in writing. A taxpayer may also *orally* receive technical assistance from the department in preparation of returns. However this advice is advisory only and is *not* binding in the latter examination of returns. (*Emphasis added*)

45 IAC 15-3-2(e). The Department's position is that since the alleged advice was oral (via telephone), the Department is not bound under 45 IAC 15-3-2(e). The taxpayer did not avail itself of the proper procedures for a binding opinion. That said, even if the Department accepted the taxpayer's facts *arguendo*, the taxpayer does not meet the elements of estoppel. In West Pub. Co. v. Indiana Dept. of Revenue, 524 N.E.2d 1329 (Ind.Tax 1988), the court cited the following necessary elements for estoppel:

(1) A representation or concealment of material facts;
(2) made with knowledge of the facts;
(3) and made to a party ignorant of the facts;
(4) which was made with the intention that the other party would act on it;
(5) which induces the other party to act.

Id. at 1334 (quoting State ex rel. Crooke v. Lugar, 354 N.E.2d 755 (Ind.App.1976)). 45 IAC 15-3-2(e) touches upon many of the elements of estoppel. For instance, it goes to element number (1) above. A representation was not made given the fact that the Department has made it publicly known (through the regulation) that oral statements by Departmental employees are not binding and should not be seen as binding. The taxpayer either knew of 45 IAC 15-3-2(e), or if it was not aware of it, then it was negligent (ignorance of Indiana's tax laws and regulations is negligence on the taxpayer's part). The regulation also goes to elements (4) and (5), since the office manager knew (or should have known) that "oral opinions or advice will not be binding on the department" yet claims that the oral opinion is what induced the taxpayer to not fill out line 1 of the SW-100. It is not, however, reasonable to believe that the taxpayer relied on John Doe's alleged oral statements. The Department, via 45 IAC 15-3-2, has in essence given advance notice to taxpayers that oral statements are not to be construed as representations nor should oral statements induce taxpayers to act. The purported oral statements by John Doe cannot change the fact that 45 IAC 15-3-2(e) clearly states that oral advice is not binding.

It also is unclear, even on a reading of the facts favorable to the taxpayer, whether the taxpayer was induced to act as required by element (5). In West the court noted that,

> [T]here is no evidence that West in any way changed its position in reliance on Hunt's [a state employee] letter. This is not a case where West paid the tax and then, upon reviewing Hunt's letter, ceased paying. On the contrary, West paid no tax before receiving the letter, and, until the Department initiated the present proceedings, West paid no tax after receiving the letter. There is nothing which indicates that, but for the letter, West would have paid the tax. In short, West has totally failed to demonstrate reliance.

West at 1334. In the present case the taxpayer was not filling out the SW-100 prior to the letter from John Doe. After the purported telephone conversations with John Doe (beginning on February 10, 1995) the taxpayer was still not filling out line 1 on SW-100. That is to say, before the February 10, 1995, telephone call line 1 of the SW-100 was not filled out; after the telephone calls line 1of the SW-100 was not filled out. Thus, like in West, there is nothing to show "but for" the telephone calls initiated by the taxpayer's office manager that the taxpayer would have filled out line 1 of the SW-100.

It is clear that the taxpayer cannot prevail on its estoppel argument. First, the taxpayer bears the burden to establish all of the facts necessary to constitute estoppel (*See* Video Tape Exchange v. Ind. Dept. of State Revenue, 533 N.E.2d 1302, 1305 (Ind.Tax 1989)). The taxpayer has not shown clear evidence as to the five elements of estoppel (for example: we earlier assumed, for arguments sake, that the conversations between the office manager and John Doe were about line 1 of the SW-100, and we assumed, again for the sake of argument, that the office manager gave true and accurate information of all the material facts, and that nonetheless John Doe gave erroneous information to the office manager. But none of these facts was shown by the taxpayer—our earlier discussion was merely *arguendo*). Additionally, "estoppels against the state are disfavored" as the court in West noted. Id. at 1333. Finally, as the Indiana Supreme Court held long ago—

> The taxing authorities of the state during the period mentioned, could not by failing to do their duty, or by any act or failure to act, waive the right and the duty of the state to assess and collect the taxes ….

Walgreen Co. v. Gross Income Tax Division, 75 N.E.2d 784, 787 (Ind. 1947).

Turning to (B), the taxpayer makes a couple of different arguments to the effect that the City of X should pay any deficiencies. First the taxpayer argues that the Mayor of City X mandated to it that "all citizens of X … entering the landfill for the purpose of depositing their household items/refuse were to do so at 'No Charge.'" Thus "[n]o money in the form of charges or taxes were solicited or collected from these people pursuant to the instruction of [the Mayor of City X]." Regardless of whether the mayor did or did not mandate to the taxpayer the "no charge" rule, the fact of the matter is that it does not absolve the taxpayer from its duties and responsibilities. The Mayor of City X cannot relieve the taxpayer of its obligations under Indiana tax law. The second argument is that the Department of Revenue "may require the owner or operator of a Landfill to file a surety bond. The Department of Revenue did not require a bond of [Taxpayer] but may have required a bond from the City of [X] as the owner of the [City of X Sanitary Landfill]." The statute dealing with surety bonds read in pertinent part as follows for the years 1994 and 1995:

> The department of state revenue *may* require a registrant... to file a surety bond ….

IC 13-9.5-5-3.2 (*Emphasis added*. IC 13-20-22-5, which replaced IC 13-9.5-5-3.2, also states that "The department of state revenue may require a registrant... to file a surety bond ….").

It does not take much parsing of the statute to realize that the word "may" simply means "optional or discretional" (*See* Black's Law Dictionary, Abridged 6th Edition). Any surety bond was not mandatory—it was the Department's choice. (Also, a surety bond does not go to the substantive issue of whether a liability is owed or not, it simply is an additional mechanism the Department can choose to avail itself of to insure payment. As the statute further notes, the state is the "obligee").

FINDING

Taxpayer's protest is denied.

II. Tax Administration – Penalty and Interest

The taxpayer protests the imposition of the ten percent (10%) negligence penalty. The Indiana Code section 6-8.1-10-2.1 imposes a penalty if the tax deficiency was due to the negligence of the taxpayer. Department regulation 45 IAC 15-11-2(b) states that negligence is "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer."

Subsection (d) of IC 6-8.1-10-2.1 allows the penalty to be waived upon a showing that the failure to pay the deficiency was due to reasonable cause. To establish this 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...." 45 IAC 15-11-2(c).

The taxpayer paints a picture that is at cross-purposes with "ordinary business care and prudence" when it states that it was "immediately behind in the various tasks necessary to properly operate" the landfill, and when it characterizes the business as a rather impromptu "favor to the then Mayor of [X]." The taxpayer argues that this was an industry in a "nascent" state, but solid waste disposal, unlike videocassette rental in the early 1980's, can hardly be characterized as a new industry. The letter from John Doe was dated January 20, 1995, and references a law that was four years old ("Effective January 1, 1991, the State Solid Waste Management Law requires that all Solid Waste Final Disposal Facilities in Indiana file a form SW-100, Solid Waste Disposal Fee Return, by the tenth of every month"). Given these facts—taxpayer's characterization of the operation of the business, the fact that this was not a nascent industry, that the law had been on the books for four years—the taxpayer has not met its burden to show that the penalty should be waived.

(The taxpayer also makes a similar estoppel argument with regards to the penalty—*viz.*, an oral telephone conversation between the taxpayer's office manager and John Doe during which Mr. Doe allegedly waived any penalties. That argument fails for the same reason that the above estoppel argument failed—see Roman numeral **I**).

The taxpayer also protests the imposition of interest. Pursuant to IC 6-8.1-10-1(e) the Department may not "waive the interest imposed under this section."

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-990148.LOF

LETTER OF FINDINGS NUMBER: 99-0148
Sales and Use Tax
Calendar Years 1995, 1996, and 1997

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

ISSUES

I. Selling at Retail – Best Information Available

Authority: 45 IAC 2.2-6-8, IC 6-8.1-5-1

Taxpayer protests the tax.

II. Tax Administration - Penalty

Authority: IC 6-8.1-10-1

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

The Taxpayer is a sole proprietorship operating a combined tavern and package liquor store. The tavern has a kitchen and serves meals, has pool tables and games, and also has a stage used for strip dancing.

At audit it was determined that the Taxpayer's sales reported for sales tax purposes did not reconcile to sales as reported on its Federal Schedule C for 1995. Adjustments for door cover charges, lottery sales, and items that included sales tax were made.

At audit the Taxpayer informed the auditor that it would protest this issue and file amended federal income tax returns. No federal return has been filed to the Department's knowledge. This alone would not resolve the discrepancy as the 1995 cost of goods sold remains near the amount of sales reported which would leave little margin on the cost of goods sold. It is noted that the margin on cost of goods sold was much larger in 1996 and 1997 on lower sales volume.

Audit also determined that the taxpayer made numerous payments by check to credit card companies for which there was no evidence to disclose the nature of the purchases. Auditor states that the Taxpayer states these were cash draws to operate the business but was unable to provide requested support. Taxpayer provided statements from the credit card company but the detail showed no tax paid. Taxpayer did not retain the original charge slips that would have shown all charges.

After discussion with the Taxpayer on April 24, 2003, he was informed the Letter of Findings would be written based upon his protest letter dated March 9, 1999, and the discussion on April 24, 2003.

I. Selling at Retail – Best Information Available

DISCUSSION

Taxpayer simply maintains that the assessment is too high and has provided no documentation to rebut the assessment.

In reviewing the audit report and the file, it is noted that the assessment, with which the Taxpayer disagrees, stems from the difference in its federal reported income versus the ST-103's filed with the Department.

IC 6-8.1-5-4(a) states:

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

Taxpayer provided nothing to aid in the resolution of the audit.

FINDING

Taxpayer's protest is denied.

II. Tax Administration - Penalty

DISCUSSION

Taxpayer states that it had difficulty with previous records/bookkeeping and this is a first time audit.

Taxpayer's assessment in 1995 amounted to 24.23% of its total sales that were not reported for sales tax purposes. In addition, taxpayer had no use tax accrual system in place as required.

FINDING

Taxpayer's protest is denied.

CONCLUSION

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

DEPARTMENT OF STATE REVENUE

02990516.LOF

LETTER OF FINDINGS NUMBER: 99-0516
Gross Income Tax
Tax Year 1997

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

ISSUES

I. Gross Income Tax – Agency

Authority: IC 6-2.1-2-2; 45 IAC 1-1-54; Policy Management Systems Corp. v Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999); Universal Group Ltd. v. Indiana Dep't of State Revenue, 609 N.E.2d 48 (Ind. Tax 1993); Western Adjustment and Inspection Co. v. Gross Income Tax Division, 142 N.E.2d 630 (Ind. 1957); Monarch Steel Co. v. State Bd. Of Tax Comm'r, 699 N.E.2d 809, 811 (Ind. Tax Ct. 1998); Trinity Episcopal Church v. State Bd. Of Tax Comm'r, 694 N.E.2d 816, 818 (Ind. Tax. Ct. 1998); Department of Treasury v. Ice Service, Inc., 41 N.E.2d 201,203 (1942); Johnson v. Blankenship, 679 N.E.2d 505, 507 (Ind. Ct. App. 1997).

Taxpayer protests the imposition of state gross income tax on amounts allegedly received in an agency capacity.

II. Gross Income Tax – Health Maintenance Organizations and "Gross Premiums"

Authority: 45 IAC 1-1-68

Taxpayer protests the imposition of state gross income tax on amounts characterized as "gross premiums."

III. Tax Administration: Negligence Penalty

Authority: IC 6-8-10-2.1; 45 IAC 15-11-2

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

M HMO provides a variety of prepaid healthcare plans. Covered services may be paid directly by plan enrollees, paid indirectly by private insurance companies or, paid by Medicaid. In providing coverage of Medicaid paid services, M HMO contracted with the State of Indiana "to administer a risk-based managed care program for certain Medicaid recipients." M HMO, though, did not directly provide medical services to its program enrollees. Rather, M HMO contracted with a number of hospitals and other healthcare providers to provide for these covered services. Taxpayer was one such provider.

With regard to the Medicaid managed care program, M HMO and Taxpayer (a "participating provider") reached an agreement ("the AGREEMENT") to "facilitate the provision of cost effective, covered health care services" to M HMO enrollees. (The AGREEMENT characterized the legal relationship between M HMO and Taxpayer as one for the provision of "personal services.") Specifically, M HMO, as the administrator of prepaid healthcare plans, contracted with Taxpayer and its Participating Providers to provide "Covered Services" to M HMO program enrollees. In exchange for Taxpayer's provision (or arrangement) of "Covered Services," M HMO agreed to pay Taxpayer certain fees in accordance with a predetermined fee schedule.

With regard to the adopted "reimbursement" scheme, [TAXPAYER] received from [M HMO] a **monthly** fixed amount for each program ENROLLEE. This fixed amount was a function of the designated AFDC AID CATEGORY. From these payments, seven dollars ($7.00) per ENROLLEE per month was allocated to TAXPAYER for administrative services.

Taxpayer provided [M HMO] with a **quarterly** reconciliation statement. The reconciliation statement was used to compare (1) the amount of payments made by TAXPAYER to providers of covered medical services under the AGREEMENT with (2) the reimbursement amounts paid to TAXPAYER by [M HMO]. "If [TAXPAYER] payments for [covered services] exceed[ed]…payments [made] to [TAXPAYER], then [M HMO] shall fund to [TAXPAYER] the amount of the difference."

The AGREEMENT also required an **annual** reconciliation. The annual reconciliation served, functionally, to apportion certain types of accumulated surplus or deficit.

> Medical Pool Costs shall be compared to the Medical Pool Budget. If Medical Pool Costs are less than the Medical Pool Budget, [M HMO] and [TAXPAYER] shall share equally in the loss up to the point at which [TAXPAYER'S] share of the loss is equal to seven dollars ($7.00) per ENROLLEE per month allocated to [TAXPAYER] for administrative services. Thereafter, [M HMO] shall bear 100% of any loss.

The AGREEMENT also contained a STOP LOSS PROVISION. "[M HMO] and [TAXPAYER] shall share the cost of certain high cost cases."

Audit and Taxpayer disagree as to the characterization—for Indiana gross income tax purposes—of the "reimbursements" Taxpayer received from M HMO. Audit characterized the reimbursements as gross receipts derived from "the provision of services." These receipts, according to Audit, should have been included in Taxpayer's high-rated taxable gross receipts (see IC 6-2.1-1-2, IC 6-2.1-2-3, and IC 6-2.1-2-5(9).) Taxpayer, on the other hand, insists the reimbursements could not have represented taxable gross income because taxpayer lacked a beneficial interest in them. Taxpayer explains:

> It is [Taxpayer's] position that because it was merely acting on behalf of, and at the direction of M HMO with respect to those Medicaid funds and because it had no right, title, or interest in those Medicaid funds, it had no gross income tax liability on those funds.

The disagreement as to the proper characterization of the "reimbursements" resulted in assessments of Indiana gross income tax. Taxpayer protested the additional assessments. An administrative hearing was held. The results of which now follow.

I. Gross Income Tax – Agency

DISCUSSION

Indiana imposes a gross income tax upon the entire gross receipts of taxpayers who are residents of, or domiciled, in Indiana. IC 6-2.1-2-2(a)(1). For those taxpayers who are not residents of, or domiciled in, Indiana, the tax is imposed only on the gross receipts derived from business activities conducted within the state. IC 6-2.1-2-2(a)(2). However, pursuant to regulation and case law, gross receipts received in an agency capacity are not included in taxpayer's taxable gross income. Regulation 45 IAC 1-1-54 states that "[t]axpayers are not subject to gross income tax on income they receive in an agency capacity." 45 IAC 1-1-54(a).

Indiana case law reinforces the regulatory regime. "Reimbursements to an agent for amounts advanced or paid to third parties substantively represent 'pass throughs' of income and therefore are not taxable to the agent." <u>Policy Management Systems Corp. v Indiana Department of State Revenue</u>, 720 N.E.2d 20, 23 (Ind. Tax Ct. 1999) quoting <u>Universal Group Ltd. v. Indiana Dep't of State Revenue</u>, 609 N.E.2d 48, 54 (Ind.Tax 1993) (<u>UGL I</u>).

Before taxpayer may exclude income from its taxable gross receipts, taxpayer must show that its reimbursements were not subject to the state's gross income tax. That is, taxpayer bears the burden of proof. *See* <u>Western Adjustment and Inspection Co. v. Gross Income Tax Division</u>, 142 N.E.2d 630, 635 (Ind. 1957). This allocation of the burden of proof is consistent with that of other tax exemptions. Indiana courts consistently have held that tax exemptions are to be strictly construed against the taxpayer and in favor of taxation. <u>Monarch Steel Co. v. State Bd. Of Tax Comm'r</u>, 699 N.E.2d 809, 811 (Ind. Tax Ct. 1998). <u>Trinity Episcopal Church v. State Bd. Of Tax Comm'r</u>, 694 N.E.2d 816, 818 (Ind. Tax. Ct. 1998).

The Indiana Supreme Court has adopted the definition of agency which is found in Section 1 of the *Restatement of Agency*. The *Restatement* defines "agency" as "the relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act." <u>Universal Group Ltd. v. Indiana Dep't of State Revenue</u>, 642 N.E.2d 553, 556 (Ind.Tax 1994) (<u>UGL III</u>) citing <u>Department of Treasury v. Ice Service, Inc.</u>, 41 N.E.2d 201,203 (1942). "Thus, a party claiming the existence of an agency relationship must prove three elements: (1) a manifestation of consent by the principal to the agent, (2) an acceptance of the authority by the agent, and (3) control exerted by the principal over the agent." <u>Policy Management Systems</u>, 720 N.E.2d 20, 23-24, citing <u>Johnson v. Blankenship</u>, 679 N.E.2d 505, 507 (Ind. Ct. App. 1997).

Taxpayer's arguments are silent with regard to the legal requirements characteristic of agency relationships—i.e., (1) consent, (2) authority, and (3) control. Rather than offering a legal narrative, taxpayer has based its plea on equitable notions. Taxpayer reasons:

> This case…should not be about what might have happened, but what actually did happen. … All of the amounts from M HMO…were actually passed through by [Taxpayer] to pay medical and health care claims for Medicaid recipients as was required under [Taxpayer's] agreement with M HMO. … After the medical and health care claims were paid, there were no excess amounts left over for [Taxpayer] and M HMO to share or even to pay [Taxpayer] an administrative fee.

The economic effects of the contract, however, do not, even in hindsight, determine the relationship of the parties to the contract. Rather, it is the language of the contract coupled with the parties' actual performance under the contract that determine the parties' legal relationship. Nothing in the contract, or the way in which the parties performed the contract, suggests an agency relationship existed.

Taxpayer's own statement belies its contention that an agency relationship existed.

> [U]nder no scenario could [Taxpayer] ever keep more than 50% of the surplus. The fact that the auditor would impose tax against [Taxpayer] on 100% of the funds when the absolute most [Taxpayer] could ever keep was 50% of the surplus that remained after all claims were paid illustrates the unreasonableness of the auditor's position.

Taxpayer is mistaken. The auditor's position simply reflects the nature of Indiana's gross income tax. The subject of the tax imposed by IC 6-2.1 et seq. is the "entire taxable gross income" derived from Indiana sources and not, as taxpayer would prefer, one's "Indiana adjusted gross income." That taxpayer was unable to reap the benefit of its bargain does not justify re-characterization of the amounts received pursuant to the contract. Income received for the provision of medical services cannot be re-characterized as reimbursements for expenditures made in an agency capacity.

FINDING

Taxpayer's protest is denied.

II. Gross Income Tax – Health Maintenance Organizations

DISCUSSION

Taxpayer believes that even if the M HMO "reimbursements" were not received in an agency capacity, taxpayer, as an HMO, still would not have incurred additional Indiana gross income tax liabilities. Taxpayer explains:

> Assuming, but certainly not conceding, that the auditor is correct and the amounts received by [Taxpayer] from M HMO are "receipts" to [Taxpayer], then [Taxpayer], as an HMO, which is treated as a health insurance company for gross income tax purposes, does not have any taxable gross income from its contract with M HMO.

As an HMO licensed under IC 27-23, taxpayer argues that it is entitled to exclude from its taxable gross income a portion of its gross fee premium income. Taxpayer opines:

> [I]n DRG 85-1, the Department concluded that HMOs should be treated in the same manner as traditional health insurance carriers and under the authority of Regulation 45 IAC 1-1-68 found that HMOs shall be permitted, in computing their gross income tax liabilities, to exclude from their gross fees…a corresponding amount computed by multiplying the gross fee premium income by the ratio of medical and hospital care payments made by the HMO, to premiums earned by the HMO on an annual basis.
>
> Therefore, if as the auditor contends, the amounts from M HMO were "fees" to [Taxpayer] for prepaid health and medical care provided to the enrollees of the Medicaid program, [Taxpayer] should be permitted to used the gross earnings ratio method set forth in DRG 85-1 in arriving at its gross income tax liability for the Tax Year.

The language of DRG 85-1 (issued January 1985) has no effect with regard to transactions occurring during the 1997 tax period. According to *Tax Policy Directive #9* (issued July 1995), "…all rulings issued by the Department prior to <u>January 1, 1990</u> [were] declared null and void and of no effect for tax years beginning after December 31, 1995."

Additionally, DRG 85-1 could not apply because the income at issue does not represent "gross fee premium income." The income received by taxpayer pursuant to its contract with M HMO represents fees for health care services performed for M HMO ENROLLEES. DRG 85-1, on the other hand, addresses the characterization (for gross income tax purposes) of premium fee income received by HMOs from its OWN ENROLLEES.

FINDING

Taxpayer's protest is denied.

III. Tax Administration - Penalty

DISCUSSION

The Department may impose, in appropriate situations, a ten percent (10%) negligence penalty. See IC 6-8-10-2.1 and 45 IAC 15-11-2. The Department, though, may waive this penalty if taxpayer can establish that its failure to pay the full amount of tax due "was due to reasonable cause and not due to negligence." 45 IAC 15-11-2(c). A taxpayer may demonstrate reasonable cause by showing "that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed…." *Id*. In this instance, taxpayer has made such a showing.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220010041.LOF

LETTER OF FINDINGS: 01-0041

Indiana Corporate Income Tax
For the Tax Years 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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Estimated Rent Expenses – Adjusted Gross Income Property Factor.

Authority: IC 6-8.1-5-1(b); 45 IAC 3.1-1-43.

Taxpayer argues that the audit erroneously included an estimated amount for rent expenses attributable to its Indiana manufacturing site.

II. Property and Inventory Factors – Adjusted Gross Income.

Authority. IC 6-3-2-2(c); IC 6-8.1-5-1(b).

Taxpayer disagrees with the audit's calculation of the amount of inventory maintained at an Indiana distribution site which was closed in 1994 and sold in 1995. Taxpayer similarly disagrees with the value the audit attached to the distribution site property.

III. Installation and Delivery Receipts – Gross Income Tax.

Authority: IC 6-2.1-2-2(a)(1); IC 6-2.1-2-2(a)(2); IC 6-2.1-2-3; IC 6-2.1-2-5(9); 45 IAC 1.1-1-2; 45 IAC 1.1-6-10.

Taxpayer argues that the audit erred in assessing high rate gross income tax on receipts obtained for the delivery and installation of carpet and floor coverings because the taxpayer received the money while acting in an agency capacity.

IV. Deduction for Interest on Federal Obligations.

Authority: IC 6-3-2-2; Allied-Signal, Inc. v. Director, Div. Of Taxation, 504 U.S. 768 (1992); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983); ASARCO, Inc. v. Idaho State Tax Comm'n., 458 U.S. 307 (1982); Hunt Corp. v. Indiana Dept. of State Revenue, 709 N.E.2d 766 (Ind. Tax Ct. 1999); 45 IAC 3.1-1-8; 45 IAC 3.1-1-8(1); 45 IAC 3.1-1-153; 45 IAC 3.1-1-153(b).

Taxpayer challenges the audit's decision to disallow a deduction for interest attributable to federal obligations.

V. Losses Attributable to Non-Unitary Partnerships.

Authority: IC 6-3-2-2; Hunt Corp. v. Indiana Dept. of State Revenue, 709 N.E.2d 766 (Ind. Tax Ct. 1999).

Taxpayer maintains that the audit erred in excluding, as non-business income, certain business losses attributable to partnerships.

VI. Business / Non-Business Income – Adjusted Gross Income Tax.

Authority: IC 6-3-1-20; IC 6-3-1-21; May Department Store Co. v. Indiana Dept. of State Revenue, 749 N.E.2d 651 (Ind. Tax Ct. 2001); 45 IAC 3.1-1-29; 45 IAC 3.1-1-30.

Taxpayer argues that money received from the sale of a business division, money received from a settlement agreement with its insurance providers, and money received in the form of royalty payments, is "non-business" income.

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

Authority: IC 6-3-1-3.5(b); IC 6-3-2-12; IC 6-3-2-12(b); IC 6-3-2-12(c) to (e).

Taxpayer challenges the audit's calculation of the expenses related to taxpayer's acquisition of foreign source income; taxpayer maintains that the audit overstated the amount of those expenses.

VIII. Apportionment Sales Factor – Adjusted Gross Income.

Authority: Sherwin-Williams Co. v. Indiana Dept. of State Revenue, 673 N.E.2d 849 (Ind. Tax Ct. 1996); 45 IAC 3.1-1-50(5); 45 IAC 3.1-1-55(e);

Taxpayer maintains that, for purposes of the calculating the sales denominator, the receipts generated by intangible personal property should be included.

IX. 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 it is entitled to request the Department to abate the ten-percent negligence penalty because it acted with reasonable care in determining its tax liability; taxpayer states that it cooperated fully with the audit and that the grounds for its subsequent protest were supported by a reasonable interpretation of the law.

STATEMENT OF FACTS

Taxpayer is in the business of manufacturing, distributing, and selling various paints and paint coatings. It sells these products to professional, industrial, commercial, and retail customers. Taxpayer operates a manufacturing facility in Indiana. An audit was conducted during which taxpayer's business records and tax returns were reviewed. The audit determined taxpayer owed additional corporate income tax. Taxpayer disagreed with certain of the audit's conclusions and submitted a protest to that effect. An administrative hearing was held during which taxpayer explained the basis for its protest, and this Letter of Findings follows.

DISCUSSION

I. Estimated Rent Expenses – Adjusted Gross Income Property Factor.

Pursuant to 45 IAC 3.1-1-43, the numerator in the property factor includes the average value of taxpayer's Indiana property used to produce business income. Accordingly, the audit estimated the capitalized rent expense associated with taxpayer's Indiana manufacturing plant in determining the taxpayer's numerator used in turn to calculate taxpayer's adjusted gross income tax.

Taxpayer argued that the audit's estimate of rent expense was excessive and requests that the "doubling up of an incorrect rent expense amount be excluded from the property factor information for all years." To that end, taxpayer has provided one page of a lease agreement purporting to establish that the amount of actual rent expense was substantially less than the amount estimated by the audit.

Under IC 6-8.1-5-1(b), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Taxpayer has provided a single page of a multi-page lease agreement. The document does not identify the leased property nor set out the terms of the lease. Taxpayer fails to meet its burden of demonstrating that the proposed assessment is incorrect.

FINDING

Taxpayer's protest is respectfully denied.

II. Property and Inventory Factors – Adjusted Gross Income.

The audit adjusted the property numerator to reflect the value of a distribution center and the inventory contained at that center. Taxpayer's distribution center was closed in 1994 and was later sold. Taxpayer maintains that the "amount by which the factors were increased appears to be too high, due to the fact that the entire amount was added to the average balance calculated on the return."

IC 6-3-2-2(c) states in part that, "The average of property shall be determined by averaging the values at the beginning and ending of the taxable year but the department may require the averaging of monthly values during the taxable year if reasonably required to reflect properly the average value of the taxpayer's property." The audit determined the value of the property based upon the ten months during which taxpayer owned the distribution center. The audit determined the value of the inventory based upon the five months during which inventory was maintained at the distribution center. Taxpayer has suggested no alternative method for determining the value of the distribution center and its inventory but merely suggests that the amounts "appear to be too high."

Under IC 6-8.1-5-1(b), taxpayer has failed to demonstrate whatsoever that the audit erred in its assessment of the distribution center's property value and has failed to propose an alternate, justifiable valuation.

FINDING

Taxpayer's protest is respectfully denied.

III. Installation and Delivery Receipts – Gross Income Tax.

Taxpayer operates retail stores. Customers can purchase carpeting and other floor covering materials from these retail stores. When they do so, the customers can also make arrangements for the delivery and installation of the floor coverings directly with the retail stores. The customers pay the retail stores for the delivery and installation charges. Thereafter, the retail stores arrange with independent contractors to undertake the actual delivery and installation work. The retail stores then pay the independent contractors for the completed work.

The audit determined that the money received from the retail customers was subject to the state's gross income tax at the high rate. Taxpayer disagrees arguing that the delivery and installation receipts were merely "pass through" income.

Indiana imposes a gross income tax upon the entire gross receipts of a taxpayer who is a resident or domiciliary or Indiana. IC 6-2.1-2-2(a)(1). For the taxpayer who is not a resident or domiciliary of Indiana, the tax is imposed on the gross receipts which are derived from business activities conducted within the state. IC 6-2.1-2-2(a)(2). However, 45 IAC 1.1-6-10 exempts that portion of a taxpayer's income which the taxpayer receives when acting in an agency capacity. 45 IAC 1.1-1-2 defines an "agent" as follows:

(a) "Agent" means a person or entity authorized by another to transact business on its behalf.

(b) A taxpayer will qualify as an agent if it meets both of the following requirements:

(1) The taxpayer must be under the control of another. An agency relationship is not established unless the taxpayer is under the control of another in transacting business on its behalf. The relationship must be intended by both parties and may be established by contract or implied from the conduct of the parties. The representation of one (1) party that it is the agent of another party without the manifestation of consent and control by the alleged principal is insufficient to establish an agency relationship.

(2) The taxpayer must not have any right, title, or interest in the money or property received from the transaction. The income must pass through, actually or substantively, to the principal or a third party, with the taxpayer being merely a conduit through which the funds pass between a third party and the principal.

Taxpayer maintains that the audit's decision to count as gross receipts the money received for delivery and installation charges was made "arbitrarily" and that "the original return accurately calculated the gross income based on Indiana law." However, taxpayer has provided nothing which would warrant a conclusion that this money was accepted by the retail stores while acting in an agency capacity on behalf of the various independent contractors. There is nothing to indicate that taxpayer's retail stores were "under the control of" the independent contractors or that the parties ever intended to enter into an agency relationship; there is nothing to establish that the retail stores did 'not have [a] right title, or interest in the money or property received from the transaction. Id. The taxpayer's bare assertion to the contrary "is insufficient to establish an agency relationship." Id.

The retail stores received money for the delivery and installation of carpeting and floor coverings. The audit correctly determined that income obtained from the provision of these services was subject to the gross income tax at the high rate pursuant to IC 6-2.1-2-3 and IC 6-2.1-2-5(9).

FINDING

Taxpayer's protest is respectfully denied.

IV. Deduction for Interest on Federal Obligations.

The audit made an adjustment to reduce to zero amounts taxpayer deducted as government interest. Taxpayer disagrees arguing that, pursuant to U.S. Const. art. VI, § 2, the interest from the federal obligations is immune from Indiana taxes and that the deduction should be reinstated.

With respect to corporate taxpayers, 45 IAC 3.1-1-8 states that "Adjusted Gross Income" is taxable income as defined in I.R.C. § 63 but specifies certain adjustments including the requirement to "Subtract income exempt from tax under the Constitution and Statutes of the United States." 45 IAC 3.1-1-8(1).

The audit determined that certain of this interest income could not be deducted because the interest was received by "non-unitary partnerships." In part, these partnerships represent investments in low-income housing, in an "environmental" partnership, and in an executive benefit trust.

The Indiana Tax Court has stated that a corporate partner's income is determined by apportionment at the corporate partner's level when the corporate partner and the partnership have a unitary relationship. Hunt Corp. v. Indiana Dept. of State Revenue, 709 N.E.2d 766, 778 (Ind. Tax Ct. 1999). The court made its decision based on the application of IC 6-3-2-2 and appeared to find that 45 IAC 3.1-1-153 was a reasonable application of the apportionment statute. Id. at 777. In applying IC 6-3-2-2 to corporate partnerships, the court stated:

> If the income from the partnerships constitutes business income (i.e. if the affiliated group and the partnerships are engaged in a unitary business) under section 6-3-2-2, all of that income would be subject to apportionment based on an application of the affiliated group's property, payroll, and sales factors. If the income from the partnerships constitutes non-business income for the affiliated group *(i.e. if the affiliated group and the partnerships are not engaged in a unitary business), that income would be allocated to a particular jurisdiction*. Id at 776. (*Emphasis added*).

The court plainly states that all of a corporate partner's income from a partnership with a unitary relationship to that partner is business income and further states that all of a corporate partner's income from a partnership with a non-unitary relationship is non-business income. This means that there is no business / non-business distinction at the partnership level regardless of the relationship between the partner and the partnerships. While the income from a non-unitary partnership will be non-business income, it is not wholly allocated to a single state. The allocation is based on an apportionment of all partnership income at the partnership level. Although 45 IAC 3.1-1-153(c) uses the term "business income" to describe the partnership income to be allocated through a factor apportionment, this description does not result in a characterization of that income as "business income" that flows through to the corporate partner. Such an interpretation would contradict the Court's findings in Hunt. Id. at 776.

It is unnecessary to determine whether taxpayer would be entitled to benefit from the exempt character of this income if taxpayer enjoyed a unitary relationship with the partnerships. Rather, the question can be resolved by determining the threshold unitary/non-unitary question. Does taxpayer have a unitary relationship with the low-income housing, environmental, and executive benefit partnerships?

45 IAC 3.1-1-153 is determinative of whether or not a unitary relationship exists. "If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula...." 45 IAC 3.1-1-153(b). Therefore, in order to establish a unitary operation, the taxpayer must demonstrate that the relationship between itself and the partnership meet the established standards of a unitary relationship.

The unitary principal has been addressed repeatedly by the Supreme Court; while no single definition exists, one characteristic appears to be essential – day-to-day operational control. Allied-Signal, Inc. v. Director, Div. Of Taxation, 504 U.S. 768 (1992); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 166 (1983); ASARCO, Inc. v. Idaho State Tax Comm'n., 458 U.S. 307 (1982). To establish that taxpayer does have a unitary relationship with the partnerships, taxpayer must establish taxpayer has operational control of the partnerships or that management of the partnerships is centralized with the taxpayer.

Taxpayer has provided nothing to establish that it has a unitary relationship with the low-income housing, "environmental," and executive benefit trust partnerships. Taxpayer is not entitled to deduct the federal interest amounts attributable to those partnerships.

Taxpayer also claims it is entitled to deduct government interest attributable to a fourth partnership. Taxpayer identifies this partnership and its interest income as "T-X." However, taxpayer has provided nothing which establishes this income was received in the form of exempt government interest or that it has a unitary relationship with "T-X." Taxpayer has failed to meet its burden of demonstrating the audit erred in its conclusion that taxpayer was not entitled to deduct the interest income received from the four categories of partnership interests.

FINDING

Taxpayer's protest is respectfully denied.

V. Losses Attributable to Partnerships.

Taxpayer included in its federal adjusted gross income losses attributable to the "environmental" and low-income housing partnerships. The audit made an adjustment to taxpayer's federal adjustment gross income which deducted the results of these two partnerships.

In order for taxpayer to bring the partnership losses within the apportionment provisions of IC 6-3-2-2, the taxpayer must first demonstrate the income (or losses) are attributable to a partnership with which it has a unitary relationship. Hunt, 709 N.E.2d at 776. Taxpayer merely asserts that the audit erred in its "classification of [taxpayer's] partnership interest as nonbusiness." The Department has no basis for disagreeing with the audit's conclusion that the losses attributable to the "environmental" and low-income housing partnerships were received from non-unitary sources. The losses are not attributable to Indiana but are allocated elsewhere.

FINDING

Taxpayer's protest is respectfully denied.

VI. Business / Non-Business Income – Adjusted Gross Income Tax.

Taxpayer maintains that the audit erred in classifying three specific categories of income as "business income." Specifically, taxpayer argues that money received from the sale of a business subsidiary, money received from insurance settlements, and money received in the form of royalty payments should be classified as "non-business income."

The audit reclassified the income received from these three sources as "business income" subjecting the income to apportionment and taxation. IC 6-3-1-21.

"Business income" and "non-business income" are defined by the Indiana Code as follows:

> The term "business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operation. IC 6-3-1-20.

"Non-business income," in turn, "means all income other than business income." IC 6-3-1-21. For purposes of calculating an Indiana corporation's adjusted gross income tax liability, business income is apportioned between Indiana and other states using a three-factor formula, while non-business income is allocated to Indiana or another state in which the taxpayer is doing business. May Department Store Co. v. Indiana Dept. of State Revenue, 749 N.E.2d 651, 656 (Ind. Tax Ct. 2001). In that decision, the Tax Court determined that IC 6-3-1-20 incorporates two tests for determining whether the income is business or non-business: a transactional test and a functional test. Id. at 662-63. Under the transactional test, gains are classified as business income when they are derived from a transaction in which the taxpayer regularly engages. The particular transaction from which the income derives is measured against the frequency and regularity of similar transactions and practices of the taxpayer's business. Id. at 658-59.

Under the functional test, the gain arising from the sale of an asset will be classified as business income if the acquisition, management, and disposition of the property generating income constitutes an integral part of the taxpayer's regular trade or business operations. *See* IC 6-3-1-20.

Department regulations 45 IAC 3.1-1-29 and 45 IAC 3.1-1-30 provide guidance in determining whether income is business or non-business under the transactional test. 45 IAC 3.1-1-29 states in relevant part that, "Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is 'business income' or 'non-business income' is the identification of the transactions and activity which are the elements of a particular trade or business." 45 IAC 3.1-1-30 provides that, "[f]or purposes of determining whether income is derived from an activity which is in the regular course of the taxpayer's trade or business, the expression 'trade or business' is not limited to the taxpayer's corporate charter purpose of its principal business activity. A taxpayer may be in more than one trade or business, and derive business therefrom depending upon but not limited to some or all of the following:

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

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

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

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

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

A. Insurance Settlement.

Taxpayer owns and operates certain manufacturing locations. A number of its insurance carriers proposed – and taxpayer accepted – to offer an amount of money in order to settle anticipated claims for environmental property damage at these manufacturing locations. Taxpayer maintains that it is in the business of manufacturing and selling paint and not in the business of accepting insurance settlements. Accordingly, taxpayer argues that the settlement money was "non-business" income and should be allocated elsewhere.

Taxpayer owned and operated the sites in order to manufacture paint. Any environmental damages – which may or may not have occurred at these locations – presumably occurred because of the manufacturing activities. Taxpayer purchased insurance in order to assure that it would be compensated in the event this property was damaged or in the eventuality taxpayer would be held liable for that damage in the future. Taxpayer and its insurance carriers, for whatever reason, chose to anticipatorily settle any undiscovered property loss claims. The fact that taxpayer does not regularly receive insurance settlements and that taxpayer is not in the business of accepting insurance settlements is of no consequence. *See* May, 749 N.E.2d at 665; 45 IAC 3.1-1-30. The money received from the insurance settlements was "income arising from transactions and activity in the regular course of the taxpayer's trade or business business...." IC 6-3-1-20.

B. Royalty Payments.

Taxpayer develops and owns proprietary paint formulas. Taxpayer owns various foreign subsidiaries and participates in joint ventures with other paint manufacturers. Taxpayer licenses paint formulas for use by these subsidiaries and joint ventures. Taxpayer also licenses the formulas to independent foreign entities. In addition, taxpayer licenses trademarks and trade names to the subsidiaries, joint ventures, and independent entities.

The audit determined that the money received in the form of royalty payments was properly classified as business income and imposed additional tax liability accordingly.

Taxpayer disagrees stating that it does not have a unitary relationship with these foreign businesses or with its own licensing division and that the royalty payments are not business income.

Taxpayer is correct in its assertion that, in order to quality as business income, the money must be received by an entity with which it has a unitary relationship. "[I]f the taxpayer's activities carried on with the state are not unitary with its activities carried on elsewhere, the state is constitutionally constrained from including the property, income, or receipts arising from those out-of-state activities in the taxpayer's apportionable tax base." May, 749 N.E.2d at. 657 n.8.

Taxpayer misapprehends the relevance of its unitary relationship with the foreign licensees. The issue is not whether taxpayer has a unitary relationship with the related foreign businesses. The income received by the foreign licensees is irrelevant to the issue raised by taxpayer because there is no contention that the money received *by* the foreign businesses constitutes taxpayer's own income. Instead, the issue is whether or not the money *taxpayer* received in the form of royalty payments is business income.

Taxpayer maintains that the paint formulas and related trademarks are unique to each particular foreign market and are not used in its domestic market. For example, taxpayer points to the fact that certain of the paint formulas contain ingredients which are not permitted for use in the United States. Other paint formulas are adapted for to meet the unique weather conditions in the foreign markets. As taxpayer states, "these formulas were of no value in the United States and did not further domestic business." Taxpayer arrives at the conclusion that the royalty income should be "characterized as investment assets rather than operational assets."

Taxpayer is in the business of manufacturing and selling paint. Ancillary to those activities, taxpayer adapted or developed paint formulas and related proprietary trademarks. Taxpayer entered into licensing agreements with various foreign businesses to permit the businesses to make use of the formulas and trademarks. In return, taxpayer received royalty payments. The royalty income falls squarely within the definition of "business income" because the royalty income "[arose] from transactions and activity in the regular course of the taxpayer's trade or business." IC 6-3-1-20. Under the statute, "business income" specifically "includes income from tangible and intangible property [when] the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations."

C. Sale of Subsidiary's Stock.

Taxpayer acquired a parent company and its subsidiaries. According to taxpayer, in acquiring the parent company, it was required to purchase all of the parent company's subsidiaries; it could not pick-and-choose those subsidiaries which it wished to acquire and retain. Thereafter, taxpayer sold the stock of one of these subsidiaries thereby divesting itself of ownership of this particular subsidiary.

The audit determined that the money received from the sale of this subsidiary's stock constituted "business income." Taxpayer disagrees maintaining that the stock sales constituted "non-business income." To that end, taxpayer points out that it never intended to retain ownership of this subsidiary. The subsidiary was never incorporated into taxpayer's own business operations but continued to be operated as a separate business. The subsidiary retained its original employees, retained the original management staff, and continued operations at the subsidiary's original location.

In May, the court found that the transactional test was not met when the retailer taxpayer sold a retailing division to a competitor because the retailer taxpayer was not in the business of selling entire divisions. May, 749 N.E.2d at. 664. Under the taxpayer's own circumstances, it is not in the business of buying and selling unrelated subsidiary companies. Therefore, the sale of the subsidiary's stock does not meet the transactional test.

The functional test focuses on the property being disposed of by the taxpayer. Id. Specifically, the functional test requires examining the relationship of the property at issue with the business operations of the taxpayer. Id. In order to satisfy the functional test, the property generating income must have been acquired, managed, and disposed by the taxpayer in a process integral to taxpayer's regular trade or business operations. Id. In May, the Tax Court defined "integral" as "part of or [a] constituent component necessary or integral to complete the whole." Id. at 664-65. The court concluded that petitioner retailer's sale of one of its retailing divisions was not "necessary or essential" to the petitioner's regular trade or business because the sale was executed pursuant to a court order that benefited a competitor and not the petitioner. Id. at 665. In effect, the court determined that because the petitioner was forced to sell the division in order to reduce its competitive advantage, the sale was not integral to the petitioner's own business operations. Id. Therefore, the proceeds from the division's sale were not business income under the functional test. Id.

Taxpayer is in the business of manufacturing and selling paint. Taxpayer did not specifically intend to acquire this particular subsidiary and disposed of the asset less than one year after having done so. The subsidiary was never incorporated into taxpayer's own business operation but remained an independent entity until it was sold. The taxpayer's acquisition and subsequent sale of the subsidiary's stock was not a constituent function necessary or integral to complete the whole of taxpayer's business. Therefore, the sale of the subsidiary's stock is not business income under the functional test.

The Department agrees with taxpayer and concludes that the income derived from the sale of the subsidiary should be classified as non-business income.

FINDING

Taxpayer's protest is sustained in part and denied in part. The money received from the sale of the subsidiary's stock constitutes non-business income; the remainder of the income at issue is properly classified as business income.

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

Taxpayer maintains that the audit overestimated the amount of expenses it incurred in earning foreign source dividend income.

In calculating taxpayer's state adjusted gross income tax liability, the starting point is the taxpayer's own federal adjusted gross income. IC 6-3-1-3.5(b) states that Indiana adjusted gross income is same as "taxable income" as defined in I.R.C. § 63. Thereafter, the amount of federal "taxable income" is subject to certain adjustments. Specifically, IC 6-3-2-12(b) states:

A corporation that includes any foreign source dividend includes in the corporation's adjusted gross income for the taxable year; multiplied by the percentage prescribed in subsection (c), (d), or (e), as the case may be.

The aforementioned subsections (c), (d), and (e) allow corporate taxpayers to receive a one hundred (100%) deduction for foreign source dividends received from corporations in which a taxpayer has an eighty (80%) or larger ownership interest; an eighty-five percent (85%) deduction for dividends received from corporations in which a taxpayer has a fifty to seventy-nine percent (50% to 79%) ownership interest; and a fifty percent (50%) deduction for dividends received from corporations in which a taxpayer has less than a fifty percent (50%) ownership interest. IC 6-3-2-12(c) to (e).

The statutory language is cogent and clear. IC 6-3-2-12 authorizes pro rata deductions – based on the percentage ownership of the payor by the payee – of certain foreign source dividend income.

FINDING

Taxpayer's protest is sustained.

VIII. Apportionment Sales Factor – Adjusted Gross Income.

Taxpayer argues that the audit erred in excluding certain income from the sales factor. According to taxpayer, receipts "generated by intangible personal property that produced business income" should have been included in the numerator and denominator of the sales factor. In support of its position, taxpayer cites to 45 IAC 3.1-1-55(e) which states that, "Gross receipts from intangible personal property shall, if classified as business income, be attributed to this state based upon the ratio which the total property and payroll factors in this state bears to the total of the property and payroll factors everywhere...." In effect, taxpayer argues that gross receipts equals the amount received on the sale of investment securities including both the interest earned and the principal.

The audit excluded from the sales denominator the "principal returned in short term securities transactions." The audit was correct in doing so. 45 IAC 3.1-1-50(5) states that, "In some cases, certain gross receipts should be disregarded in determining the sales factor to effectuate an equitable apportionment." Taxpayer may not include the return of principal realized each time it sells investment securities because the inclusion of both the principal and interest in each rollover amount would distort the sales factor by giving extra weight to its out-of-state sales.

The Indiana Tax Court has previously addressed this legal argument and ruled that, "'Gross Receipts' for the purpose of the sales factor includes only the interest income, and not the rolled over capital or return of principal, realized from the sale of investment securities." Sherwin-Williams Co. v. Indiana Dept. of State Revenue, 673 N.E.2d 849, 853 (Ind. Tax Ct. 1996). The Tax Court spoke clearly and definitively, and the Department will not re-weigh its decision.

FINDING

Taxpayer's protest is denied.

IX. Ten-Percent Negligence Penalty.

The audit concluded with the recommendation that a ten-percent negligence penalty be assessed. Taxpayer argues that the Department should exercise its discretion to abate the penalty because it paid the correct amount of tax due in a timely manner, cooperated fully with the audit, and that its legal positions represented by the tax returns were supported by a reasonable interpretation of the applicable law and regulations.

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...."

The Department is unable to agree with taxpayer's argument that its original returns represented a reasonable interpretation of the law and that, in preparing those original returns, it "exercised ordinary business care." Its decision to include the principal received from the sale of investments accounted for more than 60 percent of its additional tax liability. The question of whether the gross proceeds generated by investment activity should be included in the sales factor has twice been protested, twice denied, and unsuccessfully litigated at the appellate court level. Nonetheless, during a third audit cycle, taxpayer proceeded to include the gross investment receipts in its sales factor. This decision, coupled with the fact that taxpayer now raises the identical issue in yet a third protest, is not indicative of the "reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420010108.LOF

LETTER OF FINDINGS: 01-0108
Use Tax
For the Years 1998, 1999, and 2000

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

ISSUE

I. Sampling Methodology - Use Tax.

Authority: IC 6-2.5-1-1 et seq.; IC 6-2.5-3-2(a); IC 6-2.5-3-2(c); IC 6-2.5-3-2(c)(1); IC 6-8.1-5-1(b); Great American Lines, Inc. v. Ind. Dept. of State Revenue, 2000 Ind. Tax LEXIS 55 (Ind. Tax Ct. Dec. 28, 2000).

Taxpayer argues that the method used by the audit to determine its use tax liability was flawed.

STATEMENT OF FACTS

Taxpayer is an Indiana construction contractor. It provides services and materials to commercial, industrial, and government customers. The Department of Revenue (Department) conducted an audit of taxpayer's business records. The audit found that taxpayer owed use tax on particular items for which it should originally have paid sales tax. Accordingly, the Department sent taxpayer notices of "Proposed Assessment." Taxpayer decided that the amounts were excessive and submitted a protest to that effect. An administrative hearing was held during which taxpayer explained the basis for its protest, and this Letter of Findings results.

FINDINGS

I. Sampling Methodology - Use Tax.

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC 6-2.5-1-1 et seq. The use tax "is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC 6-2.5-3-2(a). Use tax must be paid when a contractor – such as the taxpayer – buys materials it intends to use to construct a building for one of its customers. "The use tax is imposed on the addition of tangible personal property to a structure or facility, if, after its addition, the property becomes part of the real estate on which the structure or facility is located." IC 6-2.5-3-2(c). However, a contractor is not required to pay the use tax if "the state gross retail or use tax has been previously imposed on the sale or use of that property." IC 6-2.5-3-2(c)(1).

Taxpayer agrees that it should have been assessed use tax on certain items it purchased for which it did not originally pay sales. However, taxpayer challenges the specific methodology used by the audit to calculate its three-year use tax liability. The audit did not examine in detail the purchase records for all three years. Instead, the audit chose one year – 1999 – examined all of taxpayer's purchases for that year, and made a determination as to which of those 1999 purchases were subject to use tax. Thereafter, "The auditor and the taxpayer agreed that an error ratio of additional variable taxable purchases, to a variable such as sales per Federal Form 1120, would be used to project the additional variable taxable purchases for the years [1998] and [2000]." Assuming, for example, that 10 percent of taxpayer's 1999 purchases were subject to use tax, the audit and taxpayer agreed that 10 percent of taxpayer's 1998 and 2000 purchases would also be subject use tax without the necessity of examining each and every one of the purchases made during 1998 and 2000.

Taxpayer does not challenge the use of this method of calculating its three-year use tax liability because taxpayer plainly agreed to the method. Taxpayer signed an "Agreement for Projecting Audit Results" to that effect. Instead taxpayer challenges the accuracy of the final result because the 1999 base year percentage was skewed to reflect a greater than typical percentage of taxable purchases to total purchases. Taxpayer points out that the audit included – as subject to use tax – two specific 1999 purchases it made from a steel vendor. Taxpayer bought fabricated steel from this steel vendor which taxpayer then used to complete construction projects for one of its regular customers, a steel manufacturer.

Plainly, the two purchases from the steel vendor were subject to use tax because the fabricated steel was tangible personal property later incorporated into a structure on the steel manufacturer's real estate. IC 6-2.5-3-2(c).

Nevertheless, taxpayer maintains that these two specific purchases should be deleted from the 1999 base calculation or, at least, discounted in arriving at the 1999 base. Taxpayer explains stating that, in the normal course of its dealings with this particular steel manufacturer, the steel manufacturer typically supplied to its own fabricated steel for construction projects at its location. Therefore, taxpayer concludes that the two 1999 purchases from the steel vendor were atypical, did not represent the normal course of dealings with the steel manufacturer, and the inclusion of the two purchases into the 1999 base resulted in an over assessment of 1998 and 2000 use tax.

The taxpayer's 1998, 1999, and 2000 proposed use tax assessments are presumed correct, and the burden is on the taxpayer to prove that these assessments are wrong. IC 6-8.1-5-1(b). Taxpayer has not demonstrated that the assessments are wrong; taxpayer has demonstrated that the two 1999 purchases are "outliers," statistical observations which – their face – appear to deviate markedly from other members of the 1999 base sample and are not representative of the sampled year. *See* Great American Lines, Inc. v. Ind. Dept. of State Revenue, 2000 Ind. Tax LEXIS 55 (Ind. Tax Ct. Dec. 28, 2000). Accordingly, the audit is requested to reconsider the 1999 base determination and issue a revised 1998, 1999, and 2000 use tax assessment.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420020023.LOF

LETTER OF FINDINGS NUMBER: 02-0023
Sales and Use Tax
For the Years 1998-1999

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

ISSUE

I. Sales and Use Tax- Computer Software

Authority: IC 6-2.5-2-1, IC 6-2.5-3-2, IC 6-8.1-5-1 (b), Sales Tax Information Bulletin # 8, February 9, 1990.

The taxpayer protests the imposition of the use tax on computer software.

II. Sales and Use Tax-Graphics Design Purchases

Authority: IC 6-2.5-5-4, 45 IAC 2.2-5-8 (c).

The taxpayer protests the imposition of tax on certain graphics design purchases.

III. Sales and Use Tax- Labels and Labeling Equipment

Authority: IC 6-2.5-5-6, IC 6-2.5-5-3 (b), 45 IAC 2.2-5-14(e).

The taxpayer protests the imposition of tax on certain labels and labeling equipment.

IV. Sales and Use Tax-Materials Handling System

Authority: IC 6-2.5-5-3, 45 IAC 2.2-5-8 (d), 45 IAC 2.2-5-8 (f)(1).

The taxpayer protests the imposition of tax on the materials handling system.

V. Tax Administration- Penalty

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

The taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

The taxpayer operates a manufacturing facility producing a variety of injection-molded plastic products. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use tax, interest, and penalty. The taxpayer protested this assessment and a hearing was held.

I. Sales and Use Tax- Computer Software

DISCUSSION

Indiana imposes a sales tax on retail transactions made in Indiana. IC 6-2.5-2-1. A complementary use tax is imposed on personal property purchased in a retail transaction and used in Indiana when no sales tax has been paid. IC 6-2.5-3-2. All assessments made by the department are presumed to be correct. Taxpayers bear the burden of proving that an assessment is incorrect. IC 6-8.1-5-1 (b).

Sales Tax Information Bulletin # 8, February 9, 1990, in effect during the audit, clarified the departmental policy concerning the sales and use taxation of computers and related issues. The Information Bulletin addresses the issue of the taxability of software programs as follows:

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

The department assessed use tax on two computer software programs and maintenance agreements, one concerning financial accounting and one concerning human resources, purchased by the taxpayer. Both programs are sold to many consumers. Since neither program could be used straight out of the box, they both required customization. The sellers own the copyright on the programs. The taxpayer protests the assessment of tax on the use of these computer programs.

The taxpayer's computer software purchases fit the description of pre-written or canned software programs and is taxable.

FINDING

The taxpayer's protest is denied.

II. Sales and Use Tax-Graphics Design Purchases

DISCUSSION

The taxpayer has an arts and graphics automation department. The taxpayer's clients deliver completed artwork for application onto the plastic products to the taxpayer. The arts and graphics automation department separate the colors and digitally modify the artwork so that it will look like the original after it is printed on the plastic product. This department does not create any original artwork. The color separated and digitally modified artwork is used to produce the proofs and color separations in order to generate negatives and printing plates. The plates are then placed on a printing press to print the desired image on the plastic container. The department assessed use tax on the computers and related equipment used in this pre-press graphics department.

The taxpayer protests this assessment contending that the items qualify for exemption pursuant to IC 6-2.5-5-4 as follows:

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

The plate is a tool directly used in the direct production of the final plastic product. The issue to be determined is whether the computer and related equipment is directly used in the direct production of the tool, the printing plate.

There is no Regulation on point describing the directly used in direct production rule for a tool to be exempt. There is, however, a Regulation clarifying the parallel exemption for items directly used in direct production of tangible personal property. That Regulation, 45 IAC 2.3-5-8(c) states as follows:

> The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by

the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

The computers and related items in issue perform the first step in transforming the customer's image into a printable image on the printing plate. The contested items are used in manipulating the customer's image in a way that allows it to be photographed and processed into a negative which is used to produce the tool used to actually print the final image on the plastic containers produced by the taxpayer. The use of the computer and the related equipment has an immediate effect on the manufacture of the printing plate.

FINDING

The taxpayer's protest is sustained.

III. Sales and Use Tax- Labels and Label Printing Equipment

DISCUSSION

During the tax period, the taxpayer purchased barcode, printing ribbons and labels. The taxpayer printed and applied bar-coded labels to the boxes containing plastic sleeves of the taxpayer's product. The department assessed use tax on these items. The taxpayer protests these assessments.

The labels are used for internal inventory and quality control purposes within the taxpayer's facility. Subsequently the labels are used to provide information that allows customers to identify the enclosed product and retrieve from storage the correct plastic containers for the day's production run. The labels also impart information necessary for the taxpayer's customers to exercise quality control. The taxpayer's customers require this information and will not accept any product without this bar code label on the box. The taxpayer packages its products, such as decorated plastic tubs or glasses, by stacking them and then encasing the stacks in plastic sleeves. Several sleeves of product are then placed in a cardboard box. During the tax period, the taxpayer printed the labels and then attached them to the cardboard boxes.

The taxpayer contends that the bar-coded labels qualify for exemption as property acquired "for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business" pursuant to IC 6-2.5-5-6. To be incorporated in the product, the labels must become part of the product during the production process.

This exemption is explained at 45 IAC 2.2-5-14(e) as follows:

... incorporated as a material or an integral part into tangible personal property for sale means:

(1) The material must be incorporated into and become a component of the finished product.

(2) The material must constitute a material or integral part of the finished product.

(3) The tangible property must be produced for sale by the purchaser.

The taxpayer's argument that its customers require the information contained on the labels and therefore they become part of the product is not persuasive. The required packaging for the taxpayer's product is the plastic sleeves. The labels are affixed to the cardboard boxes used to store and ship the product packaged in the plastic sleeves. These cardboard boxes are not an essential part of the final product. Further, the labels contain inventory and quality control information used to benefit the taxpayer in the administration of its facility rather than as an integral part of the production of taxpayer's product. The addition to the labels of information required by the taxpayer's customers does not transform the labels to exempt status.

The taxpayer also contends that the ribbons and ink used to print the bar code labels are exempt pursuant to IC 6-2.5-5-3(b) because they are directly used in the direct production of the taxpayer's product. Since the labels have been determined to not be part of the finished product, the ribbons and ink used in producing the labels do not impact the finished product. Therefore they are not exempt from the use tax.

FINDING

The taxpayer's protest is denied.

IV. Sales and Use Tax-Materials Handling System

DISCUSSION

The taxpayer also protests the assessment of use tax on certain materials handling equipment purchased during the tax period. This equipment is used in the process of unloading resin and blowing it to the production area. The taxpayer contends that this equipment qualifies for exemption pursuant to IC 6-2.5-5-3 which provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication... of tangible personal property."

To qualify for this exemption, the item must be used in the production process. The production process is defined at 45 IAC 2.2-5-8 (d) as follows:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The protested materials handling equipment actually blows the resin from trains into the production area. The taxpayer argues that the production process begins at the train and the blowing equipment actually is part of the manufacturing process because the blowing action sometimes changes the angle of repose of piles of the resin and fluidizes the resin. This fluidizing removes some of the clumps and removes some dust particles from the resin.

The department finds this argument unpersuasive. The blowing equipment actually transports the resins to the place in the plant where the manufacturing begins. As such the materials handling machine fits the example of taxable transportation equipment at 45 IAC 2.2-5-8 (f)(1) since it is "used for moving raw materials to the plant prior to their entrance into the production process."

FINDING

The taxpayer's protest is denied.

V. Tax Administration- Penalty

DISCUSSION

The taxpayer also protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Negligence is defined at 45 IAC 15-11-2(b) 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... "

The taxpayer did not provide sufficient evidence that it exercised the level of care expected of the reasonable businessman in the filing and remittance of its taxes.

FINDING

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

DEPARTMENT OF STATE REVENUE

0420020074.LOF

LETTER OF FINDINGS: 02-0074
Sales and Use Tax
For 1999 and 2000

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

ISSUE

I. Public Transportation Exemption – Aircraft.

Authority: IC 6-2.5-3-2; IC 6-2.5-5-27; IC 6-6-6.5-8; IC 6-6-6.5-8(d); IC 6-8.1-5-1(b); Panhandle Eastern Pipeline Co. v. Ind. Dept. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001); Indiana Dept. of State Revenue v. Indianapolis Transit System, Inc., 356 N.E.2d 1204 (Ind. Ct. App. 1976).

Taxpayer challenges the decision of the Department of Revenue (Department) assessing sales tax on the taxpayer's purchase of an airplane. Taxpayer maintains that it is entitled to an exemption because the airplane is being used as a support vehicle in taxpayer's transportation business.

STATEMENT OF FACTS

Taxpayer is a commercial trucking firm operating under authority of the Interstate Commerce Commission. Taxpayer bought an airplane in 1999. During October of 2000, the Department sent taxpayer a "Notice of Proposed Assessment" stating that taxpayer's airplane had not been properly registered with the state and that taxpayer was required to pay sales or use tax on the original 1999 purchase. In addition, the Department assessed late fees and interest penalties for the year 2000. Taxpayer disagreed and submitted a protest. An administrative hearing was held during which taxpayer explained the basis for its protest. This Letter of Findings follows.

DISCUSSION

I. Public Transportation Exemption – Aircraft.

The Department maintains that taxpayer should have paid sales or use tax on the purchase price of the aircraft. Taxpayer disagrees stating that the aircraft is exempt from the tax because the vehicle is used in its transportation business.

Indiana imposes an excise tax at the time a taxpayer acquires an airplane. IC 6-2.5-3-2 provides as follows:

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

(b) The use tax is also imposed on the storage, use, or consumption of a vehicle, an aircraft, or a watercraft, if the vehicle, aircraft, or watercraft:

(1) is acquired in a transaction that is an isolated or occasional sale; and

(2) is required to be titled, licensed, or registered by this state for use in Indiana.

IC 6-6-6.5-8 requires the aircraft purchaser to pay sales or use tax shortly after the aircraft is sold or transferred in Indiana. "A person shall pay the gross retail tax or use tax to the department on the earlier of: (1) the time the aircraft is registered; or (2) not later than thirty-one (31) days after the purchase date." IC 6-6-6.5-8(d).

It is not disputed that taxpayer acquired the airplane for use within this state. It is not disputed that taxpayer is engaged in the transportation business. The only question is whether or not taxpayer is entitled to the claimed exemption. The exemption to which taxpayer refers is found at IC 6-2.5-5-27 which states that, "Transactions involving tangible personal property and services are exempt from the state gross retail tax, if the person acquiring the property or service directly uses or consumes it in providing public transportation for persons or property."

Taxpayer is in the trucking business. It claims that its acquisition of the airplane was not subject to tax because the airplane is used and "reasonably necessary" for the operation of its trucking business. Specifically, taxpayer indicates that the airplane is used to pick-up and return drivers, and it is used to transport employees to contract negotiations, seminars, meetings, and instructional classes. In addition, taxpayer states that the airplane is used to visit locations to inspect vehicles it is considering purchasing and visit potential parking locations. Further, taxpayer states that the airplane is used to transport spare truck parts in emergency situations.

The Indiana Tax Court has held that the transportation exemption may not be used to prorate a taxpayer's liability. Panhandle Eastern Pipeline Co. v. Ind. Dept. of State Revenue, 741 N.E.2d 816, 818-19 (Ind. Tax Ct. 2001). Rather, the court has held that the transportation exemption "is an all or nothing exemption." Id. at 819. "If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption." Id.

Therefore, in order to obtain the benefit of the exemption for a specific purchase, the taxpayer must meet two entirely distinct qualifications; the taxpayer must demonstrate that it is predominately engaged in the business of providing public transportation, and it must also establish that the particular item of personal property is predominately used in providing public transportation. In other words, even if a company is predominately involved in providing transportation, not every particular item it buys qualifies for the exemption.

Assuming for the moment that taxpayer is predominately engaged in providing public transportation, taxpayer has not demonstrated that the aircraft itself is predominately engaged in providing public transportation. Although it may be reasonably assumed that a certain category of purchases – tires, truck parts, repair tools – are "predominately" used by a company predominately involved in providing transportation services, the Department finds no reason to conclude that an aircraft falls within this same category. The Department has no reason to doubt taxpayer's contention that the airplane is used in its truck business. However, the information taxpayer has provided and the activities taxpayer describes do not inescapably lead to the conclusion that this aircraft is *predominately* used in transportation related activities.

In Indiana Dept. of State Revenue v. Indianapolis Transit System, Inc., 356 N.E.2d 1204 (Ind. Ct. App. 1976), the court agreed that respondent transportation company's purchase of various items was not subject to sales tax pursuant to the transportation exemption. However, unlike the respondent in Indianapolis Transit, there is no reasonable contention that taxpayer "could not continue operating without the purchases it claimed should be exempted." Id. at 1209. Based on the information provided, the Department is unable to conclude taxpayer would be prevented from providing transportation services to its customers unless it had purchased and owned the airplane.

The Department is bound by the statute which states, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1(b). The Department must conclude that taxpayer has not met that burden.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220020098.LOF

LETTER OF FINDINGS: 02-0098
ADJUSTED GROSS INCOME TAX
For the Tax Year 1997

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

ISSUES

I. Allocation of Taxpayer's Income Received from Indiana Partnership Interests – Adjusted Gross Income Tax.

Authority: IC 6-3-2-2; Hunt Corp. v. Indiana Dept. of State Revenue, 709 N.E.2d 766 (Ind. Tax Ct. 1999); 45 IAC 3.1-1-153; 45 IAC 3.1-1-153(b); 45 IAC 3.1-1-153(c); 45 IAC 3.1-1-153(c)(2); 45 IAC 3.1-1-153(e).

Taxpayer argues that income received from the disposition of Indiana partnership interests should be allocated to California and that the audit erred in determining the income should be allocated to Indiana.

II. Partnership Net Operating Losses.

Authority: IC 6-3-2-2; Hunt Corp. v. Indiana Dept. of State Revenue, 709 N.E.2d 766 (Ind. Tax Ct. 1999)

Taxpayer argues that it is entitled to carry forward net operating losses from the tax years 1992 through 1997.

III. 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 maintains that it had a reasonable basis for the decisions it reached with respect to its Indiana tax liabilities. As a result, the taxpayer argues that the Department should exercise its discretion to abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a California corporation which owned an interest in two partnerships. The two partnerships directly or indirectly owned an Indiana hotel. First Partnership directly owned the hotel. Second Partnership's sole business purpose was to own an interest in First partnership.

During 1997, First Partnership sold the Indiana hotel property. Subsequently both First Partnership and Second Partnership were liquidated, and taxpayer received "distributive shares" of the partnerships' income.

Prior to 1997, First and Second Partnerships' income was 100 percent allocated to Indiana. After the hotel was sold, the Department of Revenue (Department) issued notices of "Proposed Assessment" based upon the income taxpayer derived from the partnership liquidations. Subsequently, taxpayer filed amended federal and state returns to report changes in the allocation of the distributive shares. In reporting that income, taxpayer carried forward a substantial net operating loss (NOL) from 1992 through 1995 with the result that taxpayer claimed it owed "no adjusted gross income tax and supplemental net income" for 1997.

The Department conducted a review of taxpayer's amended return and disagreed with taxpayer's position. The taxpayer challenged the Department's decision, an administrative hearing was held, and this Letter of Findings results.

FINDINGS

I. Allocation of Taxpayer's Income Received from Indiana Partnership Interests – Adjusted Gross Income Tax.

Taxpayer maintains that the money it received from the liquidation of the two partnerships should be allocated outside Indiana. The Department determined that because the partnerships' income was derived from the sale of Indiana property, the income should be allocated to Indiana.

The Indiana Tax Court has stated that a corporate partner's income is determined by apportionment at the corporate partner's level when the corporate partner and the partnership have a unitary relationship. Hunt Corp. v. Indiana Dept. of State Revenue, 709 N.E.2d 766, 778 (Ind. Tax Ct. 1999). The court made its decision based on the application of IC 6-3-2-2 and appeared to find that 45 IAC 3.1-1-153 was a reasonable application of the apportionment statute. Id. at 777. In applying IC 6-3-2-2 to corporate partnerships, the court stated:

> If the income from the partnerships constitutes business income (i.e. if the affiliated group and the partnerships are engaged in a unitary business) under section 6-3-2-2, all of that income would be subject to apportionment based on an application of the affiliated group's property, payroll, and sales factors. If the income from the partnerships constitutes non-business income for the affiliated group *(i.e. if the affiliated group and the partnerships are not engaged in a unitary business), that income would be allocated to a particular jurisdiction*. Id at 776. (*Emphasis added*).

The court plainly states that all of a corporate partner's income from a partnership with a unitary relationship to that partner is business income and further states that all of a corporate partner's income from a partnership with a non-unitary relationship is non-business income. This means that there is no business / non-business distinction at the partnership level regardless of the relationship between the partner and the partnerships.

45 IAC 3.1-1-153 governs the manner in which taxpayer's partnership income is treated for adjusted gross income tax purposes. 45 IAC 3.1-1-153(c) states that, "If the corporate partner's activities and the partnership's activities do not constitute a unitary

business under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows."

It is not disputed that taxpayer and the two partnerships did not share a unitary relationship. It is not disputed that the two partnerships' income was derived from the sale of the Indiana hotel property. It is not disputed that taxpayer received its share of this income – at the time the partnerships were liquidated – in the form of "distributive shares" in the former partnerships. Accordingly, the distributive share income is governed under 45 IAC 3.1-1-153(c)(2) which states that, "If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment." In regards to taxpayer's distributive share income, the rule states, "After determining the amount of business income attributable to Indiana... the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income." 45 IAC 3.1-1-153(e).

Taxpayer received partnership distributions of income derived from the sale of the Indiana hotel property. This income was "entirely derived from sources within Indiana." 45 IAC 3.1-1-153(c)(2). Therefore, the total amount of the partnership distributions is added to taxpayer's "other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana." 45 IAC 3.1-1-153(e). The audit review correctly determined that taxpayer's distributive share income derived from the two partnerships should be used "in determining the corporate partner's total taxable income." 45 IAC 3.1-1-153(e). Under Indiana law, there is no basis for taxpayer's assertion that the state should allocate this income elsewhere.

FINDING

Taxpayer's protest is respectfully denied.

II. Partnership Net Operating Losses.

Taxpayer argues that it is entitled to carry forward NOLs from 1992 through 1995. As a result of that carry-forward, taxpayer concludes that it has no tax liability for 1997.

The 1992 through 1995 losses were attributable to partnerships with which taxpayer – by its own admission – did not have a unitary relationship. As stated by taxpayer, "[Taxpayer] had no connections to Indiana other than [the] partnerships. [Taxpayer] did not share any centralized management, executive force, centralized purchasing, advertising, accounting, or other controlled interaction with [partnerships]."

In order for the taxpayer to bring the 1992 through 1995 partnership losses within the apportionment provisions of IC 6-3-3-2, the taxpayer must first demonstrate that the income (or losses) are attributable to a partnership with which it has a unitary relationship. Hunt Corp. v. Indiana Dept. of State Revenue, 709 N.E.2d 766, 776 (Ind. Tax Ct. 1999). "[I]f the affiliated group and partnerships are not engaged in a unitary business that income will be allocated to a particular jurisdiction." Id. Because the losses were incurred by partnerships with which it did not have a unitary relationship, the losses are irrelevant in determining the taxpayer's own adjusted gross income tax liability.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer asks the Department to exercise its discretion and abate the ten-percent negligence penalty.

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

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

Taxpayer asserts that it prepared its amended returns based upon a good faith interpretation of Indiana statutes, that it was not negligent, and that it did not intentionally disregard the law. In sum, taxpayer maintains that it had a reasonable basis for the decisions it made in regard to its Indiana tax liability.

The Department agrees with taxpayer that the positions it took in regard to its Indiana tax liabilities – however erroneous – were indicative of "reasonable cause and not due to willful neglect."

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220020309.LOF

LETTER OF FINDINGS: 02-0309
Indiana Corporate Income Tax
For the Tax Years 1998, 1999, and 2000

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

ISSUES

I. Money Received by Taxpayer While Acting in an Agency Capacity – Gross Income Tax.

Authority: IC 6-2.1-2-2(a)(1); IC 6-2.1-2-2(a)(2); Policy Management Systems Corp. v. Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999); Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994); 45 IAC 1.1-1-2; 45 IAC 1.1-6-10.

Taxpayer argues that certain money it received was actually received on behalf of its customers. Because taxpayer was acting as an agent for the customers, taxpayer maintains that the money received on behalf of these customers was not subject to gross income tax.

II. Money Received from the Sale of Inventory Stored at Customer Locations – Gross Income Tax.

Authority: IC 6-2.1-2-2; IC 6-2.1-2-3; IC 6-2.1-2-4.

Taxpayer argues that the income received from the sale of inventory items sold at various Indiana customer locations was not subject to gross income tax.

III. Business / Non-business Classification – Adjusted Gross Income Tax.

Authority: IC 6-3-1-20; IC 6-3-1-21; IC 6-3-2-2(b); IC 6-3-2-2(g) to (k); May Department Store Co. v. Indiana Dept. of State Revenue, 749 N.E.2d 651 (Ind. Tax Ct. 2001); 45 IAC 3.1-1-29; 45 IAC 3.1-1-30; I.R.C. § 338(h)(10).

Taxpayer maintains that the audit erred in reclassifying certain income as "business income." Specifically, taxpayer states that interest received on short term-deposits, rent from the lease of unused corporate property, license fee royalties, and money received from the "deemed sale of [stock] assets" should be classified as "non-business" income.

STATEMENT OF FACTS

Taxpayer was an out-of-state entity in the business of developing and supplying coatings to the electro-plating, electronics, and surface finishing industries. Taxpayer had Indiana employees which solicited business on taxpayer's behalf.

The Department of Revenue (Department) conducted an audit of taxpayer's federal returns, state income tax work-papers, and various other business records. The audit resulted in a determination that taxpayer owed additional Indiana corporate income tax. Taxpayer disagreed with the audit's decision and submitted a protest to that effect. An administrative hearing was held during which taxpayer was provided an opportunity to explain the basis for its protest; this Letter of Findings results.

DISCUSSION

I. Money Received by Taxpayer While Acting in an Agency Capacity – Gross Income Tax.

After performing "chemical management services" for Indiana customers, taxpayer was reimbursed for expenses it incurred on behalf of those customers. The audit determined that these reimbursed expenses were part of taxpayer's gross income and taxed the income at the state's high rate gross income tax.

Taxpayer maintains that the reimbursed expenses are not true income but reflected loans made to its customers. Therefore, when the customer paid back these loans to taxpayer, it was simply receiving the money in an agency capacity.

Indiana imposes a gross income tax upon the entire gross receipts of a taxpayer who is a resident or domiciliary of Indiana. IC 6-2.1-2-2(a)(1). For the taxpayer who is not a resident or domiciliary of Indiana – such as taxpayer – the tax is imposed on the gross receipts which are derived from business activities conducted within the state. IC 6-2.1-2-2(a)(2). However 45 IAC 1.1-6-10 exempts that portion of the taxpayer's income which the taxpayer receives when acting in an agency capacity. 45 IAC 1.1-1-2 defines an "agent" as follows:

(a) "Agent" means a person or entity authorized by another to transact business on its behalf.

(b) A taxpayer will qualify as an agent if it meets both of the following requirements:

(1) The taxpayer must be under the control of another. An agency relationship is not established unless the taxpayer is under the control of another in transacting business on its behalf. The relationship must be intended by both parties and may be established by contract or implied from the conduct of the parties. The representation of one (1) party that it is the agent of another party without the manifestation of consent and control by the alleged principal is insufficient to establish an agency relationship.

(2) The taxpayer must not have any right, title, or interest in the money or property received from the transaction. The income must pass through actually or substantively, to the principal or a third party, with the taxpayer being merely a conduit through which the funds pass between a third party and the principal.

The Indiana Tax Court in Policy Management Systems Corp. v. Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999) and Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994) reviewed the relationship between imposition of the state's gross income tax and agency principles, echoed the standards set out in 45 IAC 1.1-1-2 and 45 IAC 1.1-6-10, and held that an agency relationship required consent by the principal, acceptance and authority by the agent, and control of the agent by the principal.

Assuming that a true agent/principal relationship is established, the agent will not be responsible for paying gross income tax on money it receives on behalf of the principal. The agent has no gross income tax liability because it never actually controls the money. The agent is simply collecting the money on behalf of the principal and passes that identical amount over to the principal. The agent never has any possessory right to the money because the agent is always acting on behalf of the principal and at all times, the money belongs to the principal; the agent is merely a financially disinterested intermediary between the payor and the principal.

Taxpayer was not acting as an agent when it was reimbursed for expenses incurred initially on behalf of its customers. There simply is no agent/principal relationship here. The taxpayer was not "passing along" this money to anyone. Taxpayer may have incurred these expenses on behalf of and for the convenience of its customers and it may have simply been reimbursed on a dollar-for-dollar basis, but there is no agent/principal relationship between any of the parties involved in these transactions.

In addition, there is a total absence of the hallmarks that would signal taxpayer is acting as another entity's agent. There is no indication taxpayer is under the control of another entity; there is no indication that taxpayer did not ultimately have control of the reimbursed expenses. For taxpayer, the reimbursement of the expenses incurred on behalf of the customers may have been no-gain/no-loss transactions. However, taxpayer mistakes financially transparent exchanges for transactions in which it receives money while acting in a true agency capacity.

FINDING

Taxpayer's protest is respectfully denied.

II. Money Received from the Sale of Inventory Stored at Customer Locations – Gross Income Tax.

The audit adjusted taxpayer's gross income tax in order to reflect receipts obtained from the sale of inventory stored at customer locations. Taxpayer's argument is that it "disagrees with the adjustment."

Taxpayer stored inventories of goods at customer locations within Indiana. At various times during 1998, 1999, and 2000, taxpayer sold those goods to the customer.

Indiana's gross income tax "is imposed upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domciliary of Indiana." IC 6-2.1-2-2.

A taxpayer's gross receipts are subject to either the "high rate" (1.2 percent) or the "low rate (0.3 percent). IC 6-2.1-2-3. The audit determined that the sale of inventoried goods to the Indiana customers was subject to the low rate set out under IC 6-2.1-2-4. The statute provides that, "The receipt of gross income from the following is subject to the [low] rate of tax prescribed in section 3(a) of this chapter: (1) wholesale sales... (4) selling at retail."

Under IC 6-2.1-2-2, IC 6-2.1-2-3, IC 6-2.1-2-4 the audit was correct in determining that money received from the sale of goods – temporarily stored an Indiana customer's location – to that particular customer was subject to Indiana gross income tax at the low rate.

Other than disagreeing with this adjustment, taxpayer has provided no substantive basis upon which the Department is justified in reconsidering the audit's original determination.

FINDING

Taxpayer's protest is respectfully denied.

III. Business / Non-business Classification – Adjusted Gross Income Tax.

In reviewing taxpayer's adjusted gross income tax returns, the audit reclassified certain of taxpayer's income. The audit concluded that taxpayer incorrectly classified interest income, income derived from renting unused corporate property, and royalty income as "non-business income." The audit reclassified all three of these income categories as "business income."

In addition, the audit made an adjustment to reflect taxpayer's correct federal taxable income in order to properly represent a sale of stock which was treated as a sale of assets under I.R.C. § 338(h)(10). The audit concluded that the money received from the sale of stock should be treated as "business income." Again, taxpayer disagrees concluding that the money should be treated as "non-business income."

For purposes of determining a taxpayer's adjusted gross income tax liability, business income is apportioned between Indiana and other states using a three factor formula. IC 6-3-2-2(b). In contrast, non-business income is allocated to Indiana or it is allocated to another state. IC 6-3-2-2(g) to (k). Therefore, "whether income is deemed business income or non-business income determines whether it is allocated to a specific state or whether it is apportioned between Indiana and other states [in which] the taxpayer is conducting its trade or business." May Department Store Co. v. Indiana Dept. of State Revenue, 749 N.E.2d 651, 656 (Ind. Tax Ct. 2001).

Taxpayer's argument, that all four of these income categories are "non-business income," is significant because if taxpayer is correct, all this income is allocated elsewhere and is not relevant in calculating taxpayer's Indiana adjusted gross income tax.

The benchmark for determining whether income can be apportioned is the distinction between "business income" and "non-business income." That distinction is defined by the Indiana Code as follows:

> The term "business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operation. IC 6-3-1-20.

"Non-business income," in turn, "means all income other than business income." IC 6-3-1-21. For purposes of calculating an Indiana corporation's adjusted gross income tax liability, business income is apportioned between Indiana and other states using a three-factor formula, while non-business income is allocated to Indiana or another state in which the taxpayer is doing business. May, 749 N.E.2d at 656. In that decision, the Tax Court determined that IC 6-3-1-20 incorporates two tests for determining whether the income is business or non-business: a transactional test and a functional test. Id. at 662-63. Under the transactional test, gains are classified as business income when they are derived from a transaction in which the taxpayer regularly engages. The particular transaction from which the income derives is measured against the frequency and regularity of similar transactions and practices of the taxpayer's business. Id. at 658-59.

Under the functional test, the gain arising from the sale of an asset will be classified as business income if the acquisition, management, and disposition of the property generating income constitutes an integral part of the taxpayer's regular trade or business operations. *See* IC 6-3-1-20.

Department regulations 45 IAC 3.1-1-29 and 45 IAC 3.1-1-30 provide guidance in determining whether income is business or non-business under the transactional test. 45 IAC 3.1-1-29 states in relevant part that, "Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is 'business income' or 'non-business income' is the identification of the transactions and activity which are the elements of a particular trade or business." 45 IAC 3.1-1-30 provides that, "[f]or purposes of determining whether income is derived from an activity which is in the regular course of the taxpayer's trade or business, the expression 'trade or business' is not limited to the taxpayer's corporate charter purpose of its principal business activity. A taxpayer may be in more than one trade or business, and derive business therefrom depending upon but not limited to some or all of the following:

(1) The nature of the taxpayer's trade or business.
(2) The substantiality of the income derived from the activities and the percentage that income is of the taxpayer's total income for a given tax period.
(3) The frequency, number of continuity of the activities and transactions involved.
(4) The length of time the property producing income was owned by the taxpayer.
(5) The taxpayer's purpose in acquiring and holding the property producing income.

The functional test focuses on the property being disposed of by the taxpayer. Id. Specifically, the functional test requires examining the relationship of the property at issue with the business operations of the taxpayer. May, 749 N.E.2d at 664. In order to satisfy the functional test, the property generating income must have been acquired, managed, and disposed by the taxpayer in a process integral to taxpayer's regular trade or business operations. Id. In May, the Tax Court defined "integral" as "part of or [a] constituent component necessary or integral to complete the whole." Id. at 664-65. The court concluded that petitioner retailer's sale of one of its retailing divisions was not "necessary or essential" to the petitioner's regular trade or business because the sale was executed pursuant to a court order that benefited a competitor and not the petitioner. Id. at 665. In effect, the court determined that because the petitioner was forced to sell the division in order to reduce its competitive advantage, the sale was not integral to the petitioner's own business operations. Id. Therefore, the proceeds from the division's sale were not business income under the functional test. Id.

A. Interest, Rent, Royalty Income.

Taxpayer receives money from the investment of "excess corporate cash" in short term deposit accounts. Taxpayer receives money from "the rental of unused corporate property." Taxpayer receives money in the form of "copyright[] and patent[]" license royalties.

Under the "transactional" test, these three categories of income are properly classified as business income because this income is derived from activities in which taxpayer regularly engages. There is nothing especially extraordinary about a company investing its excess cash in short-term, interest-bearing accounts; to the contrary, it would be decidedly irregular for any business entity – having access to unused cash assets – to allow those assets to remain dormant and unexploited. Similarly, taxpayer's practice of renting underutilized corporate property and licensing its copyrights and patents are also activities which occur in the regular course and operation of the taxpayer's business. Taxpayer argues that it is in the business of "producing and selling high performance specialty chemicals" and that it is not in the business of investing cash, renting property, or licensing intellectual property. However, the issue is not whether this income is or is not high-performance chemical income; the issue is whether or not receipts in the form of interest, rental, and royalties are *business* income. Under the "transactional test," this income is.

These first three income categories are also properly classified as business income under the functional test. The property to which this income is attributable – excess cash, underutilized property, and intellectual property – were all acquired and managed by the taxpayer "in a process integral to taxpayer's regular trade or business operations." May, 749 N.E.2d at 664. Taxpayer did not stumble across these assets by sheer happenstance. The cash, rental property, and intellectual property are each essential components within taxpayer's diverse but integrated business operation.

B. Deemed Sale of Assets.

Taxpayer and parent company entered into an agreement, pursuant to I.R.C. § 338(h)(10), whereby taxpayer sold its stock in the form of a "deemed asset sale." Under I.R.C. § 338(h)(10), the taxpayer was deemed to have sold all of its assets to the "new target" on the date of acquisition and immediately distribute the proceeds from this deemed asset sale to its parent corporation in complete liquidation.

Taxpayer is in the business of selling "high performance chemicals," providing "chemical management services," and in managing the assets related to those particular business activities. The deemed sale of assets was an extraordinary and nonrecurring transaction for the taxpayer. Therefore, the deemed sale does not meet the transactional test because it was not activity which occurred "in the regular course of the taxpayer's trade or business." 45 IAC 3.1-1-30.

Taxpayer chose to enter into a "deemed sale" of its assets thereby generating a substantial gain. Taxpayer's independent decision to dispose of its assets was a decision necessarily integral to the taxpayer's property and meets the requirements set out under the functional test. Accordingly, the proceeds resulting from the sale of its assets were appropriately classified as business income.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20020431.LOF

LETTER OF FINDINGS NUMBER: 02-0431
SALES/USE TAX
For The Tax Periods: 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. Sales Tax – Unitary Transactions

Authority: IC 6-2.5-2-1, IC 6-8.1-3-1, IC 6-8.1-1-1, IC 6-8.1-3-12, IC 6-8.1-4-2, IC 6-2.5-4-9, 45 IAC 2.2-4-25, 45 IAC 2.2-3-12, 50 IAC 4.3-4-10. 45 IAC 2.2-1-1.

Taxpayer protests the Department's assessment of sales tax after they reported tax due in a manner prescribed by an auditor who conducted a previous audit.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation which manufactures and installs signs. The manufacturing is completed at Taxpayer's out-of-state headquarters. The signs are prepared to custom order or to the specifications of various chain store clients. The installation and the associated preparation work is performed at the customer's location. Taxpayer also provides repair services for its clients and the work is usually performed at the client's location by Taxpayer's out-of-state employees.

Taxpayer was audited by the Department of Revenue in 1987 for the periods of 1982 through 1985. During the audit, the auditor determined that Taxpayer was a contractor making improvements to realty and instructed Taxpayer to collect sales tax on only the materials portion of its sign sales/installation transactions.

In the current sales/use tax audit for the periods of 1999 through 2001, the auditor determined that the signs are not considered realty and that Taxpayer is required to collect sales tax on all elements of the unitary transaction. The auditor "grossed up" the material cost to arrive at a total manufactured cost and assessed sales tax on the difference between the manufactured costs and the cost of materials which Taxpayer remitted. Taxpayer now protests the recent assessments. More facts supplied as necessary.

I. Sales Tax: Unitary Transactions

DISCUSSION

Taxpayer, an out-of-state corporation, is in the business of manufacturing and installing outdoor signs. The signs are prepared to custom order or to the specifications of various chain store clients. The installation and the associated preparation work is performed at the customer's location. Taxpayer also provided repair service for its clients and the work is performed at the client's location by Taxpayer's out-of-state employees.

Taxpayer was audited for the periods of 1982 through 1985. During that audit, the auditor determined that Taxpayer was a contractor based on the assumption that the signs became improvements to realty. Taxpayer reported Indiana contracts which were subject to tax as "sales" instead of reporting them as "contractor's materials". The auditor accepted Taxpayer's method of reporting due to the record keeping system of Taxpayer, however, the auditor advised Taxpayer how to report sales/use tax as a contractor. The auditor made adjustments assessing sales/use tax on "materials" used on Indiana jobs which Taxpayer did not report.

Subsequently, Taxpayer was audited for the periods of 1999 through 2001. During this audit, the auditor found that the signs were not improvements to realty and that tangible personal property including fabrication and assembly were subject to tax as a unitary transaction.

"An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana." IC 6-2.5-2-1. Also, the Department of Revenue has the primary responsibility for the administration, collection, and enforcement of listed taxes. IC 6-8.1-3-1. Sales and use taxes are included in the listed taxes. IC 6-8.1-1-1. Consequently, the Department of Revenue may audit any returns filed with respect to sales/use tax. IC 6-8.1-3-12. Specifically, IC 6-8.1-4-2(a) states:

The division of audit may:

(1) have full prompt access to all local and state official records;

(2) have access, through the data processing offices of the various state agencies, to information from government and private sources that is useful in performing its functions;

(3) inspect any books, records, or property of any taxpayer which is relevant to the determination of the taxpayer's tax liabilities;

(4) detect and correct mathematical errors on taxpayer returns;

(5) detect and correct tax evasion; and

(6) employ the use of such devices and techniques as may be necessary to improve audit practices.

Regarding contractors, IC 6-2.5-4-9 states:

(a) A person is a retail merchant making a retail transaction when the person sells tangible personal property which:

(1) is to be added to a structure or facility by the purchaser; and

(2) after its addition to the structure or facility, would become a part of the real estate on which the structure or facility is located.

(b) Notwithstanding subsection (a), a transaction described in subsection (a) is not a retail transaction, if the ultimate purchaser or recipient of the property from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

In addition, 45 IAC 2.2-4-25 defines a contractor as "any person engaged in converting construction material into realty. The term 'contractor' refers to general or prime contractors, subcontractors, and specialty contractors, including but not limited to persons engaged in building, cement work, carpentry, plumbing, heating, electrical work, roofing, wrecking, excavating, plastering, tile and road construction."

As a contractor, Taxpayer would be liable for sales tax only on the materials used. 45 IAC 2.2-3-12 states in relevant part:

(d) A person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchaser price of all material so used.

(e) A person selling tangible personal property to be used as an improvement to real estate may enter into a completely separate contract to furnish the labor to install or construct such improvement, in which case the sales tax shall be collected and remitted by such seller on the materials sold for this purpose. Such sale of materials must be identifiable as a separate transaction from the contract for labor. The fact that the seller subsequently furnished information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material.

From the aforementioned statutes, it is clear that in order to be considered a contractor, Taxpayer must be making an improvement to realty. Specifically, the signs Taxpayer installs must be considered real property. 50 IAC 4.3-4-10(e) (*formerly* 50 IAC 2.2-3-1(69)) states that signs including supports and foundations are considered personal property. Although the regulation is not definitive for sales tax purposes, it is influential. The signs that Taxpayer installs are specific to the businesses to whom they are sold. Typically, business owners do not intend to leave the sign in place beyond the life of the business and are removed when the business leaves in much the same way as booths or shelves. Here, the signs are considered personal property for sales/use tax purposes.

During the current audit, the auditor correctly realized Taxpayer was not a contractor and made adjustments in keeping with 45 IAC 2.2-1-1(a) to assess sales tax on the taxable but untaxed amounts. 45 IAC 2.2-1-1(a) states: "For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price."

Taxpayer argues that the current assessments are unreasonable because they relied on the previous auditor's recommendations. The current auditor was simply ensuring that Taxpayer was in compliance with the sales tax laws of Indiana pursuant to IC 6-8.1-3-1 and IC 6-8.1-3-12. The assessments in the first audit were the result of unreported sales whereas the current audit assessments resulted in the manner Taxpayer invoiced their Indiana customers. Taxpayer was assessed in the first audit only on the unreported materials from their sales and not assessed for the combined selling charge. Nevertheless, in the Explanation of Adjustments for the

1982 through 1985 audit, the auditor stated that "[t]axpayer is a contractor" and "[t]he taxpayer was advised of the correct method of reporting for the future." Taxpayer complied with these directions. Consequently, Taxpayer's protest of the assessments is sustained. However, Taxpayer is not a contractor and should collect and remit sales/use tax accordingly.

FINDING

Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest of the current liabilities is sustained, however, Taxpayer is not considered a contractor and will prospectively collect and remit sales/use accordingly.

DEPARTMENT OF STATE REVENUE

0420020432P.LOF

LETTER OF FINDINGS NUMBER: 02-0432P
Sales/Use Tax
For the Years 1987-2000

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. Tax Administration- Fraud Penalty

Authority: IC 6-8.1-10-4, 45 IAC 15-5-7 (3).

The taxpayer protests the imposition of the one hundred percent (100%) fraud penalty.

STATEMENT OF FACTS

The taxpayer is a husband and wife who operate a small business. The Indiana Department of Revenue, hereinafter referred as the "department," determined that the taxpayer had collected but not remitted sales taxes to Indiana from 1987 through 2000. The department assessed the sales taxes, interest, and the one hundred percent (100%) fraud penalty. The taxpayer protested the assessment of the fraud penalty and a hearing was held. The husband appeared at the hearing.

I. Tax Administration- Fraud Penalty

DISCUSSION

The taxpayer protests the imposition of the one hundred per cent (100%) fraud penalty.

The fraud penalty is imposed pursuant to IC 6-8.1-10-4 as follows:

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

The Regulations set out five required elements for establishing fraud. These five elements are found at 45 IAC 15-5-7 (3) as follows:

(A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.

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

(C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.

(D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.

(E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In this case, the taxpayer misrepresented to the department that it did not have sales tax to remit by failing to file the required returns. The taxpayer had filed returns and remitted the tax correctly prior to 1987 which shows that the taxpayer understood its duty to remit the collected sales taxes to the state. Further, the taxpayer admitted at the hearing that he always knew that he was supposed to remit the collected sales taxes. The department was deceived by the taxpayer's actions in that the department did not know that the proper amount of taxes were not being remitted. The department relied on the taxpayer's indication that no taxes were due. This reliance caused injury to the state in that it did not collect the proper amount of taxes. The facts of this case meet the requirements for the imposition of the one hundred percent (100%) fraud penalty.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

4220030003.LOF

LETTER OF FINDINGS NUMBER: 03-0003
Motor Carrier Tax
Penalty
For the Years 1999, 2000, 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. Motor Carrier Fuel Tax—Adequate Documentation

Authority: IC § 6-6-4.1-1; IC § 6-6-4.1-4; IC § 6-6-4.1-10; IC § 6-6-4.1-20; IC § 6-8.1-5-4; 45 IAC 13-2-1; 45 IAC 13-4-1; 45 IAC 13-4-3.

Taxpayer protests the proposed assessment of Indiana's motor carrier fuel tax.

II. Penalty—Negligence

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

Taxpayer protests the proposed assessment of the 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer is a common carrier that transports general freight, mostly pharmaceuticals, in trucks with refrigerator units. During the audit period (January of 1999 through December of 2001), taxpayer had approximately 39 vehicles subject to Indiana's Motor Carrier Fuel Tax. Some of the trucks are company owned, and some are operator owned. Drivers complete mileage and fuel information from stations and also withdraw fuel from taxpayer's bulk storage tank. Owner operators purchase all fuel from stations. During the audit period, an outside contractor compiled fuel and mileage information for the IFTA reports from trip envelopes that taxpayer submitted.

DISCUSSION

I. Motor Carrier Fuel Tax—Adequate Documentation

Taxpayer protests the proposed assessment of Indiana's Motor Carrier Fuel Tax, IC § 6-6-4.1-1 *et seq*. (MCT). The audit determined that taxpayer had not properly recorded all fuel withdrawals from the bulk fuel tank. Therefore, there was "unaccounted for fuel" found by comparing beginning and ending amounts in the bulk fuel tank. This fuel had not been properly taxed pursuant to IC § 6-6-4.1-4. *See also*, 45 IAC 13-2-1, 45 IAC 13-4-1, and 45 IAC 13-4-3, the applicable regulations. IC § 6-6-4.1-20 imposes a penalty for failure to keep records required by IC § 6-8.1-5-4.

In the Letter of Protest submitted to the Department, taxpayer originally argued that truck owner operators could have stolen the "unaccounted for fuel." At the hearing, taxpayer explained that he thought the outside contractor was reconciling the appropriate reports on the bulk fuel tank in order to account for all fuel dispensed. Taxpayer only became aware that the outside contractor was ignorant of the fact that taxpayer had a bulk fuel tank when the audit was performed. The outside contractor had not been compiling and reconciling the proper records in order to determine taxpayer's liability under the MCT. Taxpayer fired the outside contractor immediately and hired someone to do all metering, key locking, and recordkeeping in house. This person completely revamped and modernized taxpayer's recordkeeping system and fuel security systems, and spends several hours everyday keeping records up-to-date.

Pursuant to IC § 6-6-4.1-10, taxpayer is required at all times to keep accurate records of fuel disbursed and taxes remitted on the disbursed fuel. Taxpayer admittedly did not ensure that proper records were kept; instead, he relied on the expertise of the outside contractor whose services he engaged to do the job for him. Taxpayer asserts it is currently in compliance with the record keeping provisions of MCT. He was not in compliance during the audit period. Therefore, the audit's proposed assessment of the tax is proper.

FINDING

Taxpayer's protest concerning the proposed assessment of Indiana's Motor Carrier Fuel Tax is denied.

II. Penalty—Negligence

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 stated at the hearing that there was no intent to defraud the state, and that his failure to pay the proper amount of tax was due to his reliance on the expertise of the independent contractor he specifically hired to maintain proper records.

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 set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Taxpayer failed to keep proper fuel records related to the bulk fuel tank withdrawals, which caused inadequate records for several mileage categories; the contractor's negligence caused the bulk fuel recordkeeping error. And while a taxpayer cannot avoid tax liability based on a contract, given the totality of the circumstances, waiver of the penalty is appropriate in this instance.

FINDING

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

DEPARTMENT OF STATE REVENUE

0220030078.LOF

LETTER OF FINDINGS: 03-0078
Corporate Income Tax
For the Periods 1999 and 2000

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

ISSUES

I. Pre-Merger Special Corporation Status.

Authority: IC 6-2.1-3-24; IC 6-2.1-3-24.5; IC 6-3-2-2.8(2); 45 IAC 1.1-3-11; I.R.C. § 1361(b); I.R.C. § 1361(b)-(d); I.R.C. § 1361(b)(3); I.R.C. § 1361(b)(3)(A); I.R.C. § 1361(b)(3)(B)(ii); I.R.C. § 1363.

Taxpayer, as a subsidiary of parent corporation qualified to file as an S-Corporation prior to its merger in May of 1999, argues that it was itself entitled to file tax returns as a SC (Special Corporation) return.

II. Post-Merger Special Corporation Status.

Authority: IC 6-2.1-3-24.5; 45 IAC 1.1-3-11; I.R.C. § 1361(b).

Taxpayer maintains that, having merged with its parent company in May of 1999, it was thereafter entitled to file tax returns as an S-Corporation.

III. Equitable Estoppel – Special Corporation Status.

Authority: Hi-Way Dispatch, Inc. v. Indiana Dept. of State Revenue, 756 N.E.2d 587 (Ind. Tax Ct. 2001); 45 IAC 15-3-2(d)(3); 45 IAC 15-3-2(e); Black's Law Dictionary (7th ed. 1999).

Taxpayer maintains that the Department of Revenue is equitably estopped from disallowing its pre-merger claim to Special Corporation status.

STATEMENT OF FACTS

Taxpayer performed several construction contracts within the state. Taxpayer filed an Indiana income tax return as an SC-Corporation. During an audit of taxpayer business records and tax returns, the Department of Revenue (Department) determined taxpayer did not qualify for SC-Corporation status and assessed corporate income taxes accordingly. The taxpayer disagreed with the Department's interpretation and application of the law and submitted a protest to that effect. An administrative hearing was conducted, and this Letter of Findings results.

DISCUSSION

I. Pre-Merger Special Corporation Status.

Taxpayer merged with its parent company May 1, 1999. Previous to that date, taxpayer operated as a subsidiary of the parent company completing construction projects within the state. Taxpayer maintains that because – prior to the merger – the parent company could have made an S-Corporation election, taxpayer itself could also have made an S-Corporation election. There is no dispute that during the pre-merger period, neither parent company nor taxpayer had made an S-Corporation election. Nonetheless, taxpayer maintains that because it *could* have made the election, it was entitled to submit an SC-Return.

IC 6-2.1-3-24 states that "Gross income received by a corporation that is exempt from the adjusted gross income tax under IC 6-3-2-2.8(2) is exempt from gross income tax." In turn, IC 6-3-2-2.8(2) provides an exemption for the state's adjusted gross income tax to "Any corporation which is exempt from income tax under Section 1363 of the Internal Revenue Code...." I.R.C. § 1363 sets out the tax treatment afforded S-Corporations and its shareholders.

Taxpayer maintains that it was qualified to file as an S-Corporation during the pre-merger period. According to taxpayer, it was a domestic corporation, it had no more than 75 shareholders, the shareholders were all individuals or "qualified shareholders," and taxpayer had only one class of stock. *See* I.R.C. § 1361(b)-(d).

In effect, taxpayer argues that it is a qualified subchapter S subsidiary (QSSS). A QSSS is a wholly-owned subsidiary of a parent S-Corporation that the parent corporation decides to treat as a QSSS. *See* I.R.C. § 1361(b)(3). For federal and state purposes, a QSSS is not treated as a separate entity, and all of its assets, liabilities, and tax items are treated as the assets liabilities, and tax items of the parent S-Corporation. I.R.C. § 1361(b)(3)(A). Therefore, for federal and state tax purposes, the QSSS is disregarded as an entity separate from the parent S-Corporation, and all of the QSSS's tax information is reported on the parent S-Corporation's informational tax returns.

In addition, Indiana exempts from adjusted gross income tax the income of a "Special Corporation." Under IC 6-2.1-3-24.5 and 45 IAC 1.1-3-11, a "Special Corporation" is a corporation which otherwise qualifies as an S-Corporation as defined in I.R.C. § 1361(b) but which has *not* made the required federal election. Presumably, under IC 6-2.1-3-24.5, taxpayer's parent company could have qualified to submit an Indiana tax return as a "Special Corporation."

However, the issue is not whether the parent company could have qualified to file as a Special Corporation. Taxpayer argues that as a putative QSSS, it also could have filed – without making a federal election – as a "Special Corporation." Taxpayer maintains that it met the qualifications set out in I.R.C. § 1361(b) and "[a]s a result [taxpayer] could have made a valid S election and therefore would have qualified as a special corporation for Indiana tax purposes for the [pre-merger] period."

The Department is unable to agree with taxpayer's conclusion. Under I.R.C. § 1361(b)(3), the tax treatment and the qualifications of a subsidiary owned by an S-Corporation, are not the same. In order for a putative QSSS to qualify for S-Corporation status, I.R.C. § 1361(b)(3)(B)(ii) requires the parent company to make a second federal election to treat the subsidiary as a QSSS. Under the IRC provision, only a parent-corporation which has itself made an election to file as a S-Corporation may make the second federal election to treat the subsidiary as a QSSS. Taxpayer urges the Department not to read the federal regulations so narrowly as to deny taxpayer's request for relief based upon the parent company's failure to make such an election. According to taxpayer, because the parent company *could* have made the election, it was not necessary to actually do so. The Department declines taxpayer's invitation to so interpret the Indiana and federal codes and ignore the explicit election requirement specified in I.R.C. § 1361(b)(3)(B)(ii).

FINDING

Taxpayer's protest is respectfully denied.

II. Post-Merger Special Corporation Status.

The Department's audit of taxpayer's business records and tax returns covered the periods ending April 30, 1999, and April 30, 2000. According to taxpayer, it completed a merger with the parent company on May 1, 1999. As a result, "there no longer was a parent corporation and a subsidiary C corporation situation."

Taxpayer has submitted documentation substantiating its merger with the parent company and that the merger was effective on April 30, 1999. Taxpayer has also submitted information documenting that it submitted a federal Form 2553 by which the combined corporation (taxpayer) elected to be treated as an S-Corporation. In addition, taxpayer supplied a copy of an acknowledgement by the Internal Revenue Service accepting taxpayer's "election to be treated as an S corporation with an accounting period of Jan. 31, 2001, beginning May 01, 2000."

Taxpayer argues that it was entitled to S-Corporation status after May 1, 1999 because the parent / subsidiary relationship ended and the combined entity qualified as an S-Corporation. Taxpayer's argument is based on IC 6-2.1-3-24.5 and 45 IAC 1.1-3-11, defining "Special Corporation. A "Special Corporation" is a corporation which otherwise qualifies as an S-Corporation as defined in I.R.C. § 1361(b) but which has not made the federal election. The Department agrees that – based upon the information supplied – the combined entity would have qualified as a Special Corporation under IC 6-2.1-3-24.5 as of the day the two predecessor entities merged.

FINDING

Subject to a determination by the supplemental audit, taxpayer's protest is sustained.

III. Equitable Estoppel – S-Corporation Status.

Taxpayer argues that the Department is estopped from denying its claim to S-Corporation status during the pre-merger period. According to taxpayer, taxpayer's representative sought the Department's opinion regarding its QSSS status. Taxpayer states that a representative of the Department confirmed its own conclusion that taxpayer – as a subsidiary of a qualifying parent – was a "special corporation" because the only requirement was that taxpayer "could have made the election."

Equitable estoppel is a defensive doctrine which "prevents one party from taking unfair advantage of another when, through false language or conduct, the person to be estopped has induced another person to act in a certain way...." Black's Law Dictionary 571 (7th ed. 1999). Taxpayer maintains that, after having relied upon statements of a competent Department representative, the Department may not afterwards back-track on its position to the taxpayer's detriment.

"Equitable estoppel cannot ordinarily be applied against government entities." Hi-Way Dispatch, Inc. v. Indiana Dept. of State Revenue, 756 N.E.2d 587, 598 (Ind. Tax Ct. 2001). However, application of the doctrine against a government entity is not absolutely prohibited. Id. The exception to this general rule is where "the public interest would be threatened by the government's conduct." Id.

Even accepting taxpayer's assertion, that it relied on incorrect guidance from the Department to its detriment, the Department does not conclude that the incorrect advice threatened the public's interest.

A taxpayer does have the right to rely upon the written opinions offered by the Department in response to specific requests made by a taxpayer. "In respect to rulings issued by the department, based on a particular situation which may affect the tax liability of the taxpayer, only the taxpayer to whom the ruling was issued is entitled to rely on it." 45 IAC 15-3-2(d)(3). However, the rules specifically state that "Oral opinions or advice will not be binding upon the department." 45 IAC 15-3-2(e). Where written questions inquire as to the tax consequences of a particular transactions, "[T]he department may consider such letters as rulings that may bind the department to the position stated in respect to that taxpayer only." Id.

Taxpayer sought advice from a Department representative. At this point, it is not possible to fully understand the particular question taxpayer tendered to the representative; it is not possible to know if the representative fully and correctly understood the taxpayer's question or taxpayer's particular business circumstances; it is not possible to know precisely how the representative responded to the taxpayer's questions. The advice offered was not provided in the form of a written ruling which would thereafter bind the Department. There is no indication that the oral advice offered to the taxpayer – correct or incorrect – threatened the larger public interest.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02-20030129P.LOF

LETTER OF FINDINGS NUMBER: 03-0129P
Income Tax
Calendar Year 2001

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late payment penalty, and, penalty on underpayment of estimated tax.

II. Tax Administration – Interest

Authority: IC 6-8.1-10-1

The taxpayer protests the interest assessment.

STATEMENT OF FACTS

The late payment penalty and interest, and, penalty and interest for underpayment of estimated tax, was assessed on an income tax return for the calendar year 2001.

The taxpayer is an insurance company headquartered out-of-state.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the negligence penalty should be waived as the error was the result of unintentional oversight. The taxpayer has the option of paying a premium tax or an income tax each year. This election is to be made in November of the tax year. The taxpayer normally paid the premium tax, but for 2001 decided to pay the income tax instead. However, this information was not communicated to the taxpayer's premium tax department, and therefore, the premium tax department continued to make the estimated tax payments to the Indiana Insurance Department instead on the Indiana Department of Revenue. As the Indiana Department of Revenue did not get the estimated payments, the resultant income tax computation resulted in penalty and interest assessed for the underpayment of estimated tax, and, penalty and interest for late payment.

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

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

FINDING

The taxpayer's penalty protest is denied.

II. Tax Administration – Interest

DISCUSSION

The taxpayer protests the interest assessment.

IC 6-8.1-10-1 does not allow the waiver of interest. As such, the Department finds the assessment of interest proper and denies the interest protest.

FINDING

The taxpayer's interest protest is denied.

DEPARTMENT OF STATE REVENUE

4220030138.LOF

LETTER OF FINDINGS: 03-0138
International Fuel Tax Agreement (IFTA)
For the Tax Periods 1999, 2000, and 2001

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

ISSUE

I. Fuel Tax Assessment.

Authority: IC 6-8.1-3-14; IC 6-8.1-5-1(b); IC 6-8.1-5-4(a); IFTA Articles of Agreement, R1210.200 (1998); IFTA Procedures Manual, P540, 550 (1996); IFTA Audit Manual, A100 (1998).

Taxpayer argues that the Department of Revenue (Department) audit of taxpayer's fuel purchase records resulted in an erroneous assessment of additional fuel tax; according to taxpayer, the additional assessment was based upon incorrect information.

STATEMENT OF FACTS

Taxpayer is in the business of hauling general freight. It owns a number of trucks and occasionally leases others. The Department conducted an audit of taxpayer's fuel records and determined that it owed additional fuel tax. The taxpayer argued that the assessment of additional tax was incorrect. Taxpayer submitted a protest, an administrative hearing was held, and this Letter of Findings results.

DISCUSSION

I. Fuel Tax Assessment.

IFTA is an agreement between various United States jurisdictions and Canada allowing for the apportionment of previously collected motor fuel taxes. The agreement's goal is to simplify the tax, licensing, and reporting requirements of interstate motor carriers such as taxpayer. The agreement itself is not a statute but was implemented in Indiana pursuant to the authority granted under

IC 6-8.1-3-14.

As taxpayer's home jurisdiction, Indiana audited taxpayer's records to determine the amount of fuel taxpayer used, the amount of taxes paid on that fuel, the states in which taxpayer operated its trucks, and the number of miles driven in each of those states. Thereafter, the amount of fuel tax paid was apportioned among the states in which taxpayer operated its trucks based upon the number of miles driven in each of those state taxing jurisdictions.

Taxpayer's drivers buy fuel two different ways. The first way is to buy fuel from an authorized local supplier. Each driver is assigned authorization cards. These authorization cards allow the driver to buy fuel from two different "fuel networks." The fuel networks are groups of associated suppliers which provide taxpayer a centralized billing service. As far as the driver is concerned, the authorization card works like a credit card. After each purchase, the local supplier gives the driver a copy of the invoice. When the driver returns to taxpayer's location, the driver collects the invoices and places them into a "trip envelope."

After the driver turns in a trip envelope, taxpayer's "log audit clerk" enters the fuel purchase information into the taxpayer's own computer system. However, taxpayer pays the fuel networks on the basis of a faxed invoice received directly from the fuel network.

The second way a driver can buy fuel is to pay for cost from his own pocket and turn the bill over to the log audit clerk. The clerk enters that amount on taxpayer's computer system and arranges for the driver to be reimbursed. According to taxpayer, this happens rarely because of the inconvenience to the driver.

The amount of purchased fuel recorded on taxpayer's computer system should equal the amount of invoices received from the fuel networks plus the amounts reimbursed to the drivers. In a perfect world, it would be possible to justify all these amounts, determine the total amount of fuel purchased, determine the jurisdictional miles, and determine the exact amount of any tax due.

During the audit of taxpayer's 1999 through 2001 records, it was determined that the faxed invoices received from the fuel networks, the invoices received from the individual drivers, the information written on the trip envelope, and the information contained within taxpayer's computer system could not be reconciled.

The issue raised by taxpayer stems from 76 fuel purchases recorded on taxpayer's computer system. The audit's assessment of additional fuel tax is based on these 76 purchases. Taxpayer argues that the 76 fuel purchases should be removed from the audit report because there is no record of these purchases elsewhere. According to taxpayer, the 76 purchases are simply "entry errors." Taxpayer argues that the 76 entries should be deleted because none of the entries correspond to any of the invoices received from the fuel networks and do not correspond to any of the recorded reimbursements paid individual drivers. According to taxpayer, none of the 76 entries have an invoice number and it cannot find any documentation which corresponds to these particular 76 entries.

Taxpayer comes to the conclusion that the 76 entries should be deleted because, "An audit that improperly includes purchases of fuel that the vendor generated purchase records don't include is not an accurate audit conducted in a professional manner as required by IFTA standards." *See* IFTA Audit Manual, A100.

IFTA Articles of Agreement, R1210.200 (1998) provides the standard for determining whether a proposed assessment may successfully be challenged by the licensee. "The assessment made by a base jurisdiction pursuant to this procedure shall be presumed to be correct and, in any case where the validity of the assessment is questioned, the burden of proof shall be on the licensee to establish by a fair preponderance of the evidence that the assessment is erroneous or excessive."

It is the taxpayer's responsibility to maintain specific, detailed, and accurate information concerning its fuel purchases. As set out in IC 6-8.1-5-4(a):

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks. *See also* IFTA Procedures Manual, P540, 550 (1996).

The Department does not agree with taxpayer's conclusion that it has established, by a preponderance of the evidence, that the 76 entries should be deleted from the audit report. The 76 entries were not invented by the audit; the entries were obtained from taxpayer's own records. There is nothing inherently incredible or plainly erroneous about the information contained within the 76 entries; the dates, gallons purchased, state jurisdictions, vehicle numbers are all entirely credible and comport substantively with information accepted by both taxpayer and the audit. Although taxpayer has not been able obtain documents which further substantiates the 76 entries, neither has it been able to produce information which would explain where these entries came from or information which confirms that the purchases did not occur.

Taxpayer asks the Department to choose between different sets of conflicting fuel purchase records, ignore entirely certain of those records, and select those records which provide taxpayer the most beneficial result. The Department is unable to accept taxpayer's invitation to do so because it is not up to the Department to refute, corroborate, or explain the information contained within taxpayer's own records. The proposed assessment of additional fuel tax is "prima facie evidence that the department's claim for the unpaid tax is valid." IC 6-8.1-5-1(b). "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Id. *See also* IFTA Articles of Agreement, R1210.200. Taxpayer has not met this burden.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02-20030178P.LOF

LETTER OF FINDINGS NUMBER: 03-0178P
Income Tax
Calendar Years 1999 & 2000

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ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late payment penalty, and, penalty on underpayment of estimated tax.

STATEMENT OF FACTS

The taxpayer was assessed penalty as a result of a Department audit conducted for the calendar years 1999 and 2000.

The taxpayer is a large hair care franchiser. The taxpayer has 55 locations in Indiana. The taxpayer is domiciled out-of-state.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be waived as the error was the result of an inadvertent misclassification of income at the low rate instead of the proper high rate for gross income tax.

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

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

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

04-20030180P.LOF

LETTER OF FINDINGS NUMBER: 03-0180P
Sales & Use Tax
Calendar Year 2000

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ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the negligence penalty.

II. Tax Administration – Interest

Authority: IC 6-8.1-10-1

The taxpayer protests the interest assessment.

STATEMENT OF FACTS

The taxpayer was assessed penalty and interest on a sales and use tax audit conducted by the Department for the calendar year 2000.

The taxpayer is a contractor engaged in the underground installation of cable for utility company contractors. The taxpayer is domiciled in Indiana with one business location.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty and interest be waived as the company is a new company and the penalty and interest represent substantial amounts.

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

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

FINDING

The taxpayer's penalty protest is denied.

II. Tax Administration – Interest

DISCUSSION

The taxpayer protests the interest assessment.

IC 6-8.1-10-1 does not allow the waiver of interest. As such, the Department finds the assessment of interest proper and denies the interest protest.

FINDING

The taxpayer's interest protest is denied.

DEPARTMENT OF STATE REVENUE

02-20030185P.LOF

LETTER OF FINDINGS NUMBER: 03-0185P
Income Tax
For the Years 1998-2001

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ISSUE

I. Tax Administration- Ten Percent (10%) Negligence Penalty

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

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer is in the business of performing testing services and upgrading construction of storage tanks to comply with environmental laws and regulations. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax, interest, and penalty. The taxpayer protested the imposition of the ten percent (10%) negligence penalty. The taxpayer was given ample opportunity to schedule a hearing on the protest and/or submit additional information. Since the taxpayer did neither, this finding is based on the information in the file.

I. Tax Administration- Ten Percent (10%) Negligence Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

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

This taxpayer has filed Indiana income taxes since 1991. During the period of the audit, the taxpayer ignored the law and departmental instructions for the payment of Indiana corporate income taxes. The taxpayer did not report any withholding on out of state contractors as clearly required by the law. Also, it did not file a return or pay taxes for the 2001 year. These breaches of the taxpayer's duty constitute negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

10-20030212P.LOF

LETTER OF FINDINGS NUMBER: 03-0212P
FOOD AND BEVERAGE TAX
For Years 1999, 2000, 2001 and 2002

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

ISSUES

I. Tax Administration - Interest

Authority: IC 6-8.1-10.1

Taxpayer requests waiver of the interest imposed.

II. Tax Administration - Penalty

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

Taxpayer requests waiver of the 10% negligence penalty imposed for failure to use ordinary business care.

STATEMENT OF FACTS

Taxpayer is protesting the imposition of the interest and 10% negligence penalty imposed because it was the victim of employee theft and because it is experiencing difficult financial times that may preclude it from being capable of paying the accrued penalties and interest.

I. Tax Administration - Interest

DISCUSSION

Pursuant to IC 6-8.1-10.1, the department has no authority to waive interest.

FINDINGS

The taxpayer is respectfully denied.

II. Tax Administration – Penalty

DISCUSSION

IC 6-8.1-10-2.1(d) provides:

> If a person subject to 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 the 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.

Furthermore, 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 under this section. 45 IAC 15-11-2(c). Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;
(2) judicial precedents set by Indiana courts;
(3) judicial precedents established in jurisdictions outside Indiana;
(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case. Employee theft of the magnitude in this situation, absent any civil or criminal liability against the perpetrators, does not show reasonable care and therefore does not relieve a taxpayer of its duty to collect and remit taxes as they become due.

FINDINGS

The taxpayer is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420020014.SLOF

SUPPLEMENTAL LETTER OF FINDINGS: 02-0014
Indiana Sales and Use Tax
For the Tax Years 1996 Through 2000

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

ISSUES

I. Integrated Production Process – Sales and Use Tax.

Authority: IC 6-2.5-1-1 et seq.; IC 6-2.5-5-3; IC 6-2.5-5-3(b); Rotation Products Corp. v. Dept. of State Revenue, 690 N.E.2d 795 (Ind. Tax Ct. 1998); Harlan Sprague Dawley, Inc. v. Dept. of State Revenue, 605 N.E.2d 1222 (Ind. Tax Ct. 1992); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

Taxpayer maintains that its "integrated production process" begins at the point where it first obtains waste oil from its suppliers and ends at the point where the fully processed oil is delivered to its customers.

II. Sales and Use Tax Refund Claim.

Authority: IC 6-8.1-9-1(a).

Taxpayer argues that it was entitled to submit a claim for refund of sales and use taxes paid by a predecessor company.

III. Abatement of the Ten-Percent Negligence Penalty.

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

Taxpayer repeats its assertion that the audit's assessment of the ten-percent negligence penalty was unwarranted and that it is entitled to relief from that penalty.

STATEMENT OF FACTS

Taxpayer is in the business of acquiring, processing, and reselling petroleum products. Taxpayer purchases waste oil from various suppliers and – in some circumstances – is paid by suppliers who wish to dispose of their waste oil.

Taxpayer treats the waste oil at three distinct stages. When taxpayer first picks up the oil, it is filtered as it is being pumped into one of the taxpayer's trucks in order to remove certain contaminants. Thereafter, this partially filtered oil is transferred to taxpayer's central processing facility. At this facility, the waste oil undergoes additional filtration. In addition – during the period of time considered by the audit – taxpayer employed two supplementary methods of treating the oil at the central facility. Depending upon the nature of the contaminants contained within the waste oil, taxpayer used either a heat treating process or a chemical process. After treatment at the central facility, the oil is transported to one of the taxpayer's customers. As the partially treated oil is off-loaded, the oil is once again filtered.

Taxpayer's customers are uniquely equipped to burn this fully treated oil. Those customers include asphalt companies, steel mills, papers mills, and electric utilities. Unless the waste oil was properly treated to remove the offending contaminants, these customers would be unable to use the waste oil as fuel.

Taxpayer is also engaged in the business of cleaning up, treating, and appropriately disposing of contaminated water and contaminated solids.

The audit found that taxpayer's field-filtering activities, which occurred before the oil reached the central processing facility, were "preproduction" activities. The audit found that taxpayer's field-filtering activities, which occurred after the treated oil left that same facility, were "post-production" activities. In both instances, the audit determined that taxpayer's equipment employed during these "preproduction" and "post-production" activities was not entitled to an exemption from the state's gross retail tax. Therefore, the audit concluded that taxpayer's field-filtering equipment was not entitled to the exemption.

The taxpayer disagreed with the audit's conclusion. In effect, taxpayer argued that processing of the waste oil – from the point at which the waste oil was first acquired to the point where the processed oil was delivered to one of its customers – constituted one, unbroken production process.

At least in part, the original Letter of Findings (LOF) agreed with taxpayer's argument. The LOF agreed that taxpayer's "field-filtering" activity altered the nature and composition of the oil both at the time the waste oil was pumped on-board taxpayer's truck and at the point where the fully-processed oil was off-loaded at the customers' location. Therefore, the LOF concluded that the taxpayer was entitled to purchase the field-filtering equipment without paying sales tax. However, the Department explicitly disagreed with taxpayer's implication that its exempt activities activity extended in one unbroken, indivisible process from the point at which it first acquired the waste oil to the point where it made the final delivery of the processed oil. The Department concluded that taxpayer was entitled to an exemption for the field-filtering equipment. However, it was not entitled to an exemption on the trucks used to transport the oil to the central facility, and it was not entitled to an exemption on the trucks used to deliver the treated oil to the customers.

Thereafter, taxpayer requested that the Department revisit the issue. An opportunity was provided for taxpayer to explain its position during an administrative hearing, and this Supplemental Letter of Findings follows.

DISCUSSION

I. Integrated Production Process – Sales and Use Tax.

Indiana imposes a sales tax on retail transactions and a complimentary use tax on tangible personal property that is stored, used, or consumed in the state. IC 6-2.5-1-1 et seq. In its original protest, taxpayer argued that it was entitled to a sales tax exemption on the field-filtering equipment installed on its trucks pursuant to IC 6-2.5-5-3(b). That exemption statute reads as follows:

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

Taxpayer filters the waste oil at the time the waste oil is first acquired from the supplier; in order to remove coarse contaminants, the oil is filtered at the point the oil is pumped on-board the taxpayer's truck. The oil is then transported to taxpayer's central location where further processing – including additional filtration – occurs. After the processing at the central location is complete, taxpayer transports the oil to the customer's site. As taxpayer pumps the oil out of its delivery truck, the oil is once again filtered in order to assure that the oil may be used by the customer.

The original LOF determined that taxpayer was entitled to a sales tax exemption for the field-filtering equipment because the equipment was one step in the process whereby taxpayer changed the "form, composition, and character of the waste oil" producing a marketable product.

However, taxpayer argues that – having determined the field-filtering equipment was exempt – the trucks upon which this equipment is installed are also entitled to the same exemption.

To that end taxpayer cites to General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991) *aff'd* 599 N.E.2d 588 (Ind. 1992).

In General Motors, the automobile manufacturer shipped component automobile parts to its plants and claimed an exemption for the purchase of items employed in the interdivisional transfer of those components parts. The court held that the automobile manufacturer's packing materials were part of the integral process whereby the manufacturer produced its finished product. Therefore, the automobile manufacturer's packing materials were exempt under IC 6-2.5-5-3. The court reached that decision after finding the automobile manufacturer's widely separated production facilities formed a cohesive, singular production unit in which the claimant's "manufacture of finished marketable automobiles [was] accomplished by one continuous integrated production process within which the transport of parts from component plants to assembly plants [was] an essential and integral part." General Motors, 578 N.E.2d at 404.

In finding that the automobile manufacturer's production process encompassed manufacturing activities performed at multiple sites, the court identified a number of significant facts. Specifically, the court found that "[t]he facts in the case [FN3] as well as previous judicial findings [FN4] indicate GM's production process is by nature highly integrated. The court's sole concern, however, is whether GM's manufacturer of finished automobiles qualifies as one continuous integrated production process for the purpose of exemption from sales/use tax." Id. at 402.

Footnote three gives some indication of the evidence which the court relied in arriving at a conclusion that GM's production was both "continuous" and "integrated." Specifically, the court found that "GM's component plant personnel collaborate with the assembly plant personnel (1) to develop new product concepts, (2) to individually design, engineer, and test the performance of new parts and packing materials, (3) to plan the layout and production processes for new parts, (4) to coordinate production schedules because delays at one plant would have an immediate effect on the other plants, and (5) to solve problems and ensure quality control." Id. at n.3. In addition, the court noted that a "continuity of production exists between GM's different plants [which is] demonstrated by the standard practice of shifting certain production operations back and forth between component and assembly plants when necessary for more efficient operation." Id.

It was in the context of these particularized facts and findings that the court held that GM's manufacture of automobiles represented one "continuous integrated production process." Id. at 404. It was in the context of these particularized facts and findings that the court held that GM's assembled automobiles, and not the automobile's component parts, constituted the taxpayer's most marketable product and that the production of the that "most marketable product" constituted the conclusion of GM's integrated but physically discontinuous manufacturing process.

In addition, taxpayer cites to Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983) to support its contention that its trucks are exempt from sales tax. In that case, the court found that appellee taxpayer's trucks – used to transport unfinished stone from one stage of production to another – were exempt from sales tax because the equipment was being used within that taxpayer's own on-site production process whereby it manufactured crushed stone. Cave Stone 457 N.E.2d at 521, 523.

Nonetheless, the Department must disagree with the taxpayer's contention that its trucks are exempt from sales tax because the trucks are not used to move the waste oil and the semi-processed oil *within* an integrated, continuous, indivisible, product whereby taxpayer transforms the waste oil into usable, fully processed oil.

Unlike the automobile manufacturer in General Motors, there is no indication that the initial filtering, which occurs at the time the waste oil is first loaded on-board its trucks, is inextricably linked to the processing activities which take place at taxpayer's central location. In addition, there is no indication that the filtering which occurs at the point where the semi-processed oil is off-loaded is in anyway integrated with the processing activities which occur back at the central processing facility. Instead, the fact that taxpayer has chosen to conduct certain of its filtering activities off-site – whether by happenstance, necessity, or design – does not serve to bring each and every item of equipment within the "integrated" process whereby taxpayer produces usable, processed oil.

The Department is aware of the requirement that the legislature's intent in creating the exemption must not be so narrowly defined as to preclude from exemption those items which properly belong with the ambit of the exemption. Harlan Sprague Dawley, Inc. v. Dept. of State Revenue, 605 N.E.2d 1222, 1225 (Ind. Tax Ct. 1992). However, "it is [also] well-settled that exemptions are strictly construed against the taxpayer." Rotation Products Corp. v. Dept. of State Revenue, 690 N.E.2d 795, 798 (Ind. Tax Ct. 1998).

Taxpayer is entitled to the exemption for the field-filtering equipment which acts directly upon the waste oil and the semi-processed oil. Nonetheless, the Department must give effect to the requirement that, in order to qualify for an exemption pursuant to IC 6-2.5-5-3(b), the equipment must be one of the constituent elements within "an integrated process which produces tangible personal property," Rotation Product, 690 N.E.2d at 799, and must be "an essential and integral part of an integrated production process." General Motors, 578 N.E.2d at 401. Unlike appellee taxpayer's trucks in Cave Stone, taxpayer's own trucks are not "an essential and integral part of the procedures by which the [product] is transformed into a marketable product." Cave Stone, 457 N.E.2d at 523. Taxpayer's field-filtering activities are not an indivisible, component of the taxpayer's production process because the field-filtering activities and the processing which occurs at the central location to do not together form "one continuous integrated process." General Motors, 578 N.E.2d at 402. The Department is unable to accept taxpayer's expansive construction of the exemption statute and the relevant case law.

FINDING

Taxpayer's protest is respectfully denied.

II. Sales and Use Tax Refund Claim.

At the time the original audit report was prepared, taxpayer submitted a request for refund of 1996-1999 sales and use taxes purportedly paid in error. The audit concluded – in part – that the taxpayer was not entitled to make the claim because "it had filed claim for payment of tax on purchases made by another entity and prior to the creation of taxpayer corporation." The original LOF agreed and denied the taxpayer's protest of this issue.

The relevant statute provides that, "If a person has paid more tax than the person determines is legally due for a particular taxable period, the person may file a claim for refund with the department." IC 6-8.1-9-1(a). Because taxpayer was incorporated in August of 1997, taxpayer's request for refund of taxes paid in 1996 and 1997 was denied because taxpayer had initially failed to demonstrate that it was the same "person" as the predecessor company which had originally paid the taxes. As stated in the original LOF, "the only thing which is certain is that taxpayer sprang into existence on August 4, 1997, and that taxpayer and the predecessor share similar names."

Pursuant to its request that the Department reconsider this issue within the Supplemental Letter of Findings, taxpayer has provided information documenting taxpayer's acquisition of predecessor company's assets. In a "Written Action of the Company Managers," predecessor company was directed to "transfer all of its assets, real and personal, tangible and intangible, to [taxpayer]." In a copy of the "Bill of Sale," predecessor company agreed to sell all of its "assets, tangible, and intangible, of whatever kind and nature" to taxpayer. In that Bill of Sale, predecessor company promised that it was the owner of the transferred property, that the property was free of any undisclosed encumbrances, and that the predecessor company would protect taxpayer's interest in the property if any future claims were made against that property. An examination of the Secretary of State's records indicates that predecessor company survived the sale of the assets and did not become inactive until September 2000 approximately three years after predecessor company sold taxpayer its assets.

Taxpayer has not established that it is the same "person" as predecessor company. Under IC 6-8.1-9-1(a), it is not entitled to submit a claim for refund of taxes paid by predecessor company because taxpayer is a different "person" than predecessor company. The documentation reveals that taxpayer entered into an asset sale with predecessor company; taxpayer did not merge with or subsume predecessor company evidenced by the fact that predecessor company maintained a separate business existence until three years after the date of the asset sale. In addition, the parties' own agreement indicates that taxpayer expected predecessor company would survive the asset sale in order to defend taxpayer against any future challenge to taxpayer's ownership rights to the transferred assets. Predecessor company was entitled to submit a claim for a refund of taxes. There is no indication taxpayer, by purchasing the assets of predecessor company, succeeded to that entitlement.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer repeats its assertion that it is entitled to abatement of the ten-percent negligence penalty imposed pursuant to IC 6-8.1-10-2.1(a).

Under IC 6-8.1-10-2.1(d) the Department is authorized to waive the penalty if the taxpayer demonstrates that its failure to pay the tax deficiency was based on "reasonable cause and not due to willful neglect." 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...."

In the original LOF, the department declined to abate the penalty concluding that taxpayer's "bare assertion that it 'demonstrated reasonable cause for the Department to waive the negligence penalty' [was] insufficient to establish that it exercised the 'ordinary business care and prudence' required of an 'ordinary reasonable taxpayer.'" Taxpayer has presented nothing which would permit the Department to depart from that original conclusion.

FINDING

Taxpayer's protest is respectfully denied.

INDIANA DEPARTMENT OF STATE REVENUE
REVENUE RULING #2003-01 ST
June 27, 2003

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 superceded or deleted by publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

Sales/Use Tax – Application of Sales/Use Tax to Sales of Not-For-Profit Organizations

Authority: IC 6-2.5-5-26b, Rule 45 IAC 2.2-5-58

The taxpayer requests the Department to rule whether or not the sales of the taxpayer are subject to sales/use tax.

STATEMENT OF FACTS

The taxpayer is a not-for-profit organization that provides a benefit to its members through the services it offers. The taxpayer is affiliated with a national not-for-profit organization. The mission of the taxpayer is to prepare young people to make ethical and moral choices (2002 Official Retail Catalog). The chief function of the taxpayer's organization is education (2002 Official Retail Catalog).

The taxpayer operates five stores in Indiana. The taxpayer states that the stores are not operated as free-market businesses. The taxpayer states that for example, one of the stores is located in the taxpayer's headquarters which is situated in a predominately business office setting. Moreover, the store maintains traditional office hours (8:30 a.m. – 6:00 p.m. M-F, 9:00 a.m. – 3:00 p.m. Sat.) and does not participate in any advertising or marketing campaigns.

Each store sells various items that can be classified into five broad categories:

1. Member and Leader Necessities – uniforms, uniform insignia and accessories such as badges and neckerchiefs, flags, and handbooks, guidebooks, pamphlets and program guides (taxpayer books) exclusively marketed by the taxpayer.
2. Crafts –
   a. Taxpayer kits: kits exclusively marketed by the taxpayer such as Pinewood Derby Car kit; and
   b. General craft kits: birdhouse kits, acrylic paint sets and other general craft items and kits that are not exclusively marketed by the taxpayer, but are used by members and leaders in completing requirements for various taxpayer badges and/or other skill ranks.
3. Awards – medals, trophies, plaques and sculptures specifically designed for taxpayer for recognition of members and their leaders.
4. Custom Design: awards, name plates and articles of clothing with an embroidered taxpayer design or logo intended to recognize individuals who further the taxpayer's mission or who participate in a taxpayer event e.g. summer camp, day camp.
5. Camping:
   a. Taxpayer camping items: camping items exclusively marketed by the taxpayer such as taxpayer wall tents (used by members and leaders participating in taxpayer summer camp) and the taxpayer official camping gear which includes items such as taxpayer book bag, belt pack and canteen (used by members and leaders participating in day camp or resident camp); and
   b. General camping items: tents, packs, sleeping bags, duffel bags and various camping utensils and general camping items that are not exclusively marketed by the taxpayer, but are purchased and used by members and leaders.

DISCUSSION

IC 6-2.5-5-26b (a) & (b) state:

(a) Sales of tangible personal property are exempt from the state gross retail tax, if:
   (1) the seller is an organization that is described in section 21(b)(1) of this chapter;
   (2) the organization makes the sale to make money to carry on a not-for-profit purpose; and
   (3) the organization does not make those sales during more than thirty (30) days in a calendar year.

(b) Sales of tangible personal property are exempt from the state gross retail tax, if:

1. the seller is an organization described in section 21(b) of this chapter;
2. the seller is not operated predominantly for social purposes;
3. the property sold is designed and intended primarily either for the organization's educational, cultural, or religious purposes, or for improvement of the work skills or professional qualifications of the organization's members; and
4. the property sold is not designed or intended for use in carrying on a private or proprietary business.

Rule 45 IAC 2.2-5-58, interpreting IC 6-2.5-5-26b, provides in part:

(a) The state gross retail tax shall not apply to sales by qualified not-for-profit organizations of tangible personal property of a kind designated and intended primarily for the educational, cultural or religious purposes of such qualified not-for-profit organization and not used in carrying out a private or proprietary business.

(b) The gross receipts from each sale of tangible personal property by a qualified not-for-profit organization are exempt under this rule only if:

(1) The nature of the property sold will further the educational, cultural or religious purposes of the organization; and
(2) The organization is not carrying on a private or proprietary business with respect to such sales.

(c) Furthering the educational, cultural or religious purpose. The primary purpose of the property sold must be to further the educational, cultural or religious purpose of the qualified not-for-profit organization.

Firstly, it should be noted that the "thirty (30) day sales rule" exemption from collecting sales/use tax contained in IC 6-2.5-5-26b (a) is not applicable to the taxpayer as the taxpayer makes sales for more than thirty (30) days in a calendar year.

Secondly, it is clear from the above statute and regulation that for the taxpayer's sales of tangible personal property to be exempt from sales/use tax the sales must be both made in furtherance of the educational purpose of the taxpayer's organization and not sold in the "carrying on" of a private or proprietary business.

Here, all the tangible personal property sold by the taxpayer, i.e., member and leader necessities, taxpayer craft kits and general craft kits, awards, custom design items, and taxpayer camping items and general carrying items, is used for educational purposes, hence, consistent with the taxpayer's purpose of organization. Further, all items are predominantly sold to members, leaders and others involved with the taxpayer's organization, therefore, the taxpayer is not carrying on a private or proprietary business. This being the case, the taxpayer's sale of the above listed items is not subject to sales/use tax.

RULING

The Department rules that member and leader necessities, taxpayer craft kits and general craft kits, awards, custom design items, and taxpayer camping items and general camping items sold by the taxpayer are not subject to sales/use tax.

CAVEAT

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

INDIANA DEPARTMENT OF STATE REVENUE