DEPARTMENT OF STATE REVENUE
Departmental Notice #2
December 1, 2003
Prepayment of Sales Tax on Gasoline

This document is not a "statement" required to be published in the Indiana Register under IC 4-22-7-7. However, under IC 6-2.5-7-14, the Department is required to publish the prepayment rate in the June and December issues of the Indiana Register. The purpose of this notice is to inform each refiner, terminal operator, and qualified distributor known to the Department to be required to collect prepayments of sales tax on gasoline of the "prepayment rate" effective for the next six-month period. A prepayment rate is calculated twice a year by the Department and is effective for the period January 1 through June 30, or, July 1 through December 31, as appropriate.

The prepayment rate is defined by IC 6-2.5-7-1 as the product of:

1) the statewide average retail price per gallon of gasoline (excluding the Indiana gasoline tax, the federal gasoline tax, and the Indiana gross retail tax); multiplied by
2) the state gross retail tax rate [6%]; multiplied by
3) ninety percent (90%); and then
4) rounded to the nearest one-tenth of one cent ($0.001)

The prepayment rate of sales tax on gasoline for the six – (6) month period beginning January 1, 2004, is six and five-tenths cents ($.065) per gallon.

Using the most recent retail price of gasoline available (as required by IC 6-2.5-7-14(b)), the Department has determined the statewide average retail price per gallon of gasoline to be one dollar and twenty and two tenths cents ($1.202). The most recent retail price of gasoline available was based on data contained in the November 2003 Petroleum Marketing Monthly as published by the Energy Information Agency.

The prepayment rates for periods beginning July 1, 1994 are set out below:

Period			Rate Per Gallon
July 1, 1994	to	December 31, 1994	2.9 cents
January 1, 1995	to	June 30, 1995	3.7 cents
July 1, 1995	to	December 31, 1995	3.3 cents
January 1, 1996	to	June 30, 1996	3.3 cents
July 1, 1996	to	December 31, 1996	3.4 cents
January 1, 1997	to	June 30, 1997	4.0 cents
July 1, 1997	to	December 31, 1997	3.9 cents
January 1, 1998	to	June 30, 1998	4.0 cents
July 1, 1998	to	December 31, 1998	2.9 cents
January 1, 1999	to	June 30, 1999	3.0 cents
July 1, 1999	to	December 31, 1999	2.4 cents
January 1, 2000	to	June 30, 2000	3.6 cents
July 1, 2000	to	December 31, 2000	4.6 cents
January 1, 2001	to	June 30, 2001	4.9 cents
July 1, 2001	to	December 31, 2001	4.9 cents
January 1, 2002	to	June 30, 2002	4.9 cents
July 1, 2002	to	December 31, 2002	3.2 cents
January 1, 2003	to	June 30, 2003	5.3 cents
July 1, 2003	to	December 31, 2003	6.6 cents
January 1, 2004	to	June 30,2004	6.5 cents

Indiana Department of State Revenue
Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:
PAMELA R. TEDERS
DOCKET NO. 29-2002-0187

PROPOSED ORDER

The Criminal Investigation Division of the Indiana Department of Revenue conducted an investigation of the Fraternal Order of Eagles No. 3164 on August 3, 2001. As a result of the investigation, on March 5, 2002, the Petitioner was prohibited from having any involvement with charity gaming in Indiana for a period of three (3) years. The Petitioner protested in a timely manner.

FINDINGS OF FACTS

1) Petitioner protested the Department's proposed actions on March 23, 2002.
2) The Department acknowledged the Petitioner's appeal in a letter dated April 9, 2002.
3) The Department contacted the Petitioner a second time regarding setting a hearing on May 10, 2002.
4) The Department sent Petitioner a letter dated May 21, 2003 regarding the legislative changes that directly affected the procedures governing the administrative hearing.
5) The Department contacted the Petitioner a second time regarding setting a hearing on July 15, 2003.
6) Pursuant to IC 4-21.5-3-1 notice was given to the Petitioner on July 15, 2003 regarding a possible dismissal of her appeal.
7) Petitioner has repeatedly failed to respond to the Department's correspondence.

STATEMENT OF LAW

1) IC 4-21.5-3-24 states, "(a) At any stage of a proceeding, if a party fails to:
(1) file a responsive pleading required by statute or rule;
(2) attend or participate in a prehearing conference, hearing, or other stage of the proceeding; or
(3) take action on a matter for a period of sixty (60) days, if the party is responsible for taking the action;
the administrative law judge may serve upon all parties written notice of a proposed default or dismissal order, including a statement of the grounds.

(b) Within seven (7) days after service of a proposed default or dismissal order, the party against whom it was issued may file a written motion requesting that the proposed default order not be imposed and stating the grounds relied upon. During the time within which a party may file a written motion under this subsection, the administrative law judge may adjourn the proceedings or conduct them without the participation of the party against whom a proposed default order was issued, having due regard for the interest of justice and the orderly and prompt conduct of the proceedings.

(c) If the party has failed to file a written motion under subsection (b), the administrative law judge shall issue the default or dismissal order. If the party has filed a written motion under subsection (b), the administrative law judge may either enter the order or refuse to enter the order.

(d) After issuing a default order, the administrative law judge shall conduct any further proceedings necessary to complete the proceeding without the participation of the party in default and shall determine all issues in the adjudication, including those affecting the defaulting party. The administrative law judge may conduct proceedings in accordance with section 23 of this chapter to resolve any issue of fact.

CONCLUSIONS OF LAW

1) IC 4-21.5-3-24 states, "(a) At any stage of a proceeding, if a party fails to: (1) file a responsive pleading required by statute or rule; (2) attend or participate in a prehearing conference, hearing, or other stage of the proceeding; or (3) take action on a matter for a period of sixty (60) days, if the party is responsible for taking the action; the administrative law judge may serve upon all parties written notice of a proposed default or dismissal order, including a statement of the grounds.
2) The Petitioner's failure to respond to the Department's numerous letters is grounds for a proposed dismissal order pursuant to IC 4-21.5-3-24.

PROPOSED ORDER

The Administrative Law Judge orders the following:
Petitioner's appeal is dismissed without prejudice.
1) Administrative review of this proposed decision may be obtained by filing, with the Commissioner of the Indiana Department of State Revenue, a written document identifying the basis for each objection within fifteen (15) days after service of this proposed decision. IC 4-21.5-3-29(d).
2) Judicial review of a final order may be sought under IC 4-21.5-5.

THIS PROPOSED ORDER SHALL BECOME THE FINAL ORDER OF THE INDIANA DEPARTMENT OF STATE REVENUE UNLESS OBJECTIONS ARE FILED WITHIN FIFTEEN (15) DAYS FROM THE DATE THE ORDER IS SERVED ON THE PETITIONER.

Dated: ______________________

Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:
NATIONAL KIDNEY FOUNDATION OF INDIANA, INC.
D/B/A NATIONAL KIDNEY FOUNDATION OF INDIANA, INC.,
NORTHWEST CHAPTER
DOCKET NO. 29-2002-0544

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DEPARTMENTAL ORDER

This matter is before the Indiana Department of State Revenue, 100 N. Senate Avenue, Room N248, Indianapolis, Indiana 46204. Bruce R. Kolb, Administrative Law Judge, is acting on behalf of and under the authority of the Commissioner of the Indiana Department of State Revenue.

In lieu of an administrative hearing the Petitioner's counsel requested in a letter dated April 25, 2003 that a decision be rendered based upon the information contained in the Department's files and also contained in a letter of protest dated October 31, 2002. Pursuant to IC 4-21.5 et seq. Petitioner' correspondence shall be treated as a motion for summary judgment (IC 4-21.5-3-23). On May 29, 2003 the Department was given ten (10) days in which to make known its intention to file documents in opposition to the motion. An additional twenty (20) days was granted for any additional filings. The Department responded on June 12, 2003 and stated that it would file its response within 20 days. The Department failed to file any response within the allotted time.

Petitioner, National Kidney Foundation of Indiana, Inc., was represented by Timothy J. Bender of Bingham McHale, 2700 West Tower, 10 West Market Street, Indianapolis, Indiana 46204-4900. Steve Carpenter appeared on behalf of the Indiana Department of State Revenue.

The Department maintains a record of the proceedings. Being duly advised and having considered the entire record, the Administrative Law Judge makes the following Findings of Fact, Conclusions of Law and Departmental Order.

REASON FOR HEARING

On April 2, 2003 the Petitioner was notified of additional charity gaming license fees due and owing for the periods ending June 30, 1997 and June 30, 1998. The Petitioner protested in a timely manner.

FINDINGS OF FACT

1) The Petitioner's audit conducted by the Indiana Department of Revenue was completed on November 5, 2001.

2) The audit covered income, sales and use tax. No changes were made to the sales and use tax audit.

3) Charity gaming license fee liabilities for 1997 were created on March 21, 2002 and were subsequently cancelled on March 25, 2002. The Petitioner was then billed again on September 11, 2002.

4) Charity gaming license fee liabilities for 1998 were created on September 6, 2002 and were billed on September 11, 2002.

5) Petitioner's letter to Ms. Catherine McGuckin, CPA, Field Auditor for the Indiana Department of Revenue, dated September 14, 2001, states:

> I received a copy of your September 11, 2001, letter to Mary Kay Hensley. We are very pleased, and appreciate, that the Department of Revenue has decided not to pursue unrelated business income tax and sales/use tax assessments against National Kidney Foundation of Indiana, Inc. d/b/a National Kidney Foundation of Indiana, Northwest Chapter (the 'Corporation').
>
> Your September 11, 2001, letter, also proposes additional license fees based on asserted underreported gross receipts, for the 1996-1997, 1997-1998, and 1998-1999 fiscal years. In addition, your September 11, 2001, letter leaves open the possibility of further penalties.
>
> Because the additional asserted license fees are based upon gross receipts, and because the Corporation timely filed its financial reporting forms, I believe that the statute of limitations should bar any additional license fees from being assessed from the 1996-1997 and the 1997-1998 fiscal years….

6) The Indiana Department of Revenue issued a proposed assessment (AR-80) on September 10, 2002. The Department's billing stated, "A review of your Indiana Bingo tax return(s) for the period ending…has determined that you may owe…"

7) The explanation on the reverse side of the billing states:

> IC 4-32-11-3 PROVIDES 'LICENSE FEE CHARGED TO A QUALIFIED ORGANIZATION THAT RENEWS THE LICENSE MUST BE BASED ON THE TOTAL GROSS REVENUE OF THE QUALIFIED ORGANIZATION FROM ALLOWABLE EVENTS AND RELATED ACTIVITIES". AN AUDIT OF YOUR ORGANIZATION RECORDS INDICATES THAT YOU OWE ADDITIONAL LICENSE FEES.

8) The Department issued the proposed assessments for additional charity gaming license fees and termed the additional money owed as "Original Tax.(Bingo)."

9) The Department cancelled the assessment of the non-existent Bingo Tax on April 2, 2003.

10) The Indiana Department of Revenue Compliance Division notified Petitioner in a letter dated April 2, 2003 of additional charity gaming license fees due and owing for the periods ending June 30, 1997 and June 30, 1998.

11) Petitioner possessed Indiana charity gaming licenses for the periods June 1, 1996; June 1, 1997; and June 1, 1998.
12) Petitioner's accounting periods are May 1, 1996 to April 30, 1997; May 1, 1997 to April 30, 1998; and May 1, 1998 to April 30, 1999.
13) Petitioner's letter dated October 31, 2002, states that they timely filed CG-8s for the periods ending May 1, 1996 to April 30, 1997; May 1, 1997 to April 30, 1998; and May 1, 1998 to April 30, 1999.
14) In lieu of an administrative hearing the Petitioner's counsel requested in a letter dated April 25, 2003 that a decision be rendered based upon the information contained in the Department's files and also contained in a letter of protest dated October 31, 2002.
15) Pursuant to IC 4-21.5 et seq. Petitioner' correspondence shall be treated as a motion for summary judgment (IC 4-21.5-3-23).
16) On May 29, 2003 the Department was given ten (10) days in which to make known its intention to file documents in opposition to the motion.
17) An additional twenty (20) days was granted for any additional filings.
18) The Department responded on June 12, 2003 and stated that it would file its response within 20 days. The Department failed to file any response within the allotted time.

STATEMENT OF LAW

1) The Department's administrative hearings are conducted pursuant to IC § 4-21.5 et seq. (See, House Enrolled Act No. 1556).
2) IC 4-21.5-3-23 states, "(a) A party may, at any time after a matter is assigned to an administrative law judge, move for a summary judgment in the party's favor as to all or any part of the issues in a proceeding. The motion must be supported with affidavits or other evidence permitted under this section and set forth specific facts showing that there is not a genuine issue in dispute…"
3) Form CG-8 (Indiana Annual Bingo and/or Pull Tab License Financial Report). This report must be filed with the Indiana Department of Revenue by the 10th day of the month in which the organization's charity gaming license expires. The report is required to show all financial and accounting activity related to the organization's annual gaming license.
4) The CG-8 states, "The accounting period is a 12-month period; the year-end will always occur one month prior to the end of the gaming period. For example, if your license expires 5/31/98. then your accounting period will be from 5/1/97 to 4/30/98. **This financial statement will reflect your organization's accounting period and not the licensing period.**"
5) IC 4-32-11-3 provides, "The license fee that is charged to a qualified organization that renews the license must be based on the total gross revenue of the qualified organization from allowable events and related activities in the preceding year…"

CONCLUSIONS OF LAW

1) Petitioner timely filed its CG-8s for the periods ending May 1, 1996 to April 30, 1997; May 1, 1997 to April 30, 1998; and May 1, 1998 to April 30, 1999.
2) The Department's form CG-8 states, "The accounting period is a 12-month period; the year-end will always occur one month prior to the end of the gaming period. For example, if your license expires 5/31/98. then your accounting period will be from 5/1/97 to 4/30/98.This financial statement will reflect your organization's accounting period and not the licensing period."
3) The Petitioner has provided sufficient documentation in support of its motion for summary judgment.

DEPARTMENTAL ORDER

Following due consideration of the entire record, the Administrative Law Judge orders the following:
Petitioner's motion for summary judgment is affirmed.
1) Administrative review of this proposed decision may be obtained by filing, with the Commissioner of the Indiana Department of State Revenue, a written document identifying the basis for each objection within fifteen (15) days after service of this proposed decision. IC 4-21.5-3-29(d).
2) Judicial review of a final order may be sought under IC 4-21.5-5.

THIS DEPARTMENTAL ORDER SHALL BECOME THE FINAL ORDER OF THE INDIANA DEPARTMENT OF STATE REVENUE UNLESS OBJECTIONS ARE FILED WITHIN FIFTEEN (15) DAYS FROM THE DATE THE ORDER IS SERVED ON THE PETITIONER.

Dated: ____________________

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Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

<u>IN REGARDS TO THE MATTER OF:</u>
MS. RAQUEL MEADE
DOCKET NO. 29-2003-0136

FINDINGS OF FACT, CONCLUSIONS OF LAW AND PROPOSED ORDER

An administrative hearing was held on Thursday, May 22, 2003 in the office of the Indiana Department of State Revenue, 100 N. Senate Avenue, Room N248, Indianapolis, Indiana 46204 before Bruce R. Kolb, Administrative Law Judge acting on behalf of and under the authority of the Commissioner of the Indiana Department of State Revenue.

Petitioner, Raquel Meade, appeared *Pro Se*. Steve Carpenter appeared on behalf of the Indiana Department of State Revenue.

A hearing was conducted pursuant to IC 4-32-8-5, evidence was submitted, and testimony given. The Department maintains a record of the proceedings. Being duly advised and having considered the entire record, the Administrative Law Judge makes the following Findings of Fact, Conclusions of Law and Proposed Order.

REASON FOR HEARING

On March 6, 2003, the Petitioner was assessed civil penalties in the amount of one thousand dollars ($1,000) and is prohibited from associating with charity gaming activities in the State of Indiana for a period of ten (10) years. The Petitioner protested in a timely manner. A hearing was conducted pursuant to IC § 4-32-8-5.

SUMMARY OF FACTS

1) The Indiana Department of Revenue Criminal Investigation Division initiated an investigation of the Brooklyn Volunteer Fire Department (BVFD).

2) On March 6, 2003, the Petitioner was assessed civil penalties in the amount of one thousand dollars ($1,000) for being an operator or worker at the BVFD's charity gaming event without being a member of the BVFD and also prohibited from associating with charity gaming activities in the State of Indiana for a period of ten (10) years.

FINDINGS OF FACTS

1) The Indiana Department of Revenue Criminal Investigation Division initiated an investigation of the Brooklyn Volunteer Fire Department (BVFD). (Record at 6).

2) According to the Department's witness, Criminal Investigation Division report regarding the Brooklyn Volunteer Fire Department (BVFD) found that the organization had, "contracted with …Raquel Meade to conduct bingo July 1, 2000 to June 30, 2001." (Department's Exhibit C).

3) According to the Department's letter dated March 6, 2003, the Criminal Investigation Division (CID) found, "Frances and Raquel Meade approached the BVFD and indicated that she and Raquel could help them raise funds to run the fire department by sponsoring bingo. The bingo games would be the responsibility of the [sic] Frances and Raquel and the BVFD would receive the money from the bingo games while the income from the pull tabs would go to Frances and Raquel for operating the charity gaming event. All responsibility of obtaining the gaming license, ordering the gaming supplies, accounting for the income, obtaining the start up money for the bingo events and payment of all expenses along with finding a bingo hall would be done by Frances and Raquel Meade." (Department's Exhibit C).

4) The Department then notified Petitioner by letter that she was prohibited from associating with charity gaming activities in the State of Indiana for a period of ten (10) years and assessed one thousand dollars ($1,000) for, "being an operator or worker at the BVFD's bingo event without being a member of the BVFD." (Department's Exhibit C).

5) Petitioner was not a member of the BVFD. (Record at 8).

6) Petitioner entered into a negotiated plea agreement with the State of Indiana on May 3, 2002. (Department's Exhibit E).

7) The Petitioner having entered into a negotiated plea agreement with the State of Indiana, plead guilty to the charge of entering into a contract or agreement in violation of IC 4-32-9-15 which is a Class D Felony. (Department's Exhibit E).

STATEMENT OF LAW

1) Pursuant to 45 IAC 18-8-4, the burden of proving that the Department's findings are incorrect rests with the individual or organization against which the department's findings are made. The department's investigation establishes a prima facie presumption of the validity of the department's findings.

2) The Department's administrative hearings are conducted pursuant to IC § 4-21.5 et seq. (See, House Enrolled Act No. 1556).

3) "[B]ecause Pendelton's interest in his insurance license was a property interest, and not a liberty interest. Rather, a preponderance of the evidence would have been sufficient." Pendelton v. McCarty, 747 N.E. 2d 56, 65 (Ind. App. 2001).

4) "It is reasonable…to adopt a preponderance of the evidence standard where it can be demonstrated that a protected property interest exists." Burke v. City of Anderson, 612 N.E.2d 559, 565 (Ind.App. 1993).

5) IC 4-32-9-23 provides, "An operator or a worker may not be a person who has been convicted of or entered a plea of nolo contendere to a felony committed in the preceding ten (10) years, regardless of the adjudication, unless the department determines that: (1) the person has been pardoned or the person's civil rights have been restored; or (2) subsequent to the conviction or entry of the plea the person has engaged in the kind of good citizenship that would reflect well upon the integrity of the qualified organization and the department."

6) IC 4-32-9-27 states, "An operator or a worker may not directly of indirectly participate, other than in a capacity as operator

or worker, in an allowable event…"

7) IC 4-32-9-28 states, "An operator must be a member in good standing of the qualified organization that is conducting an allowable event for at least one (1) year at the time of the allowable event."

8) According to IC 4-32-9-29, "A worker must be a member in good standing of a qualified organization that is conducting an allowable event for at least thirty (30) days at the time of the allowable event."

9) IC 4-32-12-2 states, "The department ***may impose*** upon a qualified organization or an individual the following ***civil penalties***:(1) Not more than one thousand dollars ($1,000) for the first violation.(2) Not more than two thousand five hundred dollars ($2,500) for the second violation.(3) Not more than five thousand dollars ($5,000) for each additional violation." (Emphasis added).

10) IC 4-32-12-1(a) provides in pertinent part, "The Department may suspend… an individual …for any of the following: (1) Violation of a provision of this article or of a rule of the department..."

11) IC 4-32-12-3 states, In addition to the penalties described in section 2 of this chapter, the department may do all or any of the following:

(1) Suspend or revoke the license.

(2) Lengthen a period of suspension of the license.

(3) Prohibit an operator or an individual who has been found to be in violation of this article from associating with charity gaming conducted by a qualified organization.

(4) Impose an additional civil penalty of not more than one hundred dollars ($100) for each day the civil penalty goes unpaid.

CONCLUSIONS OF LAW

1) On March 6, 2003, the Petitioner was assessed civil penalties in the amount of one thousand dollars ($1,000) and was prohibited from associating with charity gaming activities in the State of Indiana for a period of ten (10) years.

2) The Petitioner violated IC 4-32-9-15 which is a Class D Felony.

PROPOSED ORDER

Following due consideration of the entire record, the Administrative Law Judge orders the following:

The Petitioner's appeal is denied.

1) Administrative review of this proposed decision may be obtained by filing, with the Commissioner of the Indiana Department of State Revenue, a written document identifying the basis for each objection within fifteen (15) days after service of this proposed decision. IC 4-21.5-3-29(d).

2) Judicial review of a final order may be sought under IC 4-21.5-5.

THIS PROPOSED ORDER SHALL BECOME THE FINAL ORDER OF THE INDIANA DEPARTMENT OF STATE REVENUE UNLESS OBJECTIONS ARE FILED WITHIN FIFTEEN (15) DAYS FROM THE DATE THE ORDER IS SERVED ON THE PETITIONER.

Dated: ____________________ ____________________

Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:
CRISIS CENTER INCORPORATED
DOCKET NO. 29-2003-0159

FINDINGS OF FACT, CONCLUSIONS OF LAW AND PROPOSED ORDER

An administrative hearing was held on Tuesday, July 22, 2003 in the office of the Indiana Department of State Revenue, 100 N. Senate Avenue, Room N248, Indianapolis, Indiana 46204 before Bruce R. Kolb, Administrative Law Judge acting on behalf of and under the authority of the Commissioner of the Indiana Department of State Revenue.

Petitioner, Crisis Center, Inc., was represented by Katrina M. Clingerman, Ice Miller, One American Square, Box 82001, Indianapolis, IN 46282-0002. Steve Carpenter appeared on behalf of the Indiana Department of State Revenue.

A hearing was conducted pursuant to IC 4-32-8-5, evidence was submitted, and testimony given. The Department maintains a record of the proceedings. Being duly advised and having considered the entire record, the Administrative Law Judge makes the following Findings of Fact, Conclusions of Law and Proposed Order.

REASON FOR HEARING

On April 2, 2003, the Petitioner was assessed additional charity gaming license fees in the amount of $13,250. The Petitioner protested in a timely manner. A hearing was conducted pursuant to IC 4-32-8-5.

SUMMARY OF FACTS

1) The Petitioner is an Indiana nonprofit corporation and conducts licensed charitable gaming events pursuant to IC 4-32.
2) The Petitioner is required to pay charitable gaming fees pursuant to IC 4-32-11.
3) Such fees are calculated and paid based upon Petitioner's total gross revenues from allowable events and related activities during the preceding year.
4) The Indiana Department of Revenue initiated an audit investigation of the Petitioner.
5) On April 2, 2003, the Petitioner was assessed additional charity gaming license fees in the amount of $13,250.

FINDINGS OF FACTS

1) On April 2, 2003, the Petitioner was assessed additional charity gaming license fees in the amount of $13, 250.
2) Petitioner's records as reviewed by the Indiana Department of Revenue showed that they had gross income of $2,424,279 for the year ending 1999, and reported only $1,951,240 to the Department. (Record at 13).
3) Petitioner's records as reviewed by the Indiana Department of Revenue showed that they had gross income of $2,325,817 for the year ending 2000, and reported only $1,845,453 to the Department. (Record at 13).
4) Petitioner's records as reviewed by the Indiana Department of Revenue showed that they had gross income of $2,038,108 for the year ending 2001, and reported only $1,542,533 to the Department. (Record at 14).
5) Petitioner's additional charity gaming license fees owed as a result of underreported gaming fees amounted to $13,250.
6) The Petitioner's witness stated under oath that they did not have any evidence supporting its argument from the years in question. (Record at 25).
7) Petitioner stated that he shipped the games with serial number errors back to the wholesaler, and that he, "had no reason to document." (Record at 25).
8) Department's counsel upon cross-examination asked, "But yet you didn't record the errors on the documents you gave to the auditors. Correct?" Petitioner's witness responded, "Correct." (Record at 28).
9) Petitioner's counsel then went on to state regarding their exhibits, "We would submit that these are submitted as examples. We would not assert that they do come from the audit period. But the Petitioner had no reason to keep examples of this sort from the audit period until the audit had been completed and these issues were raised." (Record at 33).
10) Petitioner's witness was asked by the Administrative Law Judge, "Do you keep track of the serial numbers of the boxes you send back and the replacement boxes that you receive?" The witness responded, "I will beginning after this is concluded because I see where it's necessary, but, no, I have not." (Record at 36).

STATEMENT OF LAW

1) Pursuant to 45 IAC 18-8-4, the burden of proving that the Department's findings are incorrect rests with the individual or organization against which the department's findings are made. The department's investigation establishes a prima facie presumption of the validity of the department's findings.
2) The Department's administrative hearings are conducted pursuant to IC § 4-21.5 et seq. (See, House Enrolled Act No. 1556).
3) "[B]ecause Pendelton's interest in his insurance license was a property interest, and not a liberty interest. Rather, a preponderance of the evidence would have been sufficient." Pendelton v. McCarty, 747 N.E. 2d 56, 65 (Ind. App. 2001).
4) "It is reasonable…to adopt a preponderance of the evidence standard where it can be demonstrated that a protected property interest exists." Burke v. City of Anderson, 612 N.E.2d 559, 565 (Ind.App. 1993).
5) IC 4-32-11-1 states, "The department shall charge a license fee to an applicant under this article."
6) IC 4-21-11-3 provides, "The license fee that is charged to a qualified organization that renews the license must be based on the total gross revenue of the qualified organization from allowable events and related activities in the preceding year or, if the qualified organization held a license under IC 4-32-9-6 through IC 4-32-9-10, the fee must be based on the total gross revenue of the qualified organization from the preceding event and related activities…"
7) IC 4-32-9-17 provides in pertinent part, "A qualified organization shall maintain accurate records of all financial aspects of an allowable event under this article. A qualified organization shall make accurate reports of all financial aspects of an allowable event to the department within the time established by the department."

CONCLUSIONS OF LAW

1) On April 2, 2003, based upon an Indiana Department of Revenue audit investigation, the Petitioner was assessed additional charity gaming license fees in the amount of $13,250 for the years 1999, 2000, and 2001.
2) Petitioner, a qualified organization, failed to maintain accurate records of all its financial aspects surrounding the sale of pulltabs for the audit years in question under IC 4-32.
3) Petitioner, a qualified organization, also failed to not only make but keep accurate reports of all financial aspects regarding the sale of its pulltabs for the audit years in question under IC 4-32.
4) Petitioner failed to provide records in support of its appeal for the audit years in question.

PROPOSED ORDER

Following due consideration of the entire record, the Administrative Law Judge orders the following:

Petitioner's appeal is denied.

1) Administrative review of this proposed decision may be obtained by filing, with the Commissioner of the Indiana Department of State Revenue, a written document identifying the basis for each objection within fifteen (15) days after service of this proposed decision. IC 4-21.5-3-29(d).

2) Judicial review of a final order may be sought under IC 4-21.5-5.

THIS PROPOSED ORDER SHALL BECOME THE FINAL ORDER OF THE INDIANA DEPARTMENT OF STATE REVENUE UNLESS OBJECTIONS ARE FILED WITHIN FIFTEEN (15) DAYS FROM THE DATE THE ORDER IS SERVED ON THE PETITIONER.

Dated: _____________________ ___________________________________

Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:
MS. FRANCES MEADE
DOCKET NO. 29-2003-0202

FINDINGS OF FACT, CONCLUSIONS OF LAW AND PROPOSED ORDER

An administrative hearing was held on Thursday, May 22, 2003 in the office of the Indiana Department of State Revenue, 100 N. Senate Avenue, Room N248, Indianapolis, Indiana 46204 before Bruce R. Kolb, Administrative Law Judge acting on behalf of and under the authority of the Commissioner of the Indiana Department of State Revenue.

Petitioner, Frances Meade, appeared *Pro Se*. Steve Carpenter appeared on behalf of the Indiana Department of State Revenue.

A hearing was conducted pursuant to IC 4-32-8-5, evidence was submitted, and testimony given. The Department maintains a record of the proceedings. Being duly advised and having considered the entire record, the Administrative Law Judge makes the following Findings of Fact, Conclusions of Law and Proposed Order.

REASON FOR HEARING

On March 6, 2003, the Petitioner was assessed civil penalties in the amount of one thousand dollars ($1,000) and is prohibited from associating with charity gaming activities in the State of Indiana for a period of ten (10) years. The Petitioner protested in a timely manner. A hearing was conducted pursuant to IC § 4-32-8-5.

SUMMARY OF FACTS

1) The Indiana Department of Revenue Criminal Investigation Division initiated an investigation of the Brooklyn Volunteer Fire Department (BVFD).

2) On March 6, 2003, the Petitioner was assessed civil penalties in the amount of one thousand dollars ($1,000) for being an operator or worker at the BVFD's charity gaming event without being a member of the BVFD and also prohibited from associating with charity gaming activities in the State of Indiana for a period of ten (10) years.

FINDINGS OF FACTS

1) The Indiana Department of Revenue Criminal Investigation Division initiated an investigation of the Brooklyn Volunteer Fire Department (BVFD). (Record at 6).

2) According to the Department's witness, Criminal Investigation Division report regarding the Brooklyn Volunteer Fire Department (BVFD) found that the organization had, "contracted with …Frances Meade to conduct bingo July 1, 2000 to June 30, 2001." (Department's Exhibit C).

3) According to the Department's letter dated March 6, 2003, the Criminal Investigation Division (CID) found, "Frances and Raquel Meade approached the BVFD and indicated that she and Raquel could help them raise funds to run the fire department by sponsoring bingo. The bingo games would be the responsibility of the [sic] Frances and Raquel and the BVFD would receive the money from the bingo games while the income from the pull tabs would go to Frances and Raquel for operating the charity gaming event. All responsibility of obtaining the gaming license, ordering the gaming supplies, accounting for the income, obtaining the start up money for the bingo events and payment of all expenses along with finding a bingo hall would be done by Frances and Raquel Meade." (Department's Exhibit C).

4) The Department then notified Petitioner by letter that she was prohibited from associating with charity gaming activities in the State of Indiana for a period of ten (10) years and assessed one thousand dollars ($1,000) for, "being an operator or worker at the BVFD's bingo event without being a member of the BVFD." (Department's Exhibit C).

5) Petitioner was not a member of the BVFD. (Record at 8).

6) Petitioner was listed as an authorized operator on the BVFD annual bingo license for the period of July 1, 200 to June 30, 2001. (Department's Exhibit A).
7) Petitioner entered into a negotiated plea agreement with the State of Indiana on May 3, 2002. (Department's Exhibit E).
8) The Petitioner having entered into a negotiated plea agreement with the State of Indiana, plead guilty to the charge of entering into a contract or agreement in violation of IC 4-32-9-15 with a penalty as a Class A Misdemeanor. (Department's Exhibit F).

STATEMENT OF LAW

1) Pursuant to 45 IAC 18-8-4, the burden of proving that the Department's findings are incorrect rests with the individual or organization against which the department's findings are made. The department's investigation establishes a prima facie presumption of the validity of the department's findings.
2) The Department's administrative hearings are conducted pursuant to IC § 4-21.5 et seq. (See, House Enrolled Act No. 1556).
3) "[B]ecause Pendelton's interest in his insurance license was a property interest, and not a liberty interest. Rather, a preponderance of the evidence would have been sufficient." Pendelton v. McCarty, 747 N.E. 2d 56, 65 (Ind. App. 2001).
4) "It is reasonable…to adopt a preponderance of the evidence standard where it can be demonstrated that a protected property interest exists." Burke v. City of Anderson, 612 N.E.2d 559, 565 (Ind.App. 1993).
5) IC 4-32-9-23 provides, "An operator or a worker may not be a person who has been convicted of or entered a plea of nolo contendere to a felony committed in the preceding ten (10) years, regardless of the adjudication, unless the department determines that: (1) the person has been pardoned or the person's civil rights have been restored; or (2) subsequent to the conviction or entry of the plea the person has engaged in the kind of good citizenship that would reflect well upon the integrity of the qualified organization and the department."
6) IC 4-32-9-27 states, "An operator or a worker may not directly of indirectly participate, other than in a capacity as operator or worker, in an allowable event…"
7) IC 4-32-9-28 states, "An operator must be a member in good standing of the qualified organization that is conducting an allowable event for at least one (1) year at the time of the allowable event."
8) According to IC 4-32-9-29, "A worker must be a member in good standing of a qualified organization that is conducting an allowable event for at least thirty (30) days at the time of the allowable event."
9) IC 4-32-12-2 states, "The department ***may impose*** upon a qualified organization or an individual the following ***civil penalties***:(1) Not more than one thousand dollars ($1,000) for the first violation.(2) Not more than two thousand five hundred dollars ($2,500) for the second violation.(3) Not more than five thousand dollars ($5,000) for each additional violation." (Emphasis added).
10) IC 4-32-12-1(a) provides in pertinent part, "The Department may suspend… an individual …for any of the following: (1) Violation of a provision of this article or of a rule of the department..."
11) IC 4-32-12-3 states, In addition to the penalties described in section 2 of this chapter, the department may do all or any of the following:

(1) Suspend or revoke the license.
(2) Lengthen a period of suspension of the license.
(3) Prohibit an operator or an individual who has been found to be in violation of this article from associating with charity gaming conducted by a qualified organization.
(4) Impose an additional civil penalty of not more than one hundred dollars ($100) for each day the civil penalty goes unpaid.

CONCLUSIONS OF LAW

1) On March 6, 2003, the Petitioner was assessed civil penalties in the amount of one thousand dollars ($1,000) and was prohibited from associating with charity gaming activities in the State of Indiana for a period of ten (10) years.
2) The Petitioner violated IC 4-32-9-15 which is a Class D Felony.

PROPOSED ORDER

Following due consideration of the entire record, the Administrative Law Judge orders the following:
The Petitioner's appeal is denied.
1) Administrative review of this proposed decision may be obtained by filing, with the Commissioner of the Indiana Department of State Revenue, a written document identifying the basis for each objection within fifteen (15) days after service of this proposed decision. IC 4-21.5-3-29(d).
2) Judicial review of a final order may be sought under IC 4-21.5-5.

THIS PROPOSED ORDER SHALL BECOME THE FINAL ORDER OF THE INDIANA DEPARTMENT OF STATE REVENUE UNLESS OBJECTIONS ARE FILED WITHIN FIFTEEN (15) DAYS FROM THE DATE THE ORDER IS SERVED ON THE PETITIONER.

Dated: ____________________

____
Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

03970345.LOF

LETTER OF FINDINGS: 97-0345
State Withholding Tax
For the Tax Years 1993 and 1995

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

ISSUE

I. Withholding Tax Assessments Made Against Taxpayer as Responsible Officer.

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

Taxpayer challenges the decision by the Department of Revenue (Department) assigning him personal responsibility for the unpaid withholding taxes incurred by bankrupt corporation for which taxpayer served as a corporate officer and in which taxpayer was a shareholder.

STATEMENT OF FACTS

The Department determined that a bankrupt corporation had failed to forward to the state an amount of employee withholding taxes during 1993 and during 1995. Lacking more specific information necessary to determine the exact amount of withholding taxes due, the Department arrived at an assessment of taxes based on the "best information available."

In addition to notifying the bankrupt corporation, the Department determined that taxpayer – as a "responsible officer" and shareholder of the bankrupt corporation – was individually responsible for the unpaid taxes.

In a letter dated May 4, 1997, and received by the Department on May 7, 1997, taxpayer forwarded a letter stating that the primary lien holder had seized all of the bankrupt corporation's assets including all "valid receivables." According to taxpayer, "It is estimated that the receivables has sufficient funds to cover the IRS and [Department]."

In addition, taxpayer forwarded reconstructed financial records which purported to establish that the specific amount of withholding taxes assessed by the Department was excessive. According to taxpayer, it was necessary to reconstruct the 1993 and 1995 payroll records because, "The original Officer Records were impounded by the Primary Lender." Taxpayer stated that, based on the reconstructed records, "there is quite a difference in what appears to be an estimate by the State of Indiana and the Actual payroll that was paid out."

Taxpayer was notified on January 10, 2001, that he was entitled to explain the basis for his protest at an administrative hearing. The Department received taxpayer's response on October 23, 2001, in which he stated it would be impossible to take part in the administrative process until after July 2002. The Department responded on October 24, 2001 encouraging the taxpayer to further explain the basis for his protest by any means available. The Department offered the opportunity for taxpayer to provide the information either in writing or by telephone. Taxpayer failed to respond.

The Department sent a letter to taxpayer dated September 2, 2003. Taxpayer was again invited to explain the basis for his protest. Again, taxpayer failed to respond. This Letter of Findings is based upon taxpayer's initial 1997 letter and on the information accumulated within the protest file.

DISCUSSION

I. Withholding Tax Assessments Made Against Taxpayer as Responsible Officer.

IC 6-3-4-8 imposes upon employers the responsibility for withholding state income taxes and remitting those taxes to the state. Under IC 6-3-4-8(f), the taxes which have been withheld belong to the State of Indiana. The employer is charged with the duty of "hold[ing] the [taxes] in trust for the state of Indiana and for payment thereof to the department in the manner and at the times provided."

The bankrupt corporation was responsible for withholding its employees' income taxes and forwarding those amounts to the state of Indiana. From the language contained in IC 6-3-4-8(f), it is clear that the withheld taxes do not belong to the employer and do not constitute a fungible asset accessible to a company in distress. The withheld taxes are held in "trust for the state of Indiana...." Id.

A. Responsible Officer.

If the corporate employer is unwilling or unable to forward the withheld employee taxes, the corporation's officers may be held responsible for taxes. IC 6-3-4-8(g) provides that, that "[I]n the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

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

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

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

In his 1997 protest letter, taxpayer identifies himself as both "secretary" and "shareholder" of the bankrupt corporation. The Department's records confirm that taxpayer was both an officer of the bankrupt corporation and a designated "responsible officer." Taxpayer has not provided information explaining his duties within the bankrupt corporation or the degree of authority taxpayer exercised over the bankrupt corporation's activities. However, it is unrefuted that taxpayer was one of the four officers in the bankrupt corporation and that he owned a share of that business. As the Indiana Supreme Court has stated, "Where that person is a high-ranking corporate officer within the corporate power structure, that officer is presumed to have had sufficient control over the company's finances to give rise to a duty to remit trust taxes." Safayan, 654 N.E.2d at 273.

IC 6-8.1-5-1(c) provides in part that, "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." Under the court's holding in Safayan and IC 6-8.1-5-1(c), taxpayer has the burden of demonstrating that the proposed assessment of withholding taxes was incorrect or that he – as a responsible officer – lacked sufficient control over the bankrupt corporation's finances such that he did not have a duty to assure the bankrupt corporation remitted the unpaid trust taxes.

Taxpayer has provided nothing to refute the presumption that he was a responsible officer of the bankrupt corporation, that he had a duty to assure that the withholding taxes were paid to the state, and that he should not now be held personally responsible for the unpaid taxes.

B. Best Information Available.

The Department determined that the bankrupt corporation had failed to forward withholding taxes due in 1993 and 1995. Because the bankrupt corporation failed to provide any payroll records during those periods, the Department determined the amount of unpaid trust taxes based upon the "best information available." Taxpayer disagreed with the Department's determination and supplied information purporting to establish that "there is quite a difference in what appears to be an estimate by the State of Indiana and the Actual payroll that was paid out."

In plain, straightforward language, IC 6-8.1-5-1(a), authorizes the Department, if it reasonably believes that a taxpayer has not reported the proper amount of tax due, to make a proposed assessment of unpaid tax on the basis of the best information available to the department. Although taxpayer has provided information purporting to refute the Department's conclusion as to the amount of unremitted trust taxes, the information provided is simply taxpayer's own bare, unsubstantiated assertion. Taxpayer has provided nothing which specifically refutes the Department's conclusion or which provides a substantive basis for conclusively determining the bankrupt corporation's 1993 and 1995 payroll.

The Department's proposed assessment, under IC 6-8.1-5-1(b), is deemed to be "prima facie evidence that the department's claim for the unpaid tax is valid." That same section of the Indiana Code goes on to state that "the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Taxpayer has failed to meet this burden. He is personally responsible for the unpaid trust taxes.

FINDING

The taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02970580.LOF

LETTER OF FINDINGS NUMBER: 97-0580
Corporate Income Tax
For the Years 1992-1994

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

ISSUES

I. Gross Income Tax-Imposition of Tax

Authority: IC 6-2.1-2-2 (a)(2), IC 6-8.1-5-1 (b), 45 IAC 1.1-1-3.

The taxpayer protests the imposition of gross income tax.

II. Adjusted Gross Income Tax-Imposition of Tax

Authority: IC 6-3-2-1 (b).

The taxpayer protests the imposition of adjusted gross income tax.

STATEMENT OF FACTS

The taxpayer is an out of state manufacturer of components for automobile parts. The taxpayer sold its product through an Indianapolis sales office to an Indiana automobile parts manufacturer. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax for the tax period 1992-1994. The taxpayer protested the assessment contending that there was inadequate nexus with Indiana to assess gross or adjusted gross income tax. A hearing was held.

I. Gross Income Tax-Imposition of Tax

IC 6-2.1-2-2 (a)(2) imposes the Indiana gross income tax on "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The issue to be determined in this case is whether or not the taxpayer's gross income was derived from activities or sources in Indiana, thus subjecting that income to the Indiana gross income tax.

In the last first year of the audit, the taxpayer had a sales office in Indianapolis. During the last two years of the audit, a related corporation had the sales office in Indianapolis. The sales office was a single point of contact office for the taxpayer's only Indiana customer. Most contact between the customer and the taxpayer was handled through this office.

The Indianapolis office had two persons assigned to it. The salesman is in the office everyday. The office is used after a field call to communicate data and information to others in the taxpayer's organization. The inside salesman makes sure that all orders are entered in the computer system and assures that all orders were shipped to the right place. The office keeps track of shipment by exception which means that if the division cannot ship the product, the division contacts the sales office and the office forwards the message to the Indiana customer. If there is a problem other than quality control, the customer calls the Indianapolis office which coordinates the resolution of the problem.

All purchase orders go to the Indianapolis sales office where they are approved. This information is checked, entered into the computer system and sent to the appropriate manufacturing division. A hard copy of this order is also mailed to the manufacturing division. Specifications and blueprints are brought to the Indianapolis sales office by the salesman and copies are forwarded to the manufacturing division.

The Indianapolis office has all the Indiana customer files. These include orders kept by sequential number of the parts and drawings of all of the customer's parts. The sales office also serves as a repository for literature, bulletins, data sheets, qualification tests, and their results.

The taxpayer also provides engineering services to the customer at the customer's Indiana plant and at the Indianapolis office.

45 IAC 1.1-1-3 explains that gross income subject to the Indiana gross income tax derives from Indiana activities such as the operation of an office in Indiana, the performance of services in Indiana, and other business activities within the state. The taxpayer's activities in Indiana meet this basic test. The gross income derived from these activities is subject to the Indiana gross income tax.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Imposition of Tax

DISCUSSION

Pursuant to IC 6-3-2-1 (b), Indiana imposes an adjusted gross income tax on "that part of the adjusted gross income derived from sources within Indiana of every corporation." As discussed in the first section of this Letter of Findings, the taxpayer has significant activities in Indiana. Therefore, it is subject to the tax on the adjusted gross income from those activities.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02970581.LOF

LETTER OF FINDINGS NUMBER: 97-0581
Corporate Income Tax
For the Years 1992-1994

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

ISSUES

I. Gross Income Tax-Imposition of Tax

Authority: IC 6-2.1-2-2 (a)(2), IC 6-8.1-5-1 (b), 45 IAC 1.1-1-3.

The taxpayer protests the imposition of gross income tax.

II. Adjusted Gross Income Tax-Imposition of Tax

Authority: IC 6-3-2-1 (b).

The taxpayer protests the imposition of adjusted gross income tax.

STATEMENT OF FACTS

The taxpayer is an out of state manufacturer of components for automobile parts. The taxpayer sold its product through an Indianapolis sales office to an Indiana automobile parts manufacturer. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax for the tax period 1992-1994. The taxpayer protested the assessment contending that there was inadequate nexus with Indiana to assess gross or adjusted gross income tax. A hearing was held.

I. Gross Income Tax-Imposition of Tax

IC 6-2.1-2-2 (a)(2) imposes the Indiana gross income tax on "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The issue to be determined in this case is whether or not the taxpayer's gross income was derived from activities or sources in Indiana, thus subjecting that income to the Indiana gross income tax.

In the last first year of the audit, the taxpayer had a sales office in Indianapolis. During the last two years of the audit, a related corporation had the sales office in Indianapolis. The sales office was a single point of contact office for the taxpayer's only Indiana customer. Most contact between the customer and the taxpayer was handled through this office.

The Indianapolis office had two persons assigned to it. The salesman is in the office everyday. The office is used after a field call to communicate data and information to to others in the taxpayer's organization. The inside salesman makes sure that all orders are entered in the computer system and assures that all orders were shipped to the right place. The office keeps track of shipment by exception which means that if the division cannot ship the product, the division contacts the sales office and the office forwards the message to the Indiana customer. If there is a problem other than quality control, the customer calls the Indianapolis office which coordinates the resolution of the problem.

All purchase orders go to the Indianapolis sales office where they are approved. This information is checked, entered into the computer system and sent to the appropriate manufacturing division. A hard copy of this order is also mailed to the manufacturing division. Specifications and blueprints are brought to the Indianapolis sales office by the salesman and copies are forwarded to the manufacturing division.

The Indianapolis office has all the Indiana customer files. These include orders kept by sequential number of the parts and drawings of all of the customer's parts. The sales office also serves as a repository for literature, bulletins, data sheets, qualification tests, and their results.

The taxpayer also provides engineering services to the customer at the customer's Indiana plant and at the Indianapolis office.

45 IAC 1.1-1-3 explains that gross income subject to the Indiana gross income tax derives from Indiana activities such as the operation of an office in Indiana, the performance of services in Indiana, and other business activities within the state. The taxpayer's activities in Indiana meet this basic test. The gross income derived from these activities is subject to the Indiana gross income tax.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Imposition of Tax

DISCUSSION

Pursuant to IC 6-3-2-1 (b), Indiana imposes an adjusted gross income tax on "that part of the adjusted gross income derived from sources within Indiana of every corporation." As discussed in the first section of this Letter of Findings, the taxpayer has significant activities in Indiana. Therefore, it is subject to the tax on the adjusted gross income from those activities.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02970582.LOF

LETTER OF FINDINGS NUMBER: 97-0582
Corporate Income Tax
For the Years 1992-1994

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

ISSUES

I. Gross Income Tax-Imposition of Tax

Authority: IC 6-2.1-2-2 (a)(2), IC 6-8.1-5-1 (b), 45 IAC 1.1-1-3.

The taxpayer protests the imposition of gross income tax.

II. Adjusted Gross Income Tax-Imposition of Tax

Authority: 15 U.S.C.S.381, IC 6-3-2-1 (b), Indiana Department of State Revenue v. Continental Steel Corporation, 399 N.E.2d 754 (Ind. Ct. App. 1980), Wisconsin Department of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992), in Black's Law Dictionary, Seventh Edition, 1999, page 774.

The taxpayer protests the imposition of adjusted gross income tax.

STATEMENT OF FACTS

The taxpayer is an out of state manufacturer of components for automobile parts. The taxpayer made its Indiana sales through the Indianapolis sales office of two related corporations. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax for the tax period 1992-1994. The taxpayer protested the assessment contending that there was inadequate nexus with Indiana to assess gross or adjusted gross income tax. A hearing was held.

I. Gross Income Tax-Imposition of Tax

IC 6-2.1-2-2 (a)(2) imposes the Indiana gross income tax on "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The issue to be determined in this case is whether or not the taxpayer's gross income was derived from activities or sources in Indiana, thus subjecting that income to the Indiana gross income tax.

This situation involves three corporations, the taxpayer and two corporations which sold taxpayer's product to the Indiana customer. Each of the three corporations is a wholly owned subsidiary of a holding company. Each of the holding companies is a wholly owned subsidiary of one corporation. In the last first year of the audit, the taxpayer sold its product through one related corporation's Indianapolis sales office. During the last two years of the audit, the taxpayer sold its product through another related corporation's sales office. However, the sales office never changed. Rather, the corporate structure was changed so that the sales office was part of two different corporations. The sales office was a single point of contact office for the taxpayer's only Indiana customer. Most contact between the customer and the taxpayer was handled through this office.

The Indianapolis office had two persons assigned to it. The salesman is in the office everyday. The office is used after a field call to communicate data and information to others in the taxpayer's organization. The inside salesman makes sure that all orders are entered in the computer system and assures that all orders were shipped to the right place. The office keeps track of shipment by exception which means that if the division cannot ship the product, the division contacts the sales office and the office forwards the message to the Indiana customer. If there is a problem other than quality control, the customer calls the Indianapolis office which coordinates the resolution of the problem.

All purchase orders go to the Indianapolis sales office where they are approved. This information is checked, entered into the computer system and sent to the appropriate manufacturing division. A hard copy of this order is also mailed to the manufacturing division. Specifications and blueprints are brought to the Indianapolis sales office by the salesman and copies are forwarded to the manufacturing division.

If at any time it is considered necessary, the taxpayer's engineer from its out-of-state manufacturing facility comes into Indiana to meet with the sales representatives and employees of the taxpayer's Indiana customer.

The Indianapolis office has all the Indiana customer files. These include orders kept by sequential number of the parts and drawings of all of the customer's parts. The sales office also serves as a repository for literature, bulletins, data sheets, qualification tests, and their results.

The taxpayer also provides engineering services to the customer at the customer's Indiana plant and at the Indianapolis office.

45 IAC 1.1-1-3 explains that gross income is subject to the Indiana gross income tax if it derives from Indiana activities such as the performance of services in Indiana. The United States Supreme Court considered the issue of adequate nexus to subject income from sales in a gross income tax context in Tyler Pipe Industries, Inc. v. Washington State Department of Revenue, 483 U.S. 232 (1987). In that case, Tyler Pipe Industries, Inc. manufactured pipes which it sold in Washington through a Washington sales

office that was not owned by nor were the salesmen employees of Tyler Pipe Industries. The Court found that the daily significant activities of the salespeople in Washington such as calling on customers, establishing and maintaining valuable relationships, and providing Tyler Pipe Industries with information about the needs of the customers created sufficient contact with the state to establish the nexus necessary to submit income from sales in Washington to the Washington gross income tax. This is analogous to the taxpayer's situation in that the Indianapolis sales office is not owned by the taxpayer and the salespeople are not the taxpayer's employees or agents. Even so, the Indiana sales representatives perform substantial activities in the state. These activities create the nexus necessary to subject the taxpayer's Indiana sales to the gross income tax.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Imposition of Tax

DISCUSSION

Pursuant to IC 6-3-2-1 (b), Indiana imposes an adjusted gross income tax on "that part of the adjusted gross income derived from sources within Indiana of every corporation." The standard for sufficient nexus to impose the Indiana adjusted gross income tax is different than that for imposing the Indiana gross income tax.

15 U.S.C.S.381 (Public Law 86-272) prohibits states from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within that state unless those activities exceed the mere solicitation of sales. 15 U.S.C.S. 381 (a), (c).

The department must determine whether the taxpayer's employees' activities in Indiana exceed the 15 U.S.C.S. 381 benchmark of "mere solicitation." Indiana Department of State Revenue v. Continental Steel Corporation, 399 N.E.2d 754 (Ind. Ct. App. 1980), defines those activities which do and do not exceed the "mere solicitation," standard. In that case, the court held that, "solicitation should be limited to those generally accepted or customary acts in the industry which lead to the placing of orders not those which follow as a natural result of the transaction, such as collections, servicing complaints, technical assistance and training..." Id. at 759. Further, "solicitation must be limited to those acts which lead to the placing of orders and does not include those acts which follow as a result of the transaction." Id. The court set out examples of activity which exceeded "mere solicitation" including "giving spot credit, accepting orders, collecting delinquent accounts and picking up returned goods within the taxing state, pooling and exchanging technical personnel in a complex mutual endeavor, maintaining personal property and associated local business activity for purposes not related to soliciting orders within the taxing state." Id.

The "mere solicitation" by a corporation's employees standard was refined by the Supreme Court in Wisconsin Department of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992). The Court concluded, "although solicitation covered more than what was strictly essential to making requests for purchases, the fact that an activity is performed by salespersons does not automatically convert that activity into solicitation." Id. at 2456-57.

As discussed in the first section of this Letter of Findings, the taxpayer has significant activities in Indiana through the sales personnel and sales office of its related corporation. Although the salesmen are not employees of the taxpayer, they are employees of a related corporation. "Independent" is defined in Black's Law Dictionary, Seventh Edition, 1999 at page 774 as "1. Not subject to the control or influence of another. 2. Not associated with another (often larger) entity." In this case, the taxpayer and the corporations managing the sales offices and their employees are both owned by the same corporation. They are, then, by definition subject to the control and influence of the corporation owning all of their holding companies and are clearly associated with the other entities. They have significant dealings with the taxpayer and are subject to the taxpayer's instructions. As such, although they are not in the strict sense employees, they cannot be considered independent or independent contractors either. Even though the taxpayer does not employ the Indiana sales representatives, the taxpayer's own employee engineers come to Indiana to work with the customers on product design and other issues. The taxpayer's activities in Indiana, then, exceed "mere solicitation." Therefore, the taxpayer is subject to the tax on the adjusted gross income from those activities.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02980225.LOF
02980226.LOF
02980227.LOF

LETTERS OF FINDINGS NUMBERS:
98-0225; 98-0226; 98-0227
Corporate Income Tax
Penalty
For 1993, 1994, & 1995

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

ISSUES

I. Corporate Income Tax—Consolidated Filing

Authority: IC § 6-3-4-14(b); 45 IAC 1-1-163; IC § 6-8.1-5-1(b); 45 IAC 15-5-3(8)

Taxpayers protest the disallowance of the consolidated filings.

II. Penalty-Negligence

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

Taxpayers protest the 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer A is the parent corporation of two subsidiaries, taxpayer B and taxpayer C. The parent was a wholesale distributor of hydraulic and electrical parts prior to filing Chapter 11 bankruptcy in 1992. Taxpayer B distributed light fixtures and taxpayer C manufactured industrial parts for hydraulic assemblies. Further facts will be added as required.

I. Corporate Income Tax—Consolidated filing

DISCUSSION

Taxpayers protest the proposed assessment of Indiana corporate income tax based on the audit's determination that a consolidated filing including all three entities should be disallowed. The Department has attempted, since the receipt of the protests on these three taxpayers in 1998, to determine the basis of taxpayers' protests of the disallowance of the consolidated filings. A Departmental Hearing officer scheduled numerous hearings with the taxpayers' representative who stated he needed extra time to obtain documents. Scheduled hearings were postponed until the representative could obtain those documents. The documents were received in the Legal Division of the Indiana Department of Revenue on September 5, 2003 and September 8, 2003, by FAX. There was no supporting brief accompanying the documents. A review of the documents indicates that there is no information relevant to the issues protested.

Pursuant to IC § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made." Taxpayers' representative has not made the required showing, based on the documents the Hearing Officer has received. It should be noted that the Hearing Officer sent copies of the Audit Summaries for all three taxpayers to the representative on June 2, 2003. The Summaries clearly identify the issues in the Audit, with the proper citations to Indiana Statutes and Regulations. The documents the representative sent all relate to the bankruptcy, a matter of federal, not state, law. Moreover, the documents do not pertain to IC § 6-3-4-14(b)'s requirement that entities filing consolidated returns must have adjusted gross income "derived from sources within the state of Indiana." The documents do not pertain to 45 IAC 1-1-163's requirement that to file a consolidated return, corporations must be "incorporated or qualified to do business in Indiana." The parent is not an Indiana corporation. The parent included one of the subsidiaries in its returns for 1993 and 1994, but then filed a consolidated return in 1995. The election of a consolidated filing must be on the corporation's initial return. The parent did not do that. Taxpayers' representative argued that the consolidated filing was pursuant to an order from the bankruptcy court, but no such order has been made part of the files, nor has one been produced.

FINDING

Taxpayers' protests concerning the disallowance of the consolidated filings are denied.

II. Penalty

Penalty assessments depend on a number of factors outlined in the statute and regulation cited *supra*, and can be waived based on a showing of sufficient cause:

> 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.

Taxpayers have provided no evidence to support abatement of the negligence penalty.

FINDING

Taxpayers' requests for the abatement of the 10% negligence penalty are denied.

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER 18-990118
FINANCIAL INSTITUTIONS TAX FOR THE PERIOD 1990-96

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

ISSUES

I. Tax Procedure—Constitutional Challenges—Exhaustion of Administrative Remedies

Tax Procedure—Notice of Proposed Assessment—Notice to Correct Entity—Unitary Groups (All Tax Periods)

Authority: IND. CONST. art. III, § 1; I.R.C. (26 U.S.C.) § 7701(a)(3) (1988) (1994); IC §§ 6-5.5-1-6, -1-18(b), -6-1 and -9-2 (1988 and Supps. 1989-92) (1993); IC § 6-8.1-1-1 (1993 and Supps. 1994-97) (1998); IC § 6-8.1-1-3 (1988) (1993) (1998); IC §§ 6-8.1-1-5.5 and -5-1 (1988 and Supps. 1989-92) (1993) (1998); *Mullane v. Central Hanover Bank & Tr. Co.,* 70 S.Ct. 652 (U.S. 1950); *American Auto Trimming Co. v. Lucas,* 37 F.2d 801 (D.C. Cir. 1930); *Anheuser-Busch, Inc. v. Comm'r,* 40 B.T.A. 1100 (1939); *State v. Sproles,* 672 N.E.2d 1353 (Ind. 1996); *Bethlehem Steel Corp. v. Indiana Dep't of State Revenue,* 639 N.E.2d 264 (Ind. 1994); *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); *Dowd v. Grazer,* 116 N.E.2d 108 (Ind. 1953); *State ex rel. Standard Oil Co. v. Review Bd. of Employment Sec. Div.,* 101 N.E.2d 60 (Ind. 1951); *Owner-Operator Indep. Drivers Ass'n v. State Dep't of Revenue,* 725 N.E.2d 891 (Ind. Ct. App. 2000); *Felix v. Indiana Dep't of State Revenue,* 502 N.E.2d 119 (Ind. Ct. App. 1986); *Van Orman v. State,* 416 N.E.2d 1301 (Ind. Ct. App. 1981); *Associated Ins. Cos. v. Indiana Dep't of State Revenue,* 655 N.E.2d 1271 (Ind. Tax Ct. 1995); *Ball v. Indiana Dep't of State Revenue,* 525 N.E.2d 356, 358-359 (Ind. Tax Ct. 1988) ("*Ball I*"), *aff'd* 563 N.E.2d 522, 524 (Ind. 1990) ("*Ball II*"); 45 IAC § 15-5-1 (1988) (1992) (1996)

The protesting unitary group (hereinafter "the protestant," "the merged unitary group" or "the merged group") contends that the assessments are void because the Department addressed them to a member that was not the member that filed the combined returns for the unitary group.

II. Financial Institutions Tax—Imposition—Transacting Business of Financial Institution in Indiana—Regular Solicitation of Business in or Attribution of Receipts to Indiana (1993-96)

Tax Procedure—Protests—Burden of Proof

Authority: I.R.C. (26 U.S.C.) § 61 (1988) (1994); IC §§ 6-5.5-1-12, -17(a) and (d), -18(a), -2-1(a), -2-4, -3-1(6), -3-4, -3-5, -4-2(1), -4-4 to -4-6, -4-8, -6-9 and -8.1-5-4 (1988 and Supps. 1989-92) (1993); IC § 6-8.1-5-1(b) (1998); *Indiana Dep't of State Revenue v. Fort Wayne Nat'l Corp.,* 649 N.E.2d 109 (Ind. 1995); *State v. Huffman,* 643 N.E.2d 899 (Ind. 1994); *Peabody Coal Co. v. Ralston,* 578 N.E.2d 751 (Ind. Ct. App. 1991); *Porter Mem'l Hosp. v. Malak,* 484 N.E.2d 54 (Ind. Ct. App. 1985); *Canal Square Ltd. Partnership v. State Bd. of Tax Comm'rs,* 694 N.E.2d 801 (Ind. Tax Ct. 1998); *Longmire v. Indiana Dep't of State Revenue,* 638 N.E.2d 894 (Ind. Tax Ct. 1994); *Bullock v. Foley Bros. Dry Goods Corp.,* 802 S.W.2d 835 (Tex. App. 1990); 45 IAC § 15-5-3(b)(8) (2000); 45 IAC §§ 17-2-6(8), -8 and -3-10(b)(6)-(9) (1988 and Supp. 1991) (1992) (1996)

The protestant argues that the Department erred in imposing financial institutions tax (hereinafter "FIT") on three of its members because they did not regularly solicit business in Indiana.

III. Tax Procedure—Adjustments to Federal Returns—Timeliness of Notice to Department (1993)

Authority: I.R.C. (26 U.S.C.) §§ 6511(a), 6513(a) (1988) (1994); IC §§ 6-5.5-6-6(b), -8.1-5-2(f) and –9-1(a) (1993); IC § 33-3-5-11(a) (1998 and Supp. 2002); *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); *Marhoefer Packing Co. v. Indiana Dep't of State Revenue,* 301 N.E.2d 209 (Ind. Ct. App. 1973); *Salin Bancshares, Inc. v. Indiana Dep't of State Revenue,* 744 N.E.2d 588 (Ind. Tax Ct. 2000); *GasAmerica Services, Inc. v. Indiana Dep't of State Revenue,* 552 N.E.2d 860 (Ind. Tax Ct. 1990); 45 IAC §§ 15-5-7(d) and -9-2 (1992)

The protestant submits that the auditor and the Department erred in denying the protestant the benefit of the adjustments to its 1993 federal income tax return, because it did not report those adjustments in a timely manner.

IV. Financial Institutions Tax—Imposition—Constitutionality—Due Process Nexus (1993-96)

Financial Institutions Tax—Imposition—Constitutionality—Interstate Commerce—Substantial Nexus (1993-96)

Financial Institutions Tax—Imposition—Constitutionality—Interstate Commerce—Fairness of Apportionment and Discrimination (1993-96)

Financial Institutions Tax—Credits—Non-Resident Taxpayers—Constitutionality--Fairness of Apportionment and Discrimination (1993-96)

Authority: IND. CONST. art. III, § 1; IC §§ 6-5.5-1-12, -1-13 and -2-4 to -6 (1988 and Supps. 1989-92) (1993); *Goldberg v. Sweet,* 109 S.Ct. 582 (U.S. 1989); *United States v. Salerno,* 107 S.Ct. 2095 (U.S. 1987); *Armco, Inc. v. Hardesty,* 104 S.Ct. 2620 (U.S. 1984); *Swan & Finch Co. v. United States,* 23 S.Ct. 702 (U.S. 1903); *Burroughs Adding Machine Co. v. Terwilliger,* 135 F2d 608 (6th Cir. 1943); *Miller v. McColgan,* 110 P.2d 419 (Cal. 1941); *Bigelow v. Reeves,* 149 S.W.2d 499 (Ky. 1941); *State v. Sproles,* 672 N.E.2d 1353 (Ind. 1996); *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); *Dowd v. Grazer,* 116 N.E.2d 108 (Ind. 1953); *State ex rel. Standard Oil Co. v. Review Bd. of Employment Sec. Div.,* 101 N.E.2d 60 (Ind. 1951); *State ex rel. ANR Pipeline Co. v. Indiana Dep't of State Revenue,* 672 N.E.2d 91 (Ind. Tax Ct. 1996); *Auburn Foundry, Inc. v. State Bd. of Tax Comm'rs,* 628 N.E.2d 1260 (Ind. Tax Ct. 1994); *Tupelo Garment Co. v. State Tax Comm'n,* 173 So. 656 (Miss. 1937); *State ex rel. Whitlock v. State Bd. of Equalization,* 45 P.2d 684 (Mont. 1935); *Omaha Pub. Power Dist. v. Nebraska Dep't of Revenue,* 537 N.W.2d 312 (Neb. 1995); *TPQ Inv. Corp. v. State ex rel. Oklahoma Tax Comm'n,* 954 P.2d 139 (Okla. 1998); *Keyes v. Chambers,* 307 P.2d 498 (Or. 1957); *Burlington N. R.R. v. Strackbein,* 398 N.W.2d 144 (S.D. 1986); *Stephens v. Vermont Dep't of Taxes,* 353 A.2d 355 (Vt. 1976); *Cudahy v. Wisconsin Dep't of Taxation,* 52 N.W.2d 467 (Wis. 1952); 45 IAC §§ 17-3-7(e) and -8(b) (1988 and Supp. 1991) (1992) (1996)

The protestant contends that the FIT as applied to the three members in question violates due process and the dormant Interstate Commerce Clause because those corporations allegedly have no substantial nexus with Indiana. The protestant also submits that the FIT further violates the dormant Interstate Commerce Clause because IC § 6-5.5-2-4 apportions unfairly and thereby discriminates against interstate commerce. Lastly, the protestant argues that the credit for nonresident taxpayers of IC § 6-5.5-2-6 does not completely cure these alleged defects.

V. Tax Administration—Negligence Penalties (1993-96)—Reasonable Difference of Opinion as to Liability for Tax

Authority: IND. CONST. art. III, § 1; IC § 6-5.5-7-1(a) and -8.1-10-2.1(b) and (d) (1993); *State v. Sproles,* 672 N.E.2d 1353 (Ind. 1996); *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); *Dowd v. Grazer,* 116 N.E.2d 108 (Ind. 1953); *State ex rel. Standard Oil Co. v. Review Bd. of Employment Sec. Div.,* 101 N.E.2d 60 (Ind. 1951); *Indiana Dep't of State Revenue v. Harrison Steel Castings Co.,* 402 N.E.2d 1276 (Ind. Ct. App. 1980); 45 IAC § 15-11-2(b) and (c) (1992) (1996)

The protestant argues that the Department should abate the negligence penalties for calendar years 1993-95 and the years ending March 31, 1996 and December 31, 1996 because a reasonable difference of opinion exists as to the constitutionality of the tax.

VI. Tax Administration—Negligence Penalties (1990-92)—Reasonable Cause—Merger and Layoff of Compliance Personnel

Authority: IC § 6-5.5-7-1(a) (1988 and Supps. 1989-91); IC § 6-8.1-5-1(b) (1998); IC § 6-8.1-10-2 (1988); IC § 6-8.1-10-2.1 (1988 and Supps. 1991-92); 45 IAC § 15-11-2(b) and (c) (1988) (1992)

The protestant contends that reasonable cause exists to abate the penalty for calendar years 1990-92 due to a merger and attendant layoff of tax compliance personnel that it alleges caused it to fail to timely report certain adjustments to its federal corporate returns to the Department.

SUMMARY OF FINDINGS

The Department denies this protest as to all issues for the reasons set out below in the respective Discussion of each issue.

STATEMENT OF FACTS

The Department audited the protesting entity for financial institutions tax (hereinafter "FIT") for calendar years 1990-96 (hereinafter "the audit period"). From the beginning of 1990 through the end of the first quarter of 1996 that entity was an affiliated group consisting of a parent bank holding company (hereinafter "the original parent" or "the original holding company") and numerous affiliate members. The original parent and its affiliates functioned as a unitary group (see IC § 6-5.5-1-18(a) (1988 and Supp. 1992) (1993) (1998) for the definitions of "unitary business" and "unitary group"), so the Department will hereinafter refer to them as "the original unitary group" or "the original group". On April 1, 1996 a "reverse acquisition" merger occurred (*see generally* 26 C.F.R. (Treas. Reg.) § 1.1502-75(d)(3)(i) (1996)). As a result, the original holding company and the original unitary group were merged into, and became members of, a larger affiliated group also functioning as a unitary group (hereinafter "the acquiring unitary group" or "the acquiring group") headed by another bank holding company (hereinafter "the acquiring parent"). The resulting entity adopted the original holding company's name, and also filed this protest.

Ordinarily the Department would simply refer to a protesting entity as "the taxpayer," or possibly as "the licensee" if the protest in question involves assessment of a license tax. However, among other things, the present protesting entity contends that the Department mailed the Notices of Proposed Assessment for the underlying audit to the wrong taxpayer. Specifically, the protesting entity submits that the Department erroneously sent those Notices to the original parent. The protesting entity argues that instead the Department should have sent the Notices to another member of the original and merged unitary groups that they designated to file the combined Forms FIT-20 (Financial Institution Franchise Tax Return) on their behalves during the audit period. (The Department will hereinafter refer to this member as "the filing member" or "the filer.") To resolve this issue the Department will have to determine who was the taxpayer and who was, or were, the member or members of the merged unitary group to which the Department was legally empowered to send those Notices, as it will discuss under Issue I below. Given this circumstance and the occurrence of the "reverse acquisition" merger, the Department would unnecessarily complicate discussion of the other issues and confuse readers of this letter if it were to refer to the present protesting entity as "the taxpayer." Therefore, to avoid these problems and to promote clarity, the Department in this letter will refer to this entity as "the merged unitary group," "the merged group" or "the protestant."

The original, acquiring and merged groups all filed consolidated federal Forms 1120 (U.S. Corporation Income Tax Return) during the audit period. All federal returns were filed under the name of the original holding company. As a result of the reverse acquisition the original unitary group filed a final Form 1120 and a final combined Form FIT-20 for the first quarter of 1996. The merged unitary group filed another 1120 and another FIT-20 that reflected the activities of the original group and the original parent for the last three quarters of 1996 and of the acquiring parent and the acquiring unitary group for all of calendar 1996. There was no difference between the companies listed as being members of the original federal affiliated and original Indiana unitary groups, or between those listed as being members of the merged federal affiliated and merged Indiana unitary groups.

However, in the FIT-20s from 1993 through the end of the audit period, the reporting unitary group in question included in the numerator of the apportionment calculation only receipts of affiliate members that the group represented had tangible property or personnel in Indiana. The effect of this action was that the group in question reported Indiana receipts for only the filer and one other member for calendar years 1993-95 and only the filing member for 1996. The reporting group in question excluded from the apportionment numerator the receipts of all members represented as not having property or personnel in Indiana, which constituted all other members of the reported group, including the original and acquiring parents. As justification for this position a short written statement to this effect was attached to each FIT-20 for the 1993-96 reporting periods questioning the constitutionality of unspecified parts of IC § 6-5.5-3-1.

Three of the six issues in this protest arise out of the imposition of FIT on receipts earned during these years by three members of the original group that the merged unitary group alleges fell into this latter category. The Department will refer to these members hereinafter as Members A, B and C. Member A is a corporation chartered in a state other than Indiana and specialized in commercial real estate financing. Members B and C are both national banks. Members A and B were reported as being members of the original or merged unitary group during each reporting period in calendar years 1993-96. Member C joined and was reported as being a member of the original group in calendar year 1995 and was reported as being a member of the reporting group in question on both of the 1996 returns. None of these three members was the filer. All three had their commercial domiciles outside Indiana. None was admitted to do business in Indiana during the audit period according to the on-line records of the Department of Financial Institutions and the Business Services Division of the Secretary of State's office. The field auditor added to the numerator of the apportionment formula receipts that one or more of these members, and others, earned from loans or installment sales primarily secured by tangible property in Indiana, unsecured consumer loans to Indiana debtors, unsecured commercial loan or installment obligation proceeds applied to Indiana, and credit card charges billed to Indiana addresses. The Notices of Proposed Assessment indicate that the bulk of the resulting FIT was imposed on receipts earned during calendar years 1993-95 and the two 1996 return periods.

The auditor also made, and in one case declined to make, adjustments relating to certain omissions relating to tax compliance. The protestant submitted Internal Revenue Service ("IRS") Revenue Agent Reports ("RARs") for calendar years 1990-91, and amended federal corporate income tax returns (Form 1120X) for calendar years 1992-93, for the original unitary group that had not been submitted to the Department before. The 1990-91 RARs and the 1120X for 1992 indicated increases to the original group's federal corporate tax liability, while the 1993 1120X indicated that the federal income of original unitary group was reduced (thereby entitling it to a refund or credit of FIT). The auditor made adjustments to the original group's FIT liability for calendar years 1990-92 based on these returns. However, she declined to do so for calendar year 1993 on the ground that the changes reported on the amended federal return for that year had not been reported to the Department within one hundred twenty (120) days after the modification to the federal return for that year. The only evidence in the audit file of when the merged unitary group notified the Department is an entry in the auditor's progress report (i.e., log) dated March 30, 1998 and documenting a conversation between her and the merged group's successor contact person for the audit. In that conversation the successor contact person indicated that she believed that the 1993 Form 1120X was filed in 1995, which would have been before the merger. The successor contact person represented that she would get back with the auditor if he found any proof that the Department had received timely notice, but never did so. The merged unitary group has not provided any such proof during this protest, nor is there any such proof in the file.

The Department assessed penalties for all years of the audit period for failing to follow the regulations on sourcing of loan, credit interest and fee receipts and for failing to report and pay the tax on such items.

The auditor also submitted the Audit Summary under the name and federal identification number of the original parent. Her reasons for doing so, as stated in the Audit Summary, were twofold. First, the auditor stated that before the FIT was enacted the original unitary group was the same entity that had filed Indiana income tax returns. Second, she noted that the original parent had been the responsible filing member of the original federal consolidated group during the audit period. The Department issued the Notices of Proposed Assessment to the original holding company, rather than to the Indiana filing member, as a result. The original parent, rather than the filing member, submitted this protest. Additional facts will be provided if and as needed under the Discussion of each issue below.

I. Tax Procedure—Constitutional Challenges—Exhaustion of Administrative Remedies
Tax Procedure—Notice of Proposed Assessment—Notice to Correct Entity—Unitary Groups (All Tax Periods)

DISCUSSION

A. INTRODUCTION: INDIANA LAW REQUIRES EXHAUSTION OF ADMINISTRATIVE REMEDIES IF A TAX IS CHALLENGED ON CONSTITUTIONAL GROUNDS.

As the Department will summarize under the Discussion of Issue III below, the protestant has challenged the assessment in this protest on two federal constitutional grounds. For this reason, the Department will discuss at the outset the Indiana law governing the administrative procedure to be followed when a constitutional challenge is made to an assessment of a tax that this Department administers.

The Indiana Supreme Court has held that constitutional analysis is beyond the Department's expertise. *State v. Sproles,* 672 N.E.2d 1353, 1360 (Ind. 1996). Taxpayer claims that a tax statute is unconstitutional on its face in particular are beyond the Department's administrative authority and adjudicative jurisdiction on the additional ground of the Indiana state constitutional doctrine of separation of powers. IND. CONST. art. III, § 1; *Dowd v. Grazer,* 116 N.E.2d 108, 112 (Ind. 1953); *State ex rel. Standard Oil Co. v. Review Bd. of Employment Sec. Div.,* 101 N.E.2d 60, 66 (Ind. 1951). However, it is also well settled that a taxpayer challenging on constitutional grounds a tax statute that the Department administers or a tax that it has levied nevertheless must make that challenge by exhausting, and may not bypass, its statutory administrative remedies before raising it in the Indiana Tax Court. *Sproles,* 672 N.E.2d at 1361, citing, among other opinions, *Felix v. Indiana Dep't of State Revenue,* 502 N.E.2d 119 (Ind. Ct. App. 1986); *Owner-Operator Indep. Drivers Ass'n v. State Dep't of Revenue,* 725 N.E.2d 891, 893-94 (Ind. Ct. App. 2000) (citing *Sproles*). As a matter of procedure the protestant therefore was correct to raise its constitutional issues with the Department initially. The Court of Appeals in *Felix* stated the reasons for the exhaustion requirement as follows:

> [T]he "absolute and indispensible [sic] prerequisite" of [exhausting administrative remedies] "serves to advise the appropriate internal revenue officials of the claims intended to be asserted by the taxpayer, so as to insure an orderly administration of the revenue." *McConnell v. United States* (E.D. Tenn. 1969), 295 F. Supp. 605, 606. Finally, *the requirement of [exhausting administrative remedies] even for a constitutional challenge will afford the Department the opportunity to resolve the matter on nonconstitutional grounds. See Christian v. New York State Department of Labor* (1974), 414 U.S. 614, 622-24, 94 S.Ct. 747, 751-52, 39 L.Ed.2d 38, 45-47. *For example, the Department may determine in an audit that [a taxpayer's] claimed refund is inappropriate for other reasons or that is [sic] allowable under other tax provisions. Weinberger v. Salfi* (1975), 422 U.S. 749, 762, 95 S.Ct. 2457, 2465, 45 L.Ed.2d 522, 537.

502 N.E.2d at 122 (emphases added), approved in *Sproles*, 672 N.E.2d at 1361. The Department interprets the emphasized language as requiring it, whenever possible, to decide any tax protest in which, or any issue in a protest in connection with which, the taxpayer in question has raised constitutional issues on any non-constitutional grounds that taxpayer may also have raised. *See Bethlehem Steel Corp. v. Indiana Dep't of State Revenue,* 639 N.E.2d 264, 272 (Ind. 1994) (finding it unnecessary to resolve a constitutional challenge after deciding the case on non-constitutional grounds). However, if the Department cannot successfully resolve a protest on such alternative grounds, or if a taxpayer has not raised any non-constitutional issues, it will only address claims of unconstitutionality to the extent necessary to resolve a protest and only as applied to the taxpayer and assessment in question. In addition, the Department will do so only to the extent authorized, or at least not barred, by statute or constitutional provision. In particular, the Department cannot and will not entertain facial attacks on a statute concerning a tax that it administers. IND. CONST. art. III, § 1; *Grazer,* 116 N.E.2d at 112; *Standard Oil,* 101 N.E.2d at 66.

As the Department will explain under its Discussion of Issue IV below, the present protestant has attacked the FIT, and the credit against that tax for nonresident taxpayers, on their faces rather than as applied to it in this audit. IND. CONST. art. III, § 1 as interpreted in *Grazer* and *Standard Oil* therefore prevent the Department from addressing these arguments. However, in addition to its constitutional challenges, the merged unitary group has also attacked the assessment on three non-constitutional grounds. Accordingly, and consistent with *Felix* as approved in *Sproles,* the Department will address these non-constitutional arguments.

B. THE PROTESTANT'S ARGUMENT

As noted in the Statement of Facts, the Department issued the Notices of Proposed Assessment to the original parent. The merged unitary group contends that the Department should have served the Notices on the filing member instead. In so arguing the merged group implies that the Department must read the first sentence of 45 IAC § 15-5-1 (1988) (1992) (1996) literally as requiring it to serve the Notices of Proposed Assessment on the filing member as the taxpayer that improperly reported that group's and the original unitary group's FIT liability.

More importantly, the protestant also submits that the Department's serving the Notices on the original parent instead of the filing member invalidated the proposed assessments. The protestant argues that the original parent was neither a "taxpayer" as defined in IC § 6-5.5-1-17(a) nor the filing taxpayer member of the unitary group for purposes of IC §§ 6-5.5-6-1 and -2-4, and therefore was not the proper entity upon which the Department should have served the Notices of Proposed Assessment. Implicit in this argument is the proposition that the definition of "taxpayer" in IC § 6-5.5-1-17(a) should also define that word in 45 IAC § 15-5-1 when the Department serves a Notice of Proposed Assessment of FIT, in order to identify the allegedly correct entity upon which to serve that Notice.

C. THE DEPARTMENT'S RESTATEMENT OF THE ISSUES

The Department views this matter somewhat differently than does the merged unitary group. In the Department's view the real questions to be answered are threefold. The first is whether the word "taxpayer" in this factual context refers to the entire original or merged unitary group the returns for the period in question covered, or the member that actually prepared and filed those returns, or caused them to be prepared and filed. The second and third questions are related to each other but distinct from the first question. They are, second, whether the Department was legally empowered to send the Notices of Proposed Assessment to the original parent, and third, whether the original parent was empowered to receive those Notices on behalf of the merged unitary group.

D. THE "TAXPAYER" ON WHICH THE DEPARTMENT SERVED THE NOTICES OF PROPOSED ASSESSMENT WAS THE ENTIRE MERGED UNITARY GROUP

Turning first to the question of the identity of the "taxpayer," it is necessary at the outset to put 45 IAC § 15-5-1, and its use of that word, into the proper legal context. This regulation read during the audit period, and at this writing still reads, as follows:

> Sec. 1. If the department believes that a *taxpayer* has improperly reported a listed tax liability, the department may at any time within the prescribed statute of limitations period issue to such *taxpayer* a formal notice that the department proposes to assess additional tax. The formal notice shall be based on the best information available to the department. Any written advisement which informs the *taxpayer* of the amount of the proposed assessment for a particular tax period shall constitute a formal notice. A formal notice shall be sent through the United States mail.

Id (emphases added). The Department promulgated 45 IAC § 15-5-1 as one of the regulations intended to implement IC § 6-8.1-5-1, which forms part of the Tax Administration Act, P.L. 61, § 1, 1980 Ind. Acts 660, 660-684, codified as amended at IC article 6-8.1 (1998) (hereinafter "the TAA"). The TAA governs the procedures for assessment, collection and administration of the taxes for which the General Assembly has made the Department responsible. IC § 6-8.1-1-1 appropriately defines them as being "listed taxes," compiling them and citing to the parts of IC title 6 in which they are located. *Id.* The Financial Institutions Tax Act, P.L. 347-1989(ss), § 1, 1989 Ind. Acts 2496, 2496-2519, codified as amended at IC article 6-5.5 (1988 and Supps. 1989-92) (1993 and Supps. 1994-97) (hereinafter "the FITA"), has made the FIT a listed tax ever since it first took effect on January 1, 1990 (*see id.* §§ 1 and 31, 1989 Ind. Acts at 2496 and 2540, respectively, indicating effective date). The FITA includes IC § 6-5.5-9-2, 1989 Ind. Acts at 2518, which states that "[f]or purposes of administration and enforcement the provisions of IC 6-8.1 that are applicable to a listed tax and an income tax apply to the tax imposed by this article." *Id.* (The legislature made a technical amendment to add the FIT to IC § 6-8.1-1-1 during the audit period in P.L. 71-1993, § 15, 1993 Ind. Acts 3294, 3310.) The TAA thus applies to questions of the Department's authority to administer the FIT.

It follows that for purposes of determining the entities upon whom the Department is authorized to serve a Notice of Proposed Assessment of FIT under 45 IAC § 15-5-1 that the definition of "taxpayer" in IC § 6-8.1-1-5.5 controls. That definition is broad enough to include the definition of "taxpayer" in IC § 6-5.5-1-17(a). The latter statute defines "taxpayer" for purposes of the FITA as "a *corporation* that is transacting the business of a financial institution in Indiana[.]" *Id* (emphasis added). (*But see* IC § 6-5.5-1-18(a) (indicating that a unitary group can also include "a partnership, a limited liability company, or a trust, … or any other entity, … that conducts … the business of a financial institution …[,]" *id.*). The FITA's definition of "corporation" in IC § 6-5.5-1-6 reads as follows:

> "Corporation" means an entity that is:
>
> (1) A corporation (as defined in Internal Revenue Code [26 U.S.C.] Section 7701(a)(3)) for federal income tax purposes, including an entity taxed as a corporation under the Internal Revenue Code; and
>
> (2) Organized under the laws of the United States, this state, any other taxing jurisdiction, or a foreign government.

Id. (I.R.C. § 7701(a)(3) (1988) (1994) in turn states that "[t]he term 'corporation' includes associations, joint-stock companies, and insurance companies." *Id.*) In contrast, IC § 6-8.1-1-5.5 states that "'taxpayer' means a *person* liable for the payment of taxes." *Id* (emphasis added). The TAA's definition of "person" in IC § 6-8.1-1-3 "includes [in relevant part] … national bank, bank, … *corporation*, …*or any group or combination acting as a unit.*" *Id* (emphases added). This definition thus includes all of the entities described in IC § 6-5.5-1-6 and I.R.C. § 7701(a)(3). That being the case, the merged group's argument that the definition of "taxpayer" in IC § 6-5.5-1-17(a) applies to 45 IAC § 15-5-1 in this protest raises an unnecessary argument that does nothing to advance its position.

Moreover, the Department would observe that the protestant's argument that the first sentence of 45 IAC § 15-5-1 authorized service of the Notices only on the filing member is a double-edged sword for the protestant. The reason this is so is because the sections of the TAA that deal with protest procedure imply that the person to whom the Department sent the Notice of Proposed Assessment is also the person that has standing to protest that assessment. For example, IC § 6-8.1-5-1(c) requires that "[t]he notice [of proposed assessment] shall state that *the person* [to whom the Department sent it] has sixty (60) days from the date the notice is mailed to pay the assessment or to file a written protest." *Id* (emphasis added). In the same vein, IC § 6-8.1-5-1(e) states that "the department shall issue a letter of findings and shall send a copy of the letter through the United States mail *to the person who filed the protest*…." *Id* (emphasis added).

Carrying the merged unitary group's argument to its logical conclusion, if its literal interpretation of the first sentence of 45 IAC § 15-5-1 were adopted, then it follows that IC § 6-8.1-5-1(c) and (e) would also have to be interpreted literally as giving only the filer standing to protest. However, the merged group submitted the original protest letter in this dispute on letterhead of the original parent, signed by its then Senior Tax Counsel and Vice President, and not in the name of the filing member. Therefore, if the Department were to agree with the merged group's argument and sustain it on this issue, the Department also would have to treat this protest as having been submitted *ultra vires* and deny it in its entirety for lack of standing, or at the very least for failure to join an indispensable party.

Fortunately for the merged unitary group, the TAA does not require such a result. As previously noted, the definition of "person" in IC § 6-8.1-1-3 "includes … *any group or combination acting as a unit.*" *Id* (emphasis added). In turn, IC § 6-8.1-1-5.5 states that " 'taxpayer' means *a person* liable for the payment of taxes[,]" *id.* These two quotations, as applied to 45 IAC § 15-5-1 and IC § 6-8.1-5-1(c) and (e), are thus plainly sufficient to interpret those authorities as referring, in a situation involving an income or franchise tax audit of a group, to the entire group that the erroneous return covers. *Cf. Associated Ins. Cos. v. Indiana Dep't of State Revenue,* 655 N.E.2d 1271, 1274 (Ind. Tax Ct. 1995) (stating that "[t]he spirit and intent of the [former] gross income tax consolidated filing statute is to treat an affiliated group as a single taxpayer[ ]"). It therefore follows that when the Department serves a Notice of Proposed Assessment in such a situation, or the group covered by the erroneous return protests the proposed assessment, the effect of the Notice or protest is not restricted just to the member that filed or caused the filing of the erroneous return. The Notice covers, and the protest binds, the whole group. These results are consistent with the Indiana rules of statutory interpretation that statutes governing tax assessment and collection, and remedial statutes (including statutes containing tax remedies, such as the TAA), are to be liberally construed. *See Department of Treasury v. Dietzen's Estate,* 21 N.E.2d 137, 139 (Ind. 1939) (tax assessment statutes); *Economy Oil Corp. v. Indiana Dep't of State Revenue,* 321 N.E.2d 215, 218 (Ind. Ct. App. 1974) (same, citing *Dietzen's Estate*). *See also W. H. Dreves, Inc. v. Osolo Sch. Twp.,* 28 N.E.2d 252, 254 (Ind. 1940) (remedial statutes), citing, *inter alia, Board of Comm'rs of Marion County v. Millikan,* 190 N.E.185 (Ind. 1934) (property tax refund case).

E. THE DEPARTMENT'S SERVICE OF THE NOTICES OF PROPOSED ASSESSMENT ON THE ORIGINAL PARENT INSTEAD OF THE FILING MEMBER WAS VALID AND ACTED AS SERVICE ON ALL MEMBERS OF THE MERGED UNITARY GROUP.

The FITA and case law support the proposition that service on the original parent was proper. The last sentence of IC § 6-5.5-6-1 makes each member of a unitary group jointly and severally liable for the FIT liability of the group. Treating service of the Notices of Proposed Assessment on any member of the merged unitary group, including the original parent, as providing notice to all the other group members is thus completely consistent with the last sentence of IC § 6-5.5-6-1. It is also consistent with the "joint contractor" theory of liability on which the District of Columbia Court of Appeals relied in American *Auto Trimming Co. v. Lucas,* 37 F.2d 801, 804 (D.C. Cir. 1930). In that case the Commissioner of Internal Revenue had failed to serve a notice of deficiency on one of two sibling corporations (the same individual owning all or a substantial majority of the stock in each). The former Board of Tax Appeals (the predecessor to the United States Tax Court) found and asserted deficiencies against both corporations, which appealed. In response, the Court of Appeals said that "[t]he filing of a consolidated return by the Detroit and Cleveland [American Auto Trimming] companies was an assertion and an admission of identity of interest. Their situation was not unlike that of joint contractors, so that *notice to either was notice to both.*" *Id.* at 804 (internal quotation marks omitted) (emphasis added), *followed in Anheuser-Busch, Inc. v. Comm'r,* 40 B.T.A. 1100, 1109 (1939).

There is also Indiana judicial precedent that provides analogous support for treating the service of the Notices on the original parent as giving notice to all the other group members. Indiana law is well settled that if the Department has served a corporation with a Notice of Proposed Assessment for an unpaid "trust fund" tax (e.g., sales or withholding tax), procedural due process does not require separate service of a Notice for the same tax on the responsible officer/s who had the statutory duty of collecting and remitting those taxes. *Ball v. Indiana Dep't of State Revenue,* 525 N.E.2d 356, 358-359 (Ind. Tax Ct. 1988) ("*Ball I*"), *aff'd* 563 N.E.2d 522, 524 (Ind. 1990) ("*Ball II*"), both following *Mullane v. Central Hanover Bank & Tr. Co.,* 70 S.Ct. 652, 657 (U.S. 1950) and *Van Orman v. State,* 416 N.E.2d 1301, 1306 (Ind. Ct. App. 1981). In that situation notice to the corporation is considered to be notice to the responsible officer sufficient to satisfy procedural due process. *Ball II,* 563 N.E.2d at 524.

In both *Ball* and *Van Orman* the person against whom the Department asserted responsible officer status was president of and majority shareholder in the corporation liable for sales tax. The Indiana Supreme Court expressed the rationale for holding such persons to have notice of the proposed assessment trust fund tax as follows:

> Under [the trust fund tax collection statutes], only those persons who have a duty to remit such assessments can be held personally liable for the failure to remit those taxes that are to be held in trust for the State. Thus, because these persons serving the corporation have direct and immediate *control* of the internal corporate processes dealing with these entrusted funds, it may be safely assumed that they are aware of the responsible officer statute which is the source of their potential personal liability and that they are aware of and privy to corporate correspondence relating to their corporate duties including notices of assessment sent to the corporation.

Id (emphasis added). The Court of Appeals' analysis in *Van Orman* was to the same effect, although blunter because the responsible officer in *Van Orman* had actually signed the protest and participated in the protest hearing. In this latter connection that court said:

> To say that Van Orman was unaware of the corporation's failure to pay the tax or to contend that he was unaware of his personal liability, in the face of IC 1971, 6-2-1-49 [the former sales tax responsible officer statute] (now repealed) [current version at IC § 6-2.5-2-1(b) (1998)], is ludicrous. All persons are charged with the knowledge of the rights and remedies

prescribed by statute. *Middleton Motors, Inc. v. Ind. Dept. [of State Revenue]* (1978), 269 Ind. 282, 380 N.E.2d 79, 81. The clear pronouncement of the statute is, ipso facto, sufficient notice that a duty exists to remit the tax fund held in trust. No personal notice of the assessment is required.

416 N.E.2d at 1306, quoted in *Ball I,* 525 N.E.2d at 358 (internal quotation marks omitted).

In the Department's view the rationales of *Ball II* and *Van Orman* made service of the Notices of Proposed Assessment on the original parent enough to impute knowledge, and therefore due process notice, of the FIT liability to the other members of the merged unitary group. As previously noted, the last sentence of IC § 6-5.5-6-1 imposes joint and several liability for a unitary group's FIT on each member of the group. That statute, like the responsible officer collection and remittance statutes at issue in *Ball I, Ball II* and *Van Orman,* gave every member of the merged group general constructive notice of its potential liability for the entire group's FIT. The original parent, like the responsible officers in those opinions, had the ability through majority stock ownership and executive power to control the other members of the group. In the unitary group context, "[u]nity is presumed whenever there is *unity of ownership, operation* and use evidenced by centralized management or *executive force, …or other controlled interaction* among entities that are members of the unitary group[.]" IC § 6-5.5-1-18(b) (emphases added). Since the original parent could control the other members, it is only proper that notice to it should also bind all the other members, including the filer. This is not to say that serving the Notices on the filing member would not have been equally valid. The Department is simply saying that serving the original parent was also permissible, either (as here) in place of, or in addition to, the filer. IC § 6-5.5-6-1 essentially enabled the original parent, as the controlling member of the group, to designate the filing member as its and the group's FIT compliance agent. However, the fact that a principal (in this case the original parent) has an agent does not ordinarily preclude third parties (e.g., the Department) from dealing directly with the principal, or deprive the principal of the ability to act for itself or entities that it controls. Certainly the original parent did so in filing and prosecuting the present protest, just as the responsible officer in *Van Orman* did on behalf of his corporation, and the protestant therefore cannot claim that it suffered any legal prejudice to its ability to make its case. Like the Court of Appeals in that case, the Department finds the protestant's contention that the Department's service of the Notices of Proposed Assessment on the original parent rather than the filing member voided the assessments to be "ludicrous." 416 N.E.2d at 1306.

As noted in the Statement of Facts, the auditor had two reasons for submitting the Audit Summary under the name of the original parent. One was that the original unitary group (and, by implication, the original parent acting as the common parent for that group) was the same entity that had filed Indiana income tax returns before the FIT was enacted. The other was that the original parent had been the responsible filing member of the federal consolidated group during the audit period. Thus, although the auditor did not rely on Treas. Reg. § 1.1502-77(a) or the responsible officer opinions, she reached the same result as those authorities. It follows that the Department did not err under either the TAA or the FITA in following the auditor's recommendation and issuing the Notices of Proposed Assessment to the original parent, instead of to the Indiana filing member.

FINDING

The merged unitary group's protest is denied as to this issue.

II. Financial Institutions Tax—Imposition—Transacting Business of Financial Institution in Indiana—Regular Solicitation of Business in or Attribution of Receipts to Indiana (1993-96)

Tax Procedure—Protests—Burden of Proof

DISCUSSION

A. INTRODUCTION.

Before turning to the merits of the merged group's argument on this issue, the Department will first give an overview of the relevant parts of the FITA, and regulations promulgated thereunder to put both the argument and the auditor's adjustment in their proper legal contexts. The Department will then discuss the protestant's procedural responsibilities because they are material to the resolution of this issue.

B. OVERVIEW OF RELEVANT PARTS OF THE FINANCIAL INSTITUTIONS TAX ACT

The Indiana Supreme Court has characterized "the FIT [a]s [being]… an excise tax on the exercise of the corporate privilege of operating as a financial institution in Indiana." *Indiana Dep't of State Revenue v. Fort Wayne Nat'l Corp.*, 649 N.E.2d 109, 112 (Ind. 1995). More precisely, IC § 6-5.5-2-1(a) "impose[s] on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising [the taxpayer's] franchise or the corporate privilege of *transacting the business of a financial institution in Indiana*." *Id* (emphasis added). IC § 6-5.5-1-17(a) defines "taxpayer" for purposes of the FITA (as distinguished from the TAA) as "a corporation that is transacting the business of a financial institution in Indiana[.]" *Id.* "Transacting the business of a financial institution in Indiana" thus defines both the taxable event and the class of persons subject to the tax. IC § 6-5.5-1-17(d) defines the term "business of a financial institution." The protestant does not dispute that the activities of the filing member and Members A through C during the audit period met that definition. It only disputes whether the auditor should have treated certain of the activities of Members A through C as having been transacted in, or attributed those activities to, Indiana.

IC chapter 6-5.5-3 sets out the rules for determining whether the entity in question is transacting business in Indiana or in some other jurisdiction. IC § 6-5.5-3-1 and its implementing regulation, 45 IAC § 17-2-6, list eight activities that constitute transacting business within Indiana. Of particular relevance in this protest are the rules that a financial institution transacts business within Indiana if it "regularly solicits business from potential customers in Indiana," IC § 6-5.5-3-1(4) and 45 IAC § 17-2-6(4), or "regularly engages in transactions with Indiana customers that involve intangible property, including loans, …[,]" IC § 6-5.5-3-1(6) and 45 IAC § 17-2-6(8). In this context "loan" includes "a lender credit card or similar arrangement[.]" IC § 24-4.5-3-106(3) (1988)(1993).

Once a taxable event has occurred, it is then necessary to determine whether the event is attributable to Indiana. IC §§ 6-5.5-3-2 to -7 set out the guidelines for doing so. The taxable event in the audit at issue in this protest is the existence of intangible assets attributable to Members A through C. Such situations are governed by IC § 6-5.5-3-5, which states in relevant part that "[i]ntangible assets are attributable to this state if the income earned on those assets is attributable to this state under this article." *Id.* The rules for attributing receipts are found in IC chapter 6-5.5-4 and its implementing regulation, 45 IAC § 17-3-10 (1992) (1996). (The auditor relied on paragraphs (b)(6) through (b)(9) of the latter regulation as authority for the assessments for the years in question.)

If a taxable event attributable to Indiana has occurred then, as noted above, the tax imposed is "measured by the taxpayer's adjusted gross income or apportioned income[.]" IC § 6-5.5-2-1(a). Apportionment of income is necessary if the tax is imposed on a nonresident taxpayer as defined in IC § 6-5.5-1-12, i.e. a taxpayer that is transacting business within Indiana as determined under IC chapter 6-5.5-3 but that has its commercial domicile outside Indiana. Members A through C each fit this definition during the audit period. The income of such nonresident taxpayers is apportioned whether transacting the business of a financial institution alone or (as is the case here) as members of a unitary group as defined in IC § 6-5.5-1-18(a). In contrast to the three-factor formula of property, payroll and sales of IC § 6-3-2-2 that is used- to apportion corporate adjusted gross income for adjusted gross income tax purposes, the FITA uses a single-factor apportionment formula based on adjusted gross income (hereinafter "AGI") and receipts. IC §§ 6-5.5-2-3 and -4 respectively set out the formulas applicable to single nonresident taxpayers and unitary groups that include nonresident taxpayers, the latter statute being the one applicable in the present case. Under each statute total AGI of the sole nonresident taxpayer or of all members of the unitary group is multiplied by the quotient of a fraction. Under each statute the numerator of that fraction includes all receipts of the sole nonresident taxpayer or the unitary group attributable to doing business in Indiana and the denominator consists of total receipts from transacting business in all taxing jurisdictions. IC § 6-5.5-4-1 makes the attribution rules of IC chapter 6-5.5-4 and 45 IAC § 17-3-10 applicable in determining what receipts are to be included in the numerators of the apportionment ratios applicable to nonresident taxpayers, whether they are filing separate returns or (as is the case here) they are members of a unitary group as defined in IC § 6-5.5-1-18(a) that is filing a combined return pursuant to the second paragraph of IC § 6-5.5-6-1. For this purpose IC § 6-5.5-4-2(1) defines "receipts" as gross income as defined in IC § 6-5.5-1-10 and I.R.C. (26 U.S.C.) § 61 (1988) (1994), with certain adjustments not in issue here. In the case of nonresident taxpayers that hold intangible assets attributable to Indiana, IC chapter 6-5.5-4 does simultaneous double duty. It establishes that such assets are attributable to Indiana as taxable events if the income from them is attributable to Indiana, and that the income from them therefore must also be included in the apportionment ratio numerator in computing the FIT.

As noted above, to support the present adjustment the auditor cited to 45 IAC § 17-3-10(b)(6)-(9), which respectively implement IC §§ 6-5.5-4-4 to -6 and -8. IC § 6-5.5-4-4 and 45 IAC § 17-3-10(b)(6) each state that "[i]nterest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property must be attributed to Indiana if the security or sale property is located in Indiana." IC § 6-5.5-4-5 and 45 IAC § 17-3-10(b)(7) both make interest income and other receipts from consumer loans not secured by real or tangible personal property attributable to Indiana if the loan is made to an Indiana resident. IC § 6-5.5-4-6 and 45 IAC § 17-3-10(b)(8) both state in relevant part that "[i]nterest income and other receipts from commercial loans and installment obligations not secured by real or tangible personal property must be attributed to Indiana if the proceeds of the loan are to be applied in Indiana." IC § 6-5.5-4-8 and 45 IAC § 17-3-10(b)(9) each state that "[i]nterest income, merchant discount, and other receipts including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders' ['cardholders' ' in the regulation] fees must be attributed to the state to which the card charges and fees are regularly billed." It is inferable from the auditor's citation to 45 IAC § 17-3-10(b)(6)-(9) that she found that Members A through C had transacted business in Indiana during the audit period because they had "regularly engage[ing] in transactions with customers in Indiana that involve intangible property, including loans, …." IC § 6-5.5-3-1(6).

C. THE PROTESTANT HAS THE BURDEN OF PROOF THAT THE PROPOSED ASSESSMENTS ARE WRONG.

The TAA specifies the administrative procedure to be followed in a protest. Under the TAA a taxpayer, defined in IC § 6-8.1-1-5.5 for purposes of that act as "a person liable for the payment of taxes[,]" *id.*, has the burden of proof in a protest. IC § 6-8.1-5-1(b) states that "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.") *Id*. *See also* BLACK'S LAW DICTIONARY 190 (7th ed. 1999) (defining "burden of proof" as a "party's duty to prove a disputed assertion or charge"). The burden of proof is two-fold, consisting of both the burden of persuasion and the burden of production. *Porter Mem'l Hosp. v. Malak*, 484 N.E.2d 54, 58 (Ind. Ct. App. 1985) (noting that "burden of proof" is not a precise term, as it can mean both the burdens of persuasion and production).

The terms “burden of production” and “burden of persuasion” have two distinct meanings. *See State v. Huffman*, 643 N.E.2d 899, 900 (Ind. 1994) (stating that there are “two senses” of the term “burden of proof,” the burdens of persuasion and production). The burden of production, also referred to as the burden of going forward, is the taxpayer’s “duty to introduce enough evidence on an issue to have the issue decided by the fact-finder.” *Id*. In other words, a taxpayer must submit evidence sufficient to establish a prima facie case, i.e., evidence sufficient to establish a given fact and which if not contradicted will remain sufficient to establish that fact. *See Longmire v. Indiana Dep’t of State Revenue*, 638 N.E.2d 894, 898 (Ind. Tax Ct. 1994); *Canal Square Ltd. Partnership v. State Bd. of Tax Comm’rs*, 694 N.E.2d 801, 804 (Ind. Tax Ct. 1998). *Cf. Bullock v. Foley Bros. Dry Goods Corp.*, 802 S.W.2d 835, 839 (Tex. App. 1990) (observing, in challenge to state’s sales and use tax audit, that comptroller’s deficiency determination is prima facie correct and that taxpayer must disprove it with documentation).

In contrast to the burden of production component of the burden of proof, the burden of persuasion is the taxpayer’s “duty to convince the fact-finder to view the facts in a way that favors that party.” BLACK’S LAW DICTIONARY 190 (7th ed. 1999). That same definition also indicates that the term “burden of persuasion is “[a]lso loosely termed *burden of proof*.” *Id* (emphasis in original.) Some cases have referenced this dual meaning. *See, e.g., Peabody Coal Co. v. Ralston*, 578 N.E.2d 751, 754 (Ind. Ct. App. 1991) (observing that in criminal cases, the “State carries the ultimate burden of proof, or burden of persuasion”).

Thus, if a taxpayer believes that a proposed assessment is based on incorrect factual findings, it is that taxpayer’s burden to produce books, records or other evidence that will prove the true facts. *See* IC §§ 6-8.1-5-4 and -5.5-6-9 (requiring taxpayers to keep books and records necessary to determine liability for any listed tax and for the FIT, respectively). If the taxpayer believes that a proposed assessment is legally insufficient, it is that taxpayer’s burden to persuade the Department that the ground on which the assessment is actually based, not the ground the taxpayer may choose or believes was chosen, is erroneous.

D. THE PROTESTANT’S ARGUMENT

IC § 6-5.5-3-4, on which the merged unitary group bases its argument, describes what activities trigger a rebuttable presumption that a person “regularly solicits business … in Indiana” as IC § 6-5.5-3-1(4) uses that phrase. During the audit period IC § 6-5.5-3-4 read, and at this writing still reads, as follows:

> Sec. 4. A person is presumed, subject to rebuttal, to regularly solicit business within Indiana if:
>
> (1) The person conducts activities described in section 1(3), 1(5), and 1(6) of this chapter [IC § 6-5.5-3-1(3), -1(5), and -1(6)] with twenty (20) or more customers within Indiana during the taxable year; or
>
> (2) The sum of the person’s assets, including the assets arising from loan transactions, and the absolute value of the person’s deposits attributable to Indiana equal at least five million dollars ($5,000,000).

Id. Title 45 IAC § 17-2-9 implements IC §§ 6-5.5-3-1(4) and -4(1), while 45 IAC § 17-2-8 defines and describes the activities that constitute “soliciting business” for purposes of these statutes. Broadly speaking, for a financial institution taxpayer to be soliciting business within the meaning of 45 IAC § 17-2-8, that taxpayer must advertise or disseminate information about its business, in any medium, to potential Indiana customers.

The merged unitary group argues that it has rebutted this presumption as to Members A through C for three reasons, which the merged group appears to offer with reference to IC § 6-5.5-3-4(1). First, the group contends that some of the transactions with these members that the auditor included in the apportionment numerator arose before the customers in question moved into Indiana. Second, the group submits that Members A through C might also buy loans from other financial institutions that had been negotiated and closed outside the state. Finally, the protestant submits that in some instances these members made loans to businesses headquartered outside Indiana but with operations within the state, and that used the loan proceeds in connection with those operations.

E. THE PROTESTANT HAS FAILED TO SUSTAIN ITS BURDEN OF PROOF AS TO THIS ARGUMENT.

However, there are several problems with this argument. First, the merged group has submitted no evidence whatever that any of the transactions to which it arguments refer in fact existed during the reporting periods in question. Nor has the protestant submitted evidence that the sum of its assets and deposits attributable to Indiana during those periods fell below the $5,000,000 minimum of IC § 6-5.5-3-4(2). Second, the merged unitary group has failed to persuade the Department that IC §§ 6-5.5-3-1(4) and -4(1) even govern this protest, let alone that the merged group has rebutted the presumption that the latter section creates. The Audit Summary in particular did not cite these statutes or 45 IAC §§ 17-2-8 or -9 to support the adjustment, which would have been a simple thing for the auditor to do if that had been her intent. Nor is there any evidence in the record, either provided by the merged group or in the audit file, of Members A through C “soliciting business” within the meaning of that regulation during the reporting periods in question for the merged unitary group to rebut under IC § 6-5.5-3-4.

G. IC § 6-5.5-3-1(6) DESCRIBES THE TAXABLE EVENT THAT OCCURRED.

Third, IC § 6-5.5-3-1(6), rather than IC §§ 6-5.5-3-1(4) and -4(1), was the basis for the auditor’s adjustment. As previously noted, the auditor cited 45 IAC § 17-3-10(b)(6)-(9) in the Audit Summary. The Department infers from this citation and the relevant entries in the Audit Summary and the auditor’s workpapers that Members A through C had transacted business in Indiana by regularly engaging with Indiana customers in transactions having intangibles, i.e. loans, as their subjects. Members A through C thereby brought themselves within the scope of IC § 6-5.5-3-1(6). IC § 6-5.5-3-4(1) does cite IC § 6-5.5-3-1(6) as describing one of the three predicate forms of transacting business in Indiana that can support a finding that a financial institution has also regularly solicited business within Indiana under IC § 6-5.5-3-1(4). However, that institution must also in addition have "solicit[ed] business" as described in 45 IAC § 17-2-8. As previously noted, there is no evidence in the record to indicate that Members A through C engaged in any such solicitation.

Moreover, and more importantly, IC § 6-5.5-3-1(6) makes engaging in intangible property transactions with Indiana customers an independent taxable event. This is the case in part because of the structure of IC § 6-5.5-3-1, which uses the word "or" between subsections (7) and (8) to describe the relationship among all of the subsections. "The word 'or' is used in the disjunctive sense, indicating that various parts of the sentence which it connects are to be taken separately." *State v. Levitt*, 203 N.E.2d 821, 827 (Ind. 1965). Disjunctive and conjunctive terms within statutes "should ordinarily be given their literal and normal definition when it is apparent that the resulting meaning was intended[.]" *Dague v. Piper Aircraft Corp.*, 418 N.E.2d 207, 211 (Ind. 1981). "[W]here the legislature uses the disjunctive 'or,' and no portion of the statute is thereby rendered meaningless, effect must be given to the plain words used by the legislature." *Babinchak v. Town of Chesterton*, 598 N.E.2d 1099, 1103 (Ind. Ct. App. 1992).

However, soliciting and engaging in transactions are also distinct taxable or legal events by virtue of the common definitions of the verbs "solicit," "engage" and "transact," the nouns "solicitation" and "transaction" and the definition of "soliciting business" in 45 IAC § 17-2-8. "[U]nless the construction is plainly repugnant to the intention of the legislature or of the context of the statute: (1) Words and phrases shall be taken in their plain, or ordinary and usual, sense." IC § 1-1-4-1(1). "It is axiomatic in Indiana that the plain, ordinary, and usual meaning of non-technical words in a statute is defined by their ordinary and accepted dictionary meaning." *Johnson County Farm Bureau Coop. Ass'n, Inc. v. Indiana Dep't of State Revenue*, 568 N.E.2d 578, 581 (Ind. Tax Ct. 1991), *aff'd and adopted* 585 N.E.2d 1336 (Ind. 1992). The verb "solicit" means in relevant part "to approach with a request or plea (as in selling or begging) …." WEBSTER'S THIRD NEW INT'L DICTIONARY 2169 (4th ed. 1976) (definition 3) (hereinafter "WEBSTER'S THIRD"). The relevant definition of the derivative noun "solicitation" is " [a]n attempt or effort to gain business …." BLACK'S LAW DICTIONARY 1398 (7th ed. 1999) (definition 4) (hereinafter "BLACK'S"). In other words, a solicitation is an effort by the soliciting party to make intended recipients of the solicitation aware of a commercial opportunity with the aim of initiating a business relationship with one or more of those recipients. Title 45 IAC § 17-2-8 describes activities of this type. It is obvious, both from the dictionary definitions of "solicit" and "solicitation" and from the descriptions of the activities in the regulation, that "soliciting business" as defined in that regulation would occur for purposes of IC §§ 6-5.5-3-1(4) and -4(1) at the beginning of any resulting business relationships with Indiana customers.

In contrast, the short definition of the intransitive verb "engage" is "[t]o employ or involve oneself; to take part in; to embark on." BLACK'S at 549. The relevant general dictionary definitions of that verb are as follows: "to begin and carry on an enterprise, esp[ecially] a business or profession … to employ or involve oneself … to take part**:** PARTICIPATE …." WEBSTER'S THIRD at 751 (definitions 2 a, 2 b and 2 c) (emphasis in original). The relevant definition of the noun "transaction" in the same dictionary simply describes it as "something that is transacted: as … a business deal[.]" *Id.* at 2425-2426 (definition 2 a). A definition in another dictionary is more explicit, defining "transaction" as "[t]he act or an instance of conducting business or other dealings." BLACK'S at 1503 (definition 1). The relevant definition in the same dictionary of the verb "transact," from which "transaction" is derived, is "[t]o carry on or conduct (negotiations, business, etc.) to a conclusion <transact business>." *Id* (definition 1). A transaction thus deals with a whole course of business conduct between two or more parties, while a solicitation is an isolated act that occurs at the beginning of any resulting transaction.

Engaging in and soliciting a transaction thus are distinct, albeit related, activities. They may, but need not necessarily, overlap in any given transaction. The creditor in a transaction may not have initially solicited it, but may nevertheless be engaged in it, as is the case where the creditor is an assignee, holder in due course or other successor in interest. Even where soliciting and engaging in a particular transaction do overlap, the fact that the solicitation may have occurred in one jurisdiction does not prevent or preclude engaging in that transaction in another jurisdiction.

Thus, even assuming without deciding that the factual representations in the merged group's argument were true, those "facts" would not be enough to invalidate the proposed assessments. The fact that the intangible property transactions attributed to Indiana were solicited and closed elsewhere, either by Members A, B or C or another financial institution to which the member in question succeeded as assignee or holder in due course, did not preclude that member from engaging in those transactions in Indiana. This was so regardless of whether the debtors in question were businesses headquartered elsewhere, but with in-state operations, or consumers who sometime during the course of their respective transactions became Indiana residents. The protestant has thus failed to meet its burden of proof that the assessment is wrong. *See* IC § 6-8.1-5-1(b) and *Malak*, 484 N.E.2d at 58, both discussed above.

FINDING

The merged unitary group's protest is denied as to this issue.

III. Tax Procedure—Adjustments to Federal Returns—Timeliness of Notice to Department (1993)

A. THE PROTESTANT'S ARGUMENT

As noted in the Statement of Facts, the auditor declined to adjust the original group's liability for calendar year 1993 on the ground that the changes had not been reported to the Department within one hundred twenty (120) days after the modification to the federal return for that year. The protestant submits that the auditor's action was erroneous for three reasons. First, the merged unitary group argues that its 120-day reporting period should not have started running until July 7, 1998, the date of a clearance and closure letter for calendar years 1992-93 it alleges it received from the IRS Joint Committee on Taxation. Second, the merged group contends that IC § 6-5.5-6-6, the section of the FITA that imposes the 120-day reporting requirement, does not impose any sanction for failing to meet that deadline. Third, the protestant submits that the auditor discriminated against it by accepting as timely notifications of changes that increased its FIT liability, while declining to accept a change that decreased that liability and entitled it to a refund of or credit against its FIT.

B. THE 120-DAY NOTIFICATION DEADLINE RAN FROM THE DATE THE ORIGINAL UNITARY GROUP'S FEDERAL FORM 1120X FOR 1993 WAS SUBMITTED.

The Department notes that the merged unitary group has not submitted a copy of the purported clearance and closure letter for 1992-93 in support of its protest. The Department therefore would be justified in declining to address the merged group's argument based on that purported letter for failing to sustain its burdens of production and proof. IC § 6-8.1-5-1(b); *Huffman*, 643 N.E.2d at 900; *Longmire*, 638 N.E.2d at 898; *Canal Square Ltd. Partnership*, 694 N.E.2d at 804. However, even if any such letter existed and was dated July 7, 1998, it would not be enough to justify the Department's granting the protestant the benefit of the 1993 reduction. IC § 6-5.5-6-6(b) states that "[t]he taxpayer shall file the notice in the form required by the department within one hundred twenty (120) days after the alteration or modification is made by the taxpayer or finally determined, *whichever occurs first.*" *Id* (emphasis added). Such records as exist indicate that the original unitary group must have submitted its Form 1120X for 1993, and that the 120-day reporting period must have expired, before the IRS allegedly issued the purported July 7, 1998 clearance and closing letter to the protestant.

The original unitary group was deemed to have paid its remaining outstanding tax liability for 1993, and filed its return, on March 15, 1994, notwithstanding that it actually filed its return on September 14, 1994 pursuant to an automatic extension of time for which it had applied. *See* I.R.C. § 6513(a) (stating that returns filed, or taxes paid, before the last day prescribed for doing so are deemed filed on the prescribed last day, notwithstanding any extension of time the taxpayer may have been granted). The three-year period of limitations created by operation of I.R.C. § 6511(a) for the original unitary group to claim a refund began on that date and would have ended on March 15, 1997. Thus, the last possible date on which the original unitary group could have submitted its 1993 Form 1120X, March 15, 1997, was nearly sixteen months before the IRS allegedly issued its purported July 7, 1998 clearance and closure letter for calendar years 1992-93. However, the protestant's contact person stated in her March 30, 1998 conversation with the auditor that the original unitary group had filed its 1120X for 1993 in 1995. Assuming, without finding, that recollection to be accurate, and further assuming for purposes of this analysis a filing date of December 31, 1995, the original group should have given the Department notice of that modification at the latest by April 30, 1996. Either way, the 1120X had to have been filed well before the purported clearance and closure letter. Since that is the case, the 120-day period for the original group to notify the Department of the change for 1993 cannot be measured from July 7, 1998 as the merged unitary group contends. Instead, by operation of IC § 6-5.5-6-6(b), quoted above, that period must be measured from the date the 1120X was filed, which would have been March 15, 1997 at the latest. The notification period therefore would have run on July 13, 1997 at the latest. There is no written notice in the audit file from either the original group or the merged group to the Department notifying it of the change to the original group's federal income, as IC § 6-5.5-6-6(b) requires. *See id* (stating that "[t]he taxpayer shall *file* the notice in the *form* required by the department ….) (emphases added). The only evidence in the file indicating that the Department had actual knowledge (as distinguished from statutory notice) indicates that the protestant did not communicate the change until over eight months later, in the March 30, 1998 conversation between its contact person and the auditor. The conversation thus was untimely even if it could have constituted notice under IC § 6-5.5-6-6(b), which it could not.

C. THE PENALTY FOR FAILING TO NOTIFY THE DEPARTMENT OF THE ORIGINAL UNITARY GROUP'S DECREASE IN FEDERAL TAXABLE INCOME FOR 1993 WAS THE LOSS OF ANY RESULTING REFUND OF FINANCIAL INSTITUTIONS TAX.

The merged unitary group argues that any failure by it or the original unitary group to give statutory notice is immaterial and should not act to deprive the combined group of a favorable adjustment because IC § 6-5.5-6-6 does not set out any sanction for such failure. It is true that IC § 6-5.5-6-6 does not contain any penalty for noncompliance; however, that omission is immaterial because other authorities, discussed below, state or imply the consequences of failing to give timely notice. The crucial facts in determining which of these authorities applies to the present issue are the merged group's filing an 1120X for 1993 and the resulting reduction in the original group's federal taxable income for that year (assuming the facts contained in the 1120X were as represented to the IRS). That filing and reduction potentially entitled the protestant to a refund of FIT the original unitary group paid for 1993. Therefore, in addition to the merged or original group giving the Department notice within 120 days of the reduction in the latter's 1993 federal income pursuant to IC § 6-5.5-6-6(b), the protestant also had to file a claim with the Department if it wished to receive any resulting refund. The applicability of the authorities governing the latter procedure is critical to the present argument because Indiana law is well settled that where the same section of a tax refund claim statute both creates the right to a refund and specifies the time period for the exercise of that right,

> the provision in fact creates a condition precedent to the statutory right of refund. The legislature may make the very existence of the right of recovery dependent upon the petition for refund being made within three years from the date the taxes are paid. A statute of limitations does not create or extinguish a right. It only places limitations upon a remedy which may be tolled or waived. The limitation in the instant case, however, is a condition essential to the existence of the right and cannot be tolled or waived.

Marhoefer Packing Co. v. Indiana Dep't of State Revenue, 301 N.E.2d 209, 216 (Ind. Ct. App. 1973). This language also requires interpreting IC § 6-5.5-6-6(b) as making the 120-day notification requirement, as applied to modifications that decrease federal income, a further condition precedent to entitlement to any refund of FIT that decrease may create.

Unlike some other listed tax statutes, which include specific sections that set out the procedure to claim a refund or credit under those laws, there are no such provisions in the FITA. The current version of the general refund claim statute, IC § 6-8.1-9-1, which is part of the TAA, therefore governs the procedure for claiming a refund of FIT. IC § 6-8.1-9-1(a) states in substance that a person who has paid more tax than was legally due may file a claim for refund of that tax, but must do so within three years of the later of the due date of the return for the period for which the person made the overpayment, or the date of payment. Subsection (b) of the regulation implementing IC § 6-8.1-9-1, 45 IAC § 15-9-2, quite clearly states: "The department has no legal method of generating a claim for refund. A claim for refund can only be initiated pursuant to IC § 6-8.1-9-1[.]" Thus, if only the person who has determined that s/he has overpaid tax can claim a refund, and the Department cannot itself generate a refund without a claim, then it follows that that person will lose the refund if s/he files no claim, or fails to do so within the statutory three-year period. In this connection *Marhoefer Packing* observes that

> This view is consonant with avoidance of stale and fiscally disruptive claims. If no time limitation were placed upon refund claims, budgetary and fiscal planning would be rendered unduly difficult in that the amount of revenue available at any given time to defray the expenses of government would be uncertain as subject to stale claims.

301 N.E.2d at 215. The same policy dictates that a financial institutions taxpayer that fails to give timely notice of a reduction to its federal income lose any resulting refund, particularly where that failure would hinder the Department's ability to complete audits and propose accurate assessments. In addition, failure to give notice or file a claim in time, or at all, deprives the Indiana Tax Court of subject-matter jurisdiction over that refund. *See* IC § 33-3-5-11(a) (1998 and Supp. 2002) (stating that "[i]f a taxpayer fails to comply with *any* statutory requirement for the initiation of an original tax appeal, the tax court does not have jurisdiction to hear the appeal[ ]") (emphasis added); *Marhoefer Packing,* 301 N.E.2d at 219 (failure to file claim within three years), approved in *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79, 81 (Ind. 1978) (three-month requirement for filing suit for refund, citing *Marhoefer*); and *GasAmerica Services, Inc. v. Indiana Dep't of State Revenue,* 552 N.E.2d 860, 862 (Ind. Tax Ct. 1990) (failure to file any claim).

It was thus unnecessary for IC § 6-5.5-6-6 to specify any sanctions for failure to give the Department timely notice of a modification that decreases federal income. The authorities discussed above already gave potential refund claimants such as the protestant and the original unitary group constructive notice of those sanctions, i.e. loss of the refund and loss of the right to seek judicial review of any issues concerning that refund. "All persons are charged with the knowledge of the rights and remedies prescribed by statute." *Middleton Motors,* 380 N.E.2d at 81.

D. THE AUDITOR TREATED ALL YEARS FOR WHICH ADJUSTMENTS TO FEDERAL TAXABLE INCOME WERE REPORTED WAS CONSISTENT.

The first above-quoted passage from *Marhoefer Packing* also serves as a response to the protestant's argument that the auditor and the Department applied IC § 6-5.5-6-6 inconsistently as between 1993 and the other years for which the combined unitary group gave belated notice. The difference between modifications that give rise to potential FIT refunds and those that increase FIT liability justifies treating failures to notify the Department of these two kinds of modifications differently. A failure to give notice of a modification that decreases federal income, either alone or in combination with a failure to file a claim for any resulting refund of FIT, is a failure to satisfy a condition precedent to that claim, will extinguish it and will deprive the Department of administrative discretion to entertain it. *Marhoefer Packing,* 301 N.E.2d at 215 and 216, both quoted above. In contrast, a failure to give the Department notice, or timely notice, of a federal modification that increases federal income will equitably estop the taxpayer from invoking, and will equitably toll, the assessment statute of limitations. *Salin Bancshares, Inc. v. Indiana Department of State Revenue,* 744 N.E.2d 588, 595-596 (Ind. Tax Ct. 2000). Although the Indiana Tax Court did not decide *Salin Bancshares* until after the audit was completed, the auditor's acceptance of the modifications that increased the original unitary group's federal income for calendar years 1990-92 was consistent with the holding in that opinion. Similarly, although the auditor did not rely on *Marhoefer Packing,* her refusal to recognize the 1993 modification was consistent with that opinion's interpretation of the nature of, and the conditions precedent required for, a refund claim.

As noted above in connection with the combined group's first argument, based on the incomplete record of the time line, it had to give the Department notice of the modification to the original group's 1993 federal income by July 13, 1997 at the latest. However, the merged group never provided the auditor, and has never provided the Department during this protest, any proof that it satisfied this condition precedent and gave the Department timely notice of that modification, nor has the Department found any such notice in its records. In addition, neither the original unitary group, nor the protestant as its successor in interest, ever claimed a refund of any refund of FIT resulting from the reduction of the original unitary group's 1993 federal income. The auditor therefore was, and the Department is, fully legally justified in refusing to give the combined group the benefit of the decrease in the original group's 1993 federal income reported on its 1120X.

FINDING

The merged unitary group's protest is denied as to this issue.

IV. Financial Institutions Tax—Imposition—Constitutionality—Due Process Nexus (1993-96)

Financial Institutions Tax—Imposition—Constitutionality—Interstate Commerce—Substantial Nexus (1993-96)

Financial Institutions Tax—Imposition—Constitutionality—Interstate Commerce—Fairness of Apportionment and Discrimination (1993-96)

Financial Institutions Tax—Credits—Non-Resident Taxpayers—Constitutionality--Fairness of Apportionment and Discrimination (1993-96)

DISCUSSION

A. THE LACK-OF-SUBSTANTIAL-NEXUS ARGUMENT

The protestant contends that IC §§ 6-5.5-3-1(4) and -4 and IC chapter 6-5.5-4 are unconstitutional because Members A through C allegedly do not have any substantial nexus with Indiana. The merged unitary group submits that these parts of the FITA are unconstitutional on their faces because they allegedly use a so-called "economic presence" standard for nexus. The merged group submits that the alleged use of this standard violates both the dormant Interstate Commerce and Fourteenth Amendment Due Process Clauses (U.S. CONST. art. I, § 8, cl. 3 and amend. XIV, § 1, respectively). It argues that the United States Supreme Court has interpreted these constitutional provisions as requiring a physical presence in a taxing jurisdiction. In support of its lack-of-due-process-nexus argument the protestant quotes from *Miller Brothers Co. v. Maryland,* 74 S.Ct. 535 (U.S. 1954). In support of its lack-of- substantial-nexus argument the merged unitary group quotes from and discusses *Complete Auto Transit, Inc. v. Brady,* 97 S.Ct. 1076 (U.S. 1977), *Quill Corp. v. North Dakota ex rel. Heitkamp,* 112 S.Ct. 1904 (U.S. 1992), *J. C. Penney National Bank v. Johnson,* 19 S.W.3d 831 (Tenn. Ct. App. 1999) and *America Online, Inc. v. Johnson,* Cause No. 97-3786-III, slip op. (Tenn. Ch. Ct. Mar. 13, 2001), *aff'd* Cause No. M2001-00927-COA-R3-CV, 2002 Tenn. App. LEXIS 555 (Tenn. Ct. App. July 30, 2002).

A challenge to a state taxation statute on the grounds that the taxpayer in question lacks a due process or substantial nexus with the taxing jurisdiction requires the reviewing authority to evaluate the nature and extent of the contacts between that taxpayer and that jurisdiction. Such an inquiry is necessarily fact-sensitive in nature. For this reason, the authority that has to rule on an attack on either of these grounds ordinarily frames the issue as being whether the taxing authority applied the statute to the taxpayer in question in an unconstitutional way, rather than whether the statute is unconstitutional on its face. Had the present challenge been made on an as-applied basis, the Department could have ruled on it. Instead, however, the merged group has challenged IC §§ 6-5.5-3-1(4) and -4 and IC chapter 6-5.5-4 on their faces. As the Department discussed under Issue I above, Members A through C transacted business in Indiana under IC § 6-5.5-3-1(6) rather than under IC §§ 6-5.5-3-1(4) and -4. However, that circumstance does not moot the present issue, since IC § 6-5.5-3-5 makes the attribution rules of IC chapter 6-5.5-4 applicable to determine whether an intangible asset is attributable to Indiana. Accordingly, the Department is barred from ruling, and declines to rule on, the protestant's lack-of-substantial-nexus argument on the authority of IND. CONST. art. III, § 1 as interpreted in *Grazer* and *Standard Oil,* and *Sproles,* all discussed under Issue I above. If the merged unitary group wishes to pursue this argument, it will have to do so through an appeal to the Indiana Tax Court and, if necessary, to the Indiana Supreme Court, since they are the only courts in Indiana that have jurisdiction to rule on facial constitutional attacks on state tax statutes. The Department would note, however, that in any such appeal the merged group will have the heavy burden of proving "that *no* set of circumstances exists under which the [challenged] Act would be valid." *United States v. Salerno,* 107 S.Ct. 2095, 2100 (U.S. 1987) (emphasis added).

B. THE UNFAIR APPORTIONMENT AND DISCRIMINATION ARGUMENTS

The protestant argues that the apportionment formula of IC § 6-5.5-2-4 also violates the dormant Interstate Commerce Clause. Specifically, the merged unitary group contends that IC § 6-5.5-2-4 fails the internal consistency prong of *Complete Auto Transit*'s fair apportionment test. In support of its position the merged group quotes from the internal consistency discussion found in *Oklahoma Tax Commission v. Jefferson Lines, Inc.,* 115 S.Ct. 1331, 1338 (U.S. 1995). (That discussion in turn cites *Container Corporation of America v. Franchise Tax Board,* 103 S.Ct. 2933, 2942 (U.S. 1983), where the United States Supreme Court first articulated the internal and external consistency requirements for fair apportionment.) The protestant further submits that because IC § 6-5.5-2-4 allegedly unfairly apportions, it also unfairly discriminates against interstate commerce. In support of this latter proposition the merged unitary group cites *Armco, Inc. v. Hardesty,* 104 S.Ct. 2620 (U.S. 1984).

Lastly, the merged group argues that IC § 6-5.5-2-6, which grants a credit against the FIT for net income, franchise or equivalent taxes owed to a nonresident taxpayer's domiciliary state, does not completely cure the alleged constitutional defects of IC § 6-5.5-2-4. In particular, the merged group contends that IC § 6-5.5-2-6(a) imposes two alleged limitations on that credit that IC § 6-5.5-2-5 (repealed 2000), the statute granting a credit to resident taxpayers or resident members of unitary groups that engage in operations in other jurisdictions, does not impose. The protestant accordingly has asked the Department to grant it credits against the proposed assessments for the years in question under IC § 6-5.5-2-5 instead.

The United States Supreme Court has said that "the internal consistency test focuses on the *text* of the challenged statute and *hypothesizes* a situation where [all] other States have passed an identical statute." *Goldberg v. Sweet,* 109 S.Ct. 582, 589 (U.S. 1989) (emphases added). A claim that a state tax statute's apportionment formula is unfair because it is internally inconsistent is thus a facial attack on the constitutionality of the apportionment statute. It follows that a claim that a state tax discriminates against interstate commerce because it is unfairly apportioned is also a facial attack. *See id; see also Armco,* 104 S.Ct. at 2624 (indicating that "the allegation [was] that a tax on its face discriminate[d] against interstate commerce[ ]"). Accordingly, the Department is barred from ruling, and declines to rule, on the merged group's unfair apportionment and discrimination arguments on the authority of IND. CONST. art. III, § 1 as interpreted in *Grazer* and *Standard Oil,* and *Sproles,* all discussed under Issue I above. If the merged unitary group wishes to pursue these arguments, it will have to do so through an appeal to the Indiana Tax Court and, if necessary, to the Indiana Supreme Court, since they are the only courts in Indiana that have jurisdiction to rule on facial constitutional attacks on state tax statutes.

The Department also cannot entertain the protestant's request for credit under IC § 6-5.5-2-5, not only because that request derives from the merged unitary group's constitutional arguments but also for two other, non-constitutional legal reasons. The first is that "[t]he right to the credit claimed is a privilege granted by the Government, and hence the statute is to be strictly construed in favor of the Government." *Burroughs Adding Machine Co. v. Terwilliger,* 135 F.2d 608, 610 (6th Cir. 1943) (citing *Swan & Finch Co. v. United States,* 23 S.Ct. 702, 703-704 (U.S. 1903)). "The statutes' operation will not be extended by construction." *TPQ Inv. Corp. v. State ex rel. Oklahoma Tax Comm'n,* 954 P.2d 139, 141 (Okla. 1998) (citing *Omaha Pub. Power Dist. v. Nebraska Dep't of Revenue,* 537 N.W.2d 312, 314 (Neb. 1995)). *Keyes v. Chambers,* 307 P.2d 498 (Or. 1957), is the best explanation of the reasons for strict interpretation of credit statutes that the Department has found. In *Keyes* the Oregon Supreme Court said:

> A provision allowing a credit against a state tax is, in effect, an exemption from liability for a tax already determined and admittedly valid. It is, therefore, in order to note before proceeding further that such credits, deductions or exemptions as the legislature may allow in the computation of an income tax are privileges accorded as a matter of legislative grace and not as a matter of taxpayer right. 85 CJS, 771-772, Taxation § 1099; *Palmer v. State Commission,* 156 Kan. 690, 135 P.2d 899 [(1943)]; *Southern Weaving Co. v. Query,* 207 S.C. 307, 34 S.E.2d 51 [(1945)]. By reason of their character as legislative grants, statutes relating to deductions allowable in computing income must be strictly construed against the taxpayer and in favor of the taxing authority. *Miller v. McColgan,* 17 Cal.2d 432, 110 P.2d 419, 424 [(1941)]; *Bigelow v. Reeves,* [149 S.W.2d 499, 501 (Ky. 1941)]; *Tupelo Garment Co. v. State Tax Commission,* 178 Miss. 730, 173 So. 656 [(1937)]; *State ex rel. Whitlock v. State Board of Equalization,* 100 Mont. 72, 45 P.2d 684 [(1935)]; *Cudahy v. Wisconsin Dept. of Taxation,* 261 Wis. 126, 52 N.W.2d 467 [(1952)]. The rule of strict construction to which we refer is equally applicable to tax credits. *Burroughs Adding Machine Co. v. Terwilliger* (CCA 6th) 135 F2d 608, 610; *Miller v. McColgan,* supra (at p 441). A "credit" to a tax has a far greater impact on the ultimate liability of the taxpayer than an allowable deduction and, therefore, is an item of greater importance as a subject for strict construction in favor of the government.

Id. at 501. *Accord, Burlington N. R.R. v. Strackbein,* 398 N.W.2d 144, 146 (S.D. 1986) and *Stephens v. Vermont Dep't of Taxes,* 353 A.2d 355, 356 (Vt. 1976). "The [merged group] must therefore bring itself strictly within the statutory provisions, and here it has not done so." *Burroughs Adding Machine,* 135 F.2d at 610. Indeed, the protestant, as a unitary group consisting partly of nonresident taxpayers, cannot bring itself within the terms of a credit that IC § 6-5.5-2-5 explicitly makes available only to resident taxpayers.

The second reason relates to the Department's lack of power to grant, and follows from the merged unitary group's inability to claim, a credit under IC § 6-5.5-2-5. It is well-settled Indiana administrative law that "[b]ecause administrative agencies are creations of the legislature, they generally cannot exercise powers beyond those specifically granted by the General Assembly." *State ex rel. ANR Pipeline Co. v. Indiana Dep't of State Revenue,* 672 N.E.2d 91, 94 (Ind. Tax Ct. 1996) (citing *Auburn Foundry, Inc. v. State Bd. of Tax Comm'rs,* 628 N.E.2d 1260, 1263 (Ind. Tax Ct. 1994)). "Administrative agencies have no common law or inherent powers; they have only the authority the legislature expressly or impliedly grants them." *Auburn Foundry, id.* Since the Department can only grant a credit under IC § 6-5.5-2-5 if a financial institution or unitary group meets all the qualifications for that credit, it follows that the Department does not even have the power, much less the discretion, to do so if the financial institution or unitary group in question does not qualify. The Department can only enforce the FITA as it is, not as the protestant would like it to be. If the merged unitary group wants the Department to have that kind of discretion (constitutional issues aside), it needs to petition the legislature to amend the FITA.

FINDING

The merged unitary group's protest is denied as to these issues.

V. Tax Administration—Negligence Penalties (1993-96)—Reasonable Difference of Opinion as to Liability for Tax

The protestant argues that the Department should abate the proposed negligence penalties for calendar years 1993-95 and the periods ending March 31, 1996 and December 31, 1996. In the merged unitary group's view a reasonable difference of opinion exists as to whether the "economic presence" theory of nexus under the FITA is constitutional, creating reasonable cause for the abatement of the penalties for these periods.

IC § 6-5.5-7-1(a) (1993) requires the Department to assess the negligence penalty prescribed in IC § 6-8.1-10-2.1(b) (1993), which is part of the general negligence penalty provision of the TAA, on any FIT taxpayer that fails to make payments of that tax as IC chapter 6-5.5-6 requires. IC § 6-8.1-10-2.1(d) and 45 IAC § 15-11-2(c) (1992) (1996) require the Department to waive the penalty if the taxpayer makes a showing of reasonable cause; the latter subsection defines "reasonable cause," while 45 IAC § 15-11-2(b) defines "negligence."

Generally speaking, if a taxpayer has a reasonable, good faith basis for failing to pay a listed tax, that basis constitutes reasonable cause to abate any negligence penalty the Department proposes to assess, or in fact assesses, for that failure. *Indiana Dep't of State Revenue v. Harrison Steel Castings Co.,* 402 N.E.2d 1276, 1278-1279 (Ind. Ct. App. 1980), *overruling, id.* at 1279 n.2, *Indiana Dep't of State Revenue v. Sohio Petroleum Co.,* 352 N.E.2d 95, 101-102 (Ind. Ct. App. 1976). The Department recognizes that a difference of legal opinion on the constitutionality of "economic presence"-based financial institutions franchise tax statutes exists. However, determining whether that difference of opinion is *reasonable,* i.e. whether the original group had, and the merged group has, a reasonable basis for their failure to pay the FIT the Department proposes to assess would require it to examine the validity of the protestant's facial constitutional attacks on IC § 6-5-5-2-4 and –6. IND. CONST. art. III, § 1 as interpreted in *Grazer* and *Standard Oil,* and *Sproles,* all forbid the Department from engaging in such an examination for the reasons discussed under Part A of Issue I, and Issue IV, above. The Department cannot do indirectly what it is forbidden, and lacks authority, to do directly; it cannot go through a constitutional back door if it is forbidden to go through the constitutional front door. If the merged unitary group wants relief from the negligence penalties for these periods, it can seek such relief in an appeal to the Indiana Tax Court if it so chooses, together with any constitutionally grounded challenge to its proposed substantive tax liability for the same periods it may choose to make.

FINDING

The merged unitary group's protest is denied as to this issue.

VI. Tax Administration—Negligence Penalties (1990-92)—Reasonable Cause—Merger and Layoff of Compliance Personnel

The protestant contends that reasonable cause exists to abate the proposed negligence penalties for calendar years 1990-92 due to the "reverse acquisition" merger of the original unitary group and attendant layoff of tax compliance personnel. The merged unitary group alleges that these events caused it to fail to timely report certain adjustments to its federal corporate returns to the Department. These adjustments were presumably made in the RARs for calendar years 1990-91, and the 1120X for calendar year 1992, of the original group that neither it nor the merged group produced until the audit.

However, the auditor did not propose the negligence penalties for these years based on the original or merged unitary groups' failures to give the Department notice of modifications to federal income, i.e. for failing to comply with IC § 6-5.5-6-6. As noted in the Statement of Facts, the auditor did so because the original group failed to follow the regulations on sourcing of loan, credit interest and fee receipts and failed to report and pay the tax on such items. Since the merged group has argued for abatement of the penalties for these years on grounds other than those that the auditor used, the protestant has failed to meet its burdens of persuasion and proof on this issue that reasonable cause exists to abate these penalties. IC § 6-8.1-5-1(b).

FINDING

The merged unitary group's protest is denied as to this issue.

DEPARTMENT OF STATE REVENUE

02990487.LOF

LETTER OF FINDINGS NUMBER: 99-0487
Income Tax
For the Years 1996-1999

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

ISSUE

I. Income Tax-Imposition

Authority: IC 6-3-2-1, IC 6-3-1-8, 26 USC 1366.

STATEMENT OF FACTS

The taxpayer is a shareholder of an Indiana sub chapter S corporation. The Indiana Department of Revenue, hereinafter referred to as the "department," performed an investigation of the sub chapter S corporation. During the investigation, the department learned that the taxpayer had not reported his share of the corporate income on his personal income tax return. The department assessed adjusted gross income tax on the taxpayer's share of the sub chapter S corporation income, penalty, and interest against the taxpayer. The taxpayer protested this assessment and a hearing was scheduled for September 3, 2003. The taxpayer failed to appear or offer any other documentation on his behalf. Therefore, this Letter of Findings is based on the file.

I. Income Tax-Imposition

DISCUSSION

Indiana imposes an adjusted gross income tax on all residents. IC 6-3-2-1. A taxpayer's Indiana income is determined by starting with the federal income and making certain adjustments. IC 6-3-1-8. Income from a sub chapter S corporation flows through to the individual shareholder's personal income for federal tax purposes. 26 USC 1366. Therefore, it also flows through to the individual shareholder's personal income for Indiana tax purposes. The taxpayer failed to report and pay the taxes owing on his share of the income from the sub chapter S corporation. The department properly assessed adjusted gross income tax on the shareholder's income which flowed through from the sub chapter S corporation.

FINDING

The taxpayer's protest is denied

DEPARTMENT OF STATE REVENUE

0220000267.LOF

LETTER OF FINDINGS NUMBER: 00-0267 ITC
ADJUSTED GROSS INCOME TAX
For Years 1992, 1993, AND 1994

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

ISSUES

I. Adjusted Gross Income Tax – Windfall Profit Tax Refund

Authority: None cited.

Taxpayer protests exclusion of windfall profit tax deduction.

II. Adjusted Gross Income Tax – Net Operating Loss Calculation

Authority: IC § 6-3-2-2.6; IC § 6-3-2-12; *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance,* 505 U.S. 71 (1992)

Taxpayer protests inclusion of foreign dividends in the Department's calculation of net operating losses.

III. Adjusted Gross Income Tax – Net Operating Loss Calculation

Authority: IC § 6-3-2-2.6; IC § 6-3-1-20; IC § 6-3-1-21; IC § 6-3-2-2

Taxpayer protests inclusion of nonbusiness income in the Department's calculation of net operating losses.

IV. Adjusted Gross Income Tax – Computational Errors

Authority: None cited.

Taxpayer protests the assessment of gross income tax on the possible double counting of receipts from taxpayer sales made to partner. Taxpayer also maintains that the net operating loss for 1991 was incorrect.

V. Adjusted Gross Income Tax – Net Operating Loss Carryforward

Authority: None cited.

Taxpayer protests the reduction in Net Operating Loss available for carryforward from 1991.

STATEMENT OF FACTS

Taxpayer is a Delaware corporation with worldwide operations, including locations within the state of Indiana. Taxpayer filed a timely protest of four audit adjustments. Two protests related to the calculation of net operating losses are treated as a single issue for this LOF.

I. Adjusted Gross Income Tax – Windfall Profit Tax Refund

DISCUSSION

For adjusted gross income tax purposes the auditor adjusted the foreign source dividend deduction (line 31 on the 1992 tax return). Included in this amount was a deduction for windfall profit tax refund, which was not attributed to Indiana. Review of the file finds that the auditor inadvertently erred in the computation of the foreign source dividend deduction. As a result, the windfall profit tax refund deduction was disallowed in error. Therefore, the taxpayer's protest is sustained.

FINDING

Taxpayer's protest is sustained.

II. Adjusted Gross Income Tax – Net Operating Loss Calculation

Taxpayer protested the Department's calculations of taxpayer's net operating loss, challenging the exclusion of taxpayer's foreign source dividend adjustment in the computation of net operating loss carry forward for years 1992, 1993, and 1994. The Taxpayer's argument is as follows:

Taxpayer asserts that the Department was incorrect in its foreign source dividend adjustment to the computation of net operating loss available for carryforward for years 1992, 1993, and 1994. *For purposes of computing adjusted gross income (loss for the years at issue*), the Taxpayer was allowed to deduct 85% of its foreign sourced dividends. However for the purpose of calculating the net operating loss available for carryforward, the auditor's adjustment seeks to add back this allowable deduction –i.e. Taxpayer is allowed to deduct 85% of its foreign sourced dividends for determining [adjusted gross] income, but it must add back this deduction in determining the net operating loss available for carryforward. *(Emphasis added)*

….

Taxpayer protest letter of March 24, 1999, pages 2 & 3.

The applicable statute, IC § 6-3-2-2.6 states in relevant part:

(b) …the amount of a taxpayer's net operating losses that are derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's income derived from sources within Indiana is determined, under section 2 of this chapter, for the same taxable year during which each loss was incurred.

Department directs the Taxpayer's attention to the language of IC 6-3-2-12(b), which states:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is *entitled to a deduction from that adjusted gross income*. The amount of the deduction equals the product of:

the amount of the foreign source dividend included 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 percent (100%) deduction for foreign source dividends received from corporations in which a taxpayer has an eighty percent (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%-79%) percent 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)-(e). *(Emphasis added)*

This 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 *from* adjusted gross income, not as part *of* the computation of adjusted gross income. There is no similar statutory deduction for the computation of an Indiana net operating loss to be carried forward, which begins with federal adjusted gross income and is modified according to the Indiana statute. Foreign source dividends are part of federal adjusted gross income and are not one of the modifications allowed by IC § 6-3-2-2.6 in arriving at the Indiana net operating loss to be carried forward. Indiana has a specific deduction for foreign source dividends in calculating Indiana adjusted gross income, but there is no statutory provision for adjusting federal taxable income in calculating the Indiana net operating loss to be carried forward. Consequently, taxpayer's protest of the foreign source dividend adjustment is denied.

Taxpayer also cited to the *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance,* 505 U.S. 71 (1992) case as proof the department could not treat foreign and domestic dividends different. Taxpayer fails to demonstrate a disparate treatment between foreign and domestic dividends. The calculation of net operating losses was intended to calculate the net losses, which, as noted above, requires the addition of offsetting amounts-including foreign and domestic dividends.

FINDING

Taxpayer's protest is denied.

III. Adjusted Gross Income Tax – Net Operating Loss Calculation

Taxpayer protests the Department's calculations of taxpayer's net operating loss, challenging the inclusion of taxpayer's non business income in the computation of net operating loss carry forward for years 1992, 1993, and 1994. The Taxpayer's argument, referring to the audit summary worksheet adjustment adding in the income in question, is as follows:

….

The audit workpapers do not provide an explanation for this adjustment. Since the dividends are classified as "business," [as part of the audit adjustment] Taxpayer asserts that there is no statutory or regulatory support for the auditor's adjustment. If the Taxpayer is permitted a business dividend deduction for computing adjusted gross income, such deduction should also be included in the computation of the net operating loss available for carryforward. Taxpayer protest letter of March 24, 1999, pages 2 & 3.

The applicable statute, IC § 6-3-2-2.6 states in relevant part:

(b) …the amount of a taxpayer's net operating losses that are derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's income derived from sources within Indiana is determined, under section 2 of this chapter, *for the same taxable year during which each loss was incurred. (Emphasis added)*

The calculation of an Indiana net operating loss to be carried forward begins with federal adjusted gross income and is modified according to the Indiana statute. With the business net operating loss reduction, the auditor calculated the taxpayer's Indiana NOL by adding back income the parent received from various entities, all of which the audit identified as unitary with the parent. The taxpayer's argument implies that the auditor erred in doing so, contending that these items of income were nonbusiness income, did not have Indiana sources, and, therefore, should have been allocated to the parent's commercial domicile outside Indiana instead of being apportioned.

This premise is incorrect. IC § 6-3-1-21 states that "[t]he term 'nonbusiness income' means all income other than business income." *Id.* IC § 6-3-1-20 in turn states that:

> [t]he 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 of the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations. *Id* (*emphasis added*)

IC § 6-3-2-2.6(a) states that the first step in calculating an Indiana NOL is to determine Indiana AGI as specified in IC § 6-3-2-2. Subsection (a) of the latter section states that "[w]ith regard to corporations and nonresident persons, 'adjusted gross income derived from sources within Indiana', for purposes of this article, shall mean and include: … (5) income from stocks, … if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter." *Id.* IC § 6-3-2-2.2(g) states that "[r]eceipts in the form of dividends from investments are attributable to this state if the taxpayer's commercial domicile is in Indiana." *Id.* The parent's commercial domicile is in a state other than Indiana, so none of the income the parent received is attributable to Indiana based on the taxpayer's commercial domicile. However, the auditor reviewed the sources of the income at issue and at the appropriate points within the audit report documented the basis for finding taxpayer had a unitary relationship with the various entities at issue. The taxpayer has failed to provide support for its argument that the relationship between the parent and the various entities was non-unitary. Therefore the Department finds that the income the parent received from these entities was unitary income, and therefore apportionable.

FINDING

Taxpayer's protest is denied.

IV. Adjusted Gross Income Tax – Computational Error

Taxpayer protests an error in listing amount of addback for a corporation. Sustained subject to audit verification.

FINDING

Taxpayer's protest is sustained subject to audit verification.

V. Adjusted Gross Income Tax – Net Operating Loss Carryforward

Taxpayer protests an error in the amount of the NOL from 1991 that was available for carryforward. This year was not audited, but the loss carryforward will effect future periods. Audit will review 1991 and will verify that the NOL of 1991 is calculated consistent with the findings in Issue II of this LOF.

FINDING

Taxpayer's protest is sustained subject to audit verification.

DEPARTMENT OF STATE REVENUE

0120000362.LOF

LETTER OF FINDINGS: 00-0362
Indiana Individual Income Tax
For the Year 1998

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

ISSUE

I. Individual Income Tax Deficiency Carry-Over.

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

Taxpayers argue that the alleged income tax deficiency B first reported to them in 1999 B was the result of an under-reporting error attributable to the Department of Revenue (Department). Taxpayers maintain that the 1999 deficiency can be traced to the Department's failure to properly record one of taxpayers' 1995 estimated quarterly tax payments.

STATEMENT OF FACTS

The Department sent taxpayers a "Notice for Payment" dated October 7, 1999. The notice indicated that taxpayers owed an additional amount of 1998 state income taxes. According to the taxpayers, they determined that they did not owe the taxes but that the purported 1998 deficiency was entirely attributable to the Department's own recording error which occurred during 1995.

The taxpayers and the Department exchanged correspondence and phone calls but were unable to resolve the disputed issue. The taxpayers eventually submitted a protest, an administrative hearing was conducted during which taxpayers' representative explained the basis for their protest, and this Letter of Findings results.

DISCUSSION

I. Individual Income Tax Deficiency Carry-Over

Taxpayers argue that the alleged 1998 tax deficiency is attributable to the Department's own record-keeping error. In addition, taxpayers argue that because the Department's under-reporting error occurred in 1995, the claim for 1998 income taxes B first submitted to the taxpayers in 1999 B is untimely and is barred by the statute of limitations.

It is undisputed that the taxpayers made quarterly estimated income tax payments during 1995. According to taxpayers, the Department failed to properly record one of these 1995 payments. However, the 1995 shortfall did not become immediately apparent because of the manner in which taxpayers elected to pay their individual state income taxes. The 1995 shortfall did not become immediately apparent because taxpayers continued to make timely, successive quarterly estimated payments for the years following 1995. These successive payments had the effect of "covering" the original 1995 deficiency. However, the 1995 deficiency was never eliminated; it was simply obscured by each subsequent quarterly tax payment. The 1995 deficiency "dominoed" its way through the years and did not manifest itself until 1998.

Taxpayers maintain the Department should abate the assessment for 1998 taxes because the Department failed to properly credit the taxpayers for the 1995 quarterly payment. However, because of the lapse in time and because the taxpayers have dealt with different bank entities during the period, taxpayers are unable to now produce information which confirms taxpayers' version of these events.

IC 6-8.1-5-1(a) states that, "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department." If the department believes that the person has not paid the proper amount of tax, "The department shall send the person a notice of proposed assessment through the United States mail." Id. This is what apparently occurred during 1999 at the time taxpayers received written notice from the Department. Nonetheless, taxpayers argue that the Department is simply wrong. Taxpayers steadfastly maintain that they paid all of the quarterly income tax payments and that they owe no additional tax.

Indiana's statute provides that, "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 has no reason whatsoever to doubt the taxpayers' good faith or veracity. However, even considering the undoubted difficulty in producing evidence of bank transactions long-past, the Department is in no position to grant taxpayers the requested relief. The statute clearly places upon taxpayers the burden of demonstrating that the 1999 notice of assessment was wrong. For the Department to now ignore this standard and abate the assessment entirely on the basis of the taxpayers' say-so would fly in the face of the dictate imposed under IC 6-8.1-5-1(b).

Taxpayers posit a secondary argument. Because they did not receive notice of the proposed assessment until October 1999 and because the assessment is now attributable to a disputed 1995 quarterly payment, the 1999 assessment was untimely and is barred by the three-year statute of limitations.

The limitations period is defined under IC 6-8.1-5-2(a) which states that, "Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed or any of the following: (1) the due date of the return." IC 6-8.1-5-2(a). According to taxpayers, because the 1999 assessment can be traced to an alleged underpayment of 1995 taxes B presumably due no later than April 15, 1996 B the Department's assessment B dated October 7 B is void pursuant to IC 6-8.1-5-2(a).

Taxpayers' argument fails because the October 7, 1999, correspondence was not a notice that taxpayers owed 1995 income tax. It was a notice that taxpayers owed additional 1998 income taxes. The 1998 shortfall can be traced back to a mistake which occurred during 1995, but the Department provided timely notice that taxpayers were required to pay 1998 taxes. Evidently, taxpayers' first 1996 quarterly payment was sufficient to cover the original 1995 deficiency; for approximately three years, each successive quarterly payment covered the previous shortfall until B for whatever reason B the deficiency found its way to the surface, and the Department determined that taxpayers did not pay all of their 1998 income taxes. It was not until 1998 that the Department reasonably believed that taxpayers had not reported the amount of tax due. The October 7, 1999, was timely submitted, and the proposed assessment is not barred by the three-year limitations period specified under IC 6-8.1-5-2(a).

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220010251.LOF

LETTER OF FINDINGS: 01-0251
Indiana Corporate Income Tax
For the Years 1989 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. Credit for Payment of Estimated Quarterly Tax.

Authority: IC 6-8.1-5-1(b).

Taxpayer argues that the Department of Revenue failed to properly credit it for a 1995 estimated quarterly payment purportedly made by means of an electronic funds transfer.

II. Computation Errors/Failure to Offset Liability.

Authority: IC 6-8.1-5-1(b).

Taxpayer maintains that the audit report failed to account for a credit contained in the audit report. In addition, taxpayer maintains that the audit report contains certain computational errors and omissions.

III. Proceeds from the Sale of Publishing Company – Gross Income Tax.

Authority: IC 6-2.1-1-2(a); IC 6-2.1-2-2(a)(1); IC 6-2.1-2-2(a)(2); Bethlehem Steel v. Indiana Dept. of State Revenue, 597 N.E.2d 1327 (Ind. Tax Ct. 1992); 45 IAC 1-1-19; 45 IAC 1-1-21; Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue (Department) erred in finding that money received from the sale of a publishing company's Indiana distribution center was subject to the state's gross income tax. Alternatively, taxpayer argues the Department should not have imposed gross income tax against all of the proceeds attributable to the sale of this Indiana asset.

IV. Abatement of the Ten-Percent Negligence Penalty.

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

Taxpayer requests that the Department exercise its discretion to abate the ten-percent negligence penalty.

DISCUSSION

Taxpayer is an out-of-state entity in the business of designing and manufacturing specialized equipment for both commercial and military use. During a number of years considered by the audit report, taxpayer owned a publishing company. That publishing company maintained a distribution center within the state.

The Department conducted an audit of taxpayer's business and tax records covering 1989 through 1996. The audit review determined that taxpayer owed additional Indiana corporate income tax. The taxpayer submitted a protest of the Department's decision, an administrative hearing was conducted during which taxpayer explained the basis for its protest, and this Letter of Findings Results.

DISCUSSION

I. Credit for Payment of Estimated Quarterly Tax.

Taxpayer argues that the audit report failed to properly credit it for a quarterly payment of estimated taxes. Taxpayer indicates that it made the 1995 estimated payment by means of an electronic funds transfer from its bank.

The rule is found at IC 6-8.1-5-1(b) which states that, "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." Under IC 6-8.1-5-1(b), the proposed assessment is provided a rebuttable presumption that the amount of the assessment is correct. Taxpayer has the burden or demonstrating the assessment is incorrect.

Taxpayer has provided a copy of its own internal business records indicating that the quarterly payment was authorized and was actually made. Taxpayer has provided a copy of its bank statement indicating that the bank made the payment. Taxpayer has provided a copy of the bank's own records indicating that the payment was made. In addition, these same records indicate that a second payment of Indiana taxes – a 1994 extension payment – was transferred to the Department by the same means and was received on the same date as the uncredited payment. This second payment was received by the Department and was credited to the taxpayer's account.

The Department's records do not indicate that the 1995 quarterly payment was received but speculates that the 1995 payment was "probably refunded." There is no substantive evidence to support that conclusion.

The taxpayer has met its burden of demonstrating that – to the extent it failed to receive credit for the amount of the 1995 quarterly payment – the proposed assessment is incorrect. Accordingly, taxpayer is entitled to receive credit for the quarterly payment.

FINDING

Taxpayer's protest is sustained.

II. Computation Error/Failure to Offset Liability.

Taxpayer maintains that the audit report contains certain errors and omissions. Specifically, taxpayer indicates that it did not receive credit for an amount labeled in the audit report as “Funds to Offset Open Liability.” In addition, taxpayer maintains that it was entitled to a refund of certain collection fees.

The Department’s records indicate that the amount labeled as “Funds to Offset Open Liability” was refunded to the taxpayer on April 3, 2002. Included in that refund check were three of the disputed collection fees. The Department’s records indicate that four of the collection fees remain unrefunded.

Under IC 6-8.1-5-1(b), the audit report – including such matters as the disposition of the amount labeled as “Funds Available to Offset Liability” – is presumed correct. Under that same provision, taxpayer has the burden of demonstrating that the assessments are incorrect.

Taxpayer raises questions which are essentially related to computation, accounting, and recordkeeping procedures. These questions are outside the purview of the administrative hearing process and not subject to satisfactory resolution in a Letter of Findings intended to address conflicting interpretations of tax law. Nonetheless, taxpayer has demonstrated that pursuant to IC 6-8.1-5-1(b), the questions it raises are not entirely frivolous or unfounded. Because there are no legal issues attached to these questions, and because taxpayer is entitled to a resolution of those questions, the audit division is requested to undertake a supplemental review of the specific claimed errors and make whatever corrections it deems appropriate.

FINDING

Subject to the results of the supplemental audit review, taxpayer’s protest is sustained.

III. Proceeds from the Sale of Publishing Company – Gross Income Tax.

Until 1995, taxpayer owned a publishing company. The publishing company had numerous physical assets which included an Indiana book distribution center. The distribution center consisted of inventory, physical plant, and associated equipment. However, the publishing company also maintained inventory in 33 other states and plant/equipment assets in seven other states. The publishing company was headquartered at an out-of-state location. Taxpayer maintains that the publishing company’s commercial domicile was in that same out-of-state location as its original headquarters.

In 1995, taxpayer sold the publishing business resulting in what taxpayer modestly describes as a “substantial profit.”

Taxpayer reported the proceeds from the sale of the Indiana inventory in its tax calculation. Initially, it failed to report the proceeds from the Indiana plant/equipment assets. The Indiana audit corrected that oversight, and taxpayer does “not dispute that these proceeds [plant/equipment] belong to Indiana.”

What is at issue is the “substantial profit” taxpayer received. Taxpayer calculates the “substantial profit” as follows: Prior to the sale, taxpayer estimated it would receive a certain amount from the sale of the publishing company based upon the value of its physical assets. Strictly for purposes of illustration, taxpayer evaluated the publishing company’s assets and determined that it would receive 10 million dollars from the sale. It did not receive 10 million; it received (again for purposes of illustration) 15 million dollars. Taxpayer describes the difference between the original estimated value of the company and the amount it received (5 million) as attributable to the publishing company’s “goodwill.”

Taxpayer maintains that none of the “goodwill” is attributable to the Indiana distribution center. Instead, it attributes the 5 million dollars to the “creative genius and business acumen that allowed [taxpayer] to get an ‘extraordinary price’ for the publishing division.” According to taxpayer, none of the 5 million dollars is attributable to Indiana but that entire 5 million dollars is attributable to its own out-of-state location where the business decisions leading to the sale of the publishing company were made. Specifically, taxpayer “believe[s] that Indiana’s connection to the goodwill transaction is modest” and that none of the proceeds from the sale of the publishing company’s goodwill were Indiana gross receipts.

The audit disagreed finding that the proceeds from the sale of the plant, equipment, inventory, and a *portion* of the goodwill – which the audit described as “Indiana goodwill” – were subject to the state’s gross income tax scheme and were taxable at the “high rate.”

Essentially, taxpayer argues that there is no such thing as “Indiana goodwill” and only the proceeds from the sale of the Indiana inventory and the Indiana plant/equipment were subject to gross income tax.

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).

For purposes of calculating a taxpayer’s “gross income,” IC 6-2.1-1-2(a) states that, “Except as expressly provided in this article, ‘gross income’ means all the gross receipts a taxpayer receives (1) from trades, businesses or commerce [and]... (3) from the sale, transfer, or exchange of property, real or personal, tangible or intangible.”

The regulations explain further. 45 IAC 1-1-19 states the gross income includes “Receipts from the conduct of a trade or business situated and regularly carried on in Indiana, including activities incident thereto (such as the disposal of *capital assets* or other property acquired or used in carrying on such trade or business in Indiana).” (*Emphasis added*). The term “capital asset” is defined at 45 IAC 1-1-21 which states, in relevant part, that, “[T]he Department extends through this regulation the definition of capital assets to include all other assets which are not considered to be inventory or stock-in-trade, even though such assets are intangible in nature, i.e., stocks, bonds, patents, trademarks, notes, copyrights, *goodwill*, etc., or current in nature, i.e. disposed of within the tax year." (*Emphasis added*).

The term "goodwill" is defined as including, "a business's reputation, patronage, and other intangible assets that are considered when appraising the business." Black's Law Dictionary 703 (7th ed. 1999).

It is apparent that when a business is sold, the proceeds from the sale are subject to Indiana's gross income tax. It is equally apparent that those proceeds attributable to the value of the business's goodwill are also subject to gross income tax. Presumably, taxpayer would agree with the general proposition that if the publishing company was located entirely within this state, the value attributable to the publishing company's goodwill would plainly be subject to Indiana's gross income tax.

However, the publishing company's operation was spread out over numerous out-of-state locations. It is taxpayer's contention that the value of the goodwill is attributable entirely to one state; the taxpayer's own out-of-state commercial domicile. In support, taxpayer cites to Bethlehem Steel v. Indiana Dept. of State Revenue, 597 N.E.2d 1327 (Ind. Tax Ct. 1992). In that case, the court found that the gross receipts petitioner received from safe harbor lease transactions were not derived from an Indiana source and were not subject to gross income tax. Id. at 1336-37. However, taxpayer's situation is distinguishable from Bethlehem Steel. In that case, the U.S. Congress legislated certain investment credits to encourage businesses to invest in new machinery in order to alleviate a national recession. Id. at 1328 n.1. Because the petitioner (Bethlehem Steel) did now owe federal income tax during the relevant years, it took advantage of a provision allowing it to enter into a sale-leaseback agreement with another company by which it sold the tax credits to that out-of-state company. Id. at 1328. The Tax Court found that the money received from the sale of the tax credits was not subject to Indiana's gross income tax. Id. at 1336-37. The court found that the tax credits were entirely unrelated to the petitioner's Indiana location and the equipment found at that location. Id. at 1337. The court concluded that the income received from the sale of the tax credits was unrelated to Bethlehem Steel's Indiana operation.

However, the proceeds from the sale of the publishing company's goodwill are not analogous to the proceeds received from the sale of Bethlehem Steel's tax credits. The sale of the publishing company's goodwill was inseparable from the sale of the publishing company itself. Taxpayer could not have severed the publishing company's "goodwill" and sold it to the highest bidder because the goodwill was inextricably linked to the publishing company itself. The publishing company, its physical assets, and its goodwill went hand-in-hand unlike Bethlehem Steel which was able to sever the tax credits and market them to an out-of-state entity. After Bethlehem Steel sold its tax credits, its Indiana operation remained entirely unaffected. After taxpayer sold the publishing company, it had entirely rid itself of Indiana distribution center together with all the other assets of the publishing company. The day after Bethlehem Steel sold its tax credits, its Indiana steel operated continued as before because the tax credits were unrelated to the Indiana assets. The day after taxpayer sold the publishing company, it was entirely out of the book publishing business. The Indiana distribution center, the inventory, the equipment, the building, and the goodwill belonged to someone else.

The Department is unable to agree with taxpayer's contention that the goodwill was entirely attributable to its own out-of-state business acumen and creative genius. The goodwill – and its associated cash value – was part-and-parcel with the inherent value of the publishing company and its associated physical assets; a portion of that goodwill is inextricably linked with the publishing company's Indiana distribution center.

Nonetheless, taxpayer offers a related challenge to the audit's assessment of additional gross income taxes. It proposes that the portion of the goodwill the audit attributed to the Indiana distribution center is overstated.

There is no reasonable contention that the value of the publishing company's goodwill (the 5 million dollars in the example above) is entirely attributable to the Indiana distribution center. Clearly, the Indiana distribution center was but one cog in a large book publishing business. However, the audit calculated the value of the Indiana goodwill "by taking the percentage of Indiana assets at cost (inventory, PPE and plant) and multiplying the percentage times the sale price of [publishing company's] goodwill." In doing so, the audit concluded that approximately 44 percent of the publishing company's goodwill was attributable to the Indiana distribution center.

Taxpayer challenges the 44 percent calculation on the ground that the publishing company's sales within the state of Indiana were relatively minor when compared to the publishing company's sales to other states. Instead, the majority of the publishing company's book sales were to larger and more populous states.

The Department is unable to accept the contention that the value of the publishing company's in-state goodwill should be based upon the amount of book sales made to the various states. Having found that the value of the goodwill was part-and-parcel with the value of the publishing company itself, the method used by the audit to attribute the Indiana goodwill appears entirely reasonable. The audit used a method of comparing the in-state and the out-of-state goodwill based upon the publishing company's in-state and out-of-state assets. After determining that 44 percent of the publishing company's buildings, equipment, and inventory were found within this state, it is not unreasonable to conclude that 44 percent of the publishing company's goodwill is associated with the assets contained within this state. Taxpayer would parcel out the goodwill based upon the percentage of in-state and out-of-state book sales. Such a method would be logically defensible if the taxpayer had sold the publishing company's customer list or its sales network. However, such is not the case because taxpayer sold the publishing company in its entirety. The buyer did not purchase and did not acquire the publishing company's past sales history; the buyer acquired the publishing company lock, stock, and barrel. The Department concludes that the audit's method of attributing the in-state goodwill of the publishing company to the in-state assets of the publishing company was neither unreasonable nor unwarranted.

FINDING

Taxpayer's protest is respectfully denied.

IV. Abatement of the Ten-Percent Negligence Penalty.

The audit assessed a ten-percent negligence penalty against the tax deficiency owed. Taxpayer argues that the penalty is unjustified because it exercised reasonable caution, care, and diligence in determining its Indiana tax liability. In addition, taxpayer maintains that a certain amount of the deficiency was attributable to legitimate but conflicting interpretations of the tax laws.

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's position is that a certain amount of the additional assessment is attributable to simple oversights and to well-founded, but conflicting interpretation of the relevant tax law. In sum, taxpayer is of the opinion that it has acted in a thoughtful and conscientious manner in regard to its Indiana state tax liabilities.

The Department agrees that in any audit of a substantial and complex business there may be room for legitimate disagreements. Nonetheless, a substantial amount of taxpayer's own additional assessment stems from its failure to report the proceeds from the 1995 sale of the publishing company's Indiana distribution center. Although there may be room for disputing whether any of the proceeds attributable to the sale of the goodwill associated with that distribution center were subject to Indiana's gross income tax, there can be no dispute that the sale of the plant and equipment – valued in the millions of dollars – was subject to gross income tax. Although this omission may be blamed on taxpayer's "change in tax reporting software programs," the Department is unable to agree that such a substantial omission is 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 respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20010262.LOF

LETTER OF FINDINGS NUMBER: 01-0262
Sales and Use Tax
For the Years 1999-2000

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. Sales and Use Tax-Manufacturing Exemption

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-3-2, IC 6-2.5-5-3, 45 IAC 2.2-5-10, 45 IAC 2.2-5-8(g), *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948).

The taxpayer protests the imposition of the use tax on a detro shaker and lamp bulbs for the microfiche reader.

II. Sales and Use Tax-Consumables

Authority: IC 6-2.5-3-2, IC 6-2.5-2-1, Information Bulletin #28 for Sales and Use Tax, issued June, 1992.

The taxpayer protests the imposition of the use tax on consumables.

III. Tax Administration-Penalty

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

The taxpayer protests the imposition of the penalty.

IV. Tax Administration-Interest

Authority: IC 6-8.1-10-1.

The taxpayer protests the imposition of interest.

STATEMENT OF FACTS

The taxpayer is a Sub-Chapter S corporation that operates a body shop which repairs and refinishes cars, converts vans, and manufactures a part used by another local company. 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-Manufacturing Exemption

DISCUSSION

The use tax is imposed on an Indiana use of tangible personal property purchased in a retail transaction. IC 6-2.5-3-2. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. IC 6-2.5-5-3 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... processing, refining, or finishing of other tangible personal property." 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production. Property has such an immediate effect if the property "is an essential and integral part of an integrated process which produces tangible personal property." 45 IAC 2.2-5-8(g).

All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.*, 79 N.E. 2d 651 (Ind. 1948). 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).

The department assessed use tax on a detro shaker and light bulbs for a microfiche reader. The taxpayer protested these assessments. The taxpayer contends that the detro shaker and light bulbs qualify for the manufacturing exemption. Both of these items are used in the process of producing custom converted vans. The light bulbs are used in reading paint formulas with the microfiche reader. The detro shaker shakes the paint prior to the spraying of the paint onto the van. The taxpayer argues that since it must read the formula and shake the paint to convert vans, the detro shaker and light bulbs are essential and integral to the van conversion process. The department disagrees. The preparation of a material for application takes place prior to the beginning of the industrial process. Therefore, the department properly assessed use tax on the use of the light bulbs and detro shaker.

FINDING

The taxpayer's protest is denied.

II. Sales and Use Tax-Consumables

DISCUSSION

The taxpayer uses many consumable items such as masking tape and disposable rags in the process of van conversion. The taxpayer protests the assessment of use tax on these consumable shop supplies. The taxpayer contends that they work with third party insurance companies that remit the payment for insured customers. According to the taxpayer, the industry practice is to pay a fixed dollar amount per repair hour for all materials used. The taxpayer lists "paint materials" on its estimates as allegedly required by the third party insurers. The taxpayer contends that the term "paint materials" includes the paint and the consumable shop supplies. The taxpayer charges sales tax on the amount of the "paint materials." The taxpayer contends that it should not have to pay use tax on the consumable shop supplies since sales tax was collected and remitted on the "paint materials" which includes the consumables.

The use tax is paid by the user or consumer of the tangible personal property. IC 6-2.5-3-2. Indiana also imposes a sales tax "on retail transactions made in Indiana. The purchaser of the tangible personal property is liable for payment of the sales tax. Merchants collect the sales tax as agents of the state and remit the tax to the Indiana Department of revenue. IC 6-2.5-2-1.

Information Bulletin #28 for Sales and Use Tax, issued June, 1992, clarifies the sales and use tax laws for motor vehicle sales and repairs. The clarification of the taxability of shop supplies is as follows:

> Consumable supplies, such as masking paper and tape, oil dri, sandpaper, buffing pads, rags and cleaning supplies, used to repair and service motor vehicles are subject to use tax if purchased exempt from sales tax. The purchaser becomes the final user of such items because its customer does not become the owner of such consumable supplies. Although the dealer may charge the customer for such items, the items are not being sold to the customer in a retail transaction. Use tax should be self assessed and remitted by the purchaser directly the Department if such consumable supplies were purchased exempt from sales tax.

In the taxpayer's situation, it is the final user of supplies such as those described in the Information Bulletin concerning the repair of the automotive vehicles. Taxpayer does not pay sales tax when it purchases the shop supplies. The shop supplies are not sold to the customer in a retail transaction. Therefore, the taxpayer owes use tax on the consumable shop supplies.

The taxpayer's contention that sales taxes were incorrectly collected and remitted to Indiana on those shop supplies does not change the taxpayer's use tax liability.

FINDING

The taxpayer's protest is denied.

III. Tax Administration-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.

Pursuant to this standard, taxpayers have the duty to learn about and follow the tax laws of the state. Although the Indiana law clearly provides that taxpayers owe use tax on tangible personal property consumed in the provision of a service, the taxpayer had no system for self-assessment of use tax and ignored its obligation to remit use tax to the state. Also, the taxpayer failed to self-assess and remit the use tax on clearly taxable items such as coveralls used to keep employees clean and maintenance items. These breaches of the taxpayer's duty constitute negligence.

FINDING

The taxpayer's protest is denied.

IV. Tax Administration-Interest

DISCUSSION

The taxpayer protests the imposition of interest. IC 6-8.1-10-1 provides that the department must assess interest if a taxpayer "incurs a deficiency upon a determination by the department." The law continues to state that "the department may not waive the interest imposed under this section." The department, therefore, has no discretionary authority to waive the interest.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20010349.LOF

LETTER OF FINDINGS NUMBER: 01-0349
Gross Income Tax
Penalty
For the Years 1996, 1997, 1998

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

ISSUES

I. Gross Income Tax-Application to out of state franchisor

Authority: IC § 6-2.1-1-2; IC § 6-2.1-2-2; 45 IAC 1-1-30; 45 IAC 1-1-48**.**

Taxpayer protests the Department's assessment of gross income tax on royalties and fees received from a franchisee operating its trademark restaurants in the state of Indiana.

II. Penalty-Request for waiver

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

Taxpayer protests the Department's imposition of the 10% negligence penalty, requesting a waiver for reasonable cause.

STATEMENT OF FACTS

Taxpayer, a corporation incorporated and domiciled outside of Indiana, granted franchises to operators of its restaurants in Indiana. In May of 1997, taxpayer sold its remaining company owned restaurants to an unrelated corporation that also happened to be taxpayer's largest franchisee. Taxpayer currently functions as a franchisor. During the audit period, and pursuant to the license agreement between taxpayer and its franchisee, taxpayer owned trademarks, service marks and trade names used in the development, organization, and operation of its restaurants which feature a unique style of food. Taxpayer has established a high degree of consumer goodwill and public acceptance of its trademark, name, system of restaurants and products, over a long period of time. Franchisees, including the unrelated corporation involved in the transactions at issue in this protest, have to conform to taxpayer's manual regarding purchasing supplies, including specifying vendors, and preparing food and beverages for sale and consumption. Taxpayer retained the right of inspection of any premises and operations, the right of first refusal in the event franchisee wished to sell, and directed insurance matters. Taxpayer was also a named insured on all policies. Taxpayer filed withholding tax returns for the periods at issue indicating that it used Indiana employees.

When a franchisee entered into a franchise agreement with taxpayer, the franchisee received the right and privilege to use taxpayer's trademarks, service marks, trade names, consumer goodwill and public acceptance in the operation of one of taxpayer's restaurants. Taxpayer received fees from the franchisee for the use of such rights and privileges. Further facts will be added as necessary.

I. Gross Income Tax-Application to out of state franchisor

DISCUSSION

In general, IC § 6-2.1-1-2(a) defines gross income as "all the gross receipts a taxpayer receives" from various sources. Subsections (1), (3), (4), and (10) are most pertinent to taxpayer's arguments in this protest. Subsection (10) is the generic catchall provision covering items not delineated in previous subsections. Therefore, "gross income means all the gross receipts a taxpayer receives from any other source not specifically described in" subsections (1) through (9). Subsection (1) describes gross receipts "from trades, business, or commerce." Subsection (3) describes gross receipts "from the sale, transfer, or exchange of property, real or personal, tangible or intangible." Subsection (4) describes gross receipts "from the performance of contracts." Any one of these subsections justifies imposing Indiana's gross income tax on taxpayer's gross receipts from its activities in Indiana.

IC § 6-2.1-2-2 imposes the tax "upon the receipt of (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." Generally speaking, whatever one chooses to call the "gross receipts" taxpayer receives—royalties, management, contract, licensing, or franchise fees—by any name, they are taxable as gross income received by taxpayer. *See*, 45 IAC 1-1-30 and 45 IAC 1-1-48. (repealed, 12-30-98). The latter regulation provides in relevant part:

> A franchise system involves a particular kind of business activity carried on by a franchisee in accordance with the terms of a contract with a franchisor. The contract generally provides for the franchisor's grant to the franchisee of the use of an exclusive brand name, patent, process, territory, advertising or other right for which the franchisee pays under a schedule of fixed or variable fees or a combination thereof. The taxability of such fees and other income of the franchisor for gross income tax purposes depends upon the business relationship of the parties, where they are incorporated and doing business, and the terms of the franchise agreement.

The regulation goes on to discuss four different franchise situations. Number four is directly on point:

> Out of state franchisor with Indiana franchisees: the franchisor is taxable upon that part of his fees and income derived from activities in this state, including the operation of an in-state situs, the rental of real and personal property in Indiana, and the performance of services for in-state franchisees, more than a minimal or incidental amount of which takes place in the state.

Taxpayer argues its licensing a third party (a corporation that is incorporated and domiciled outside of Indiana) to operate taxpayer's Indiana restaurants, and the signing of the Agreement (which took place in another state), trumps all evidence of its connections to Indiana.

The granting of the license is not, contrary to taxpayer's argument, the sole defining parameter of its business relations with its Licensees. The granting of a license, wherever that takes pace, is a nullity if the licensor and licensee do not take some positive action in accordance with, and pursuant to, the directions and mandates set forth in the license agreement. If the parties did not so act, no restaurants are built, no food is sold, and no money is earned to be passed up the chain from restaurant to licensee to licensor. The granting of a power is an inchoate possibility, an intangible, and merely exists until such a time as it is acted upon.

The License Agreement itself outlines taxpayer's retained rights: to review licensee's sales reports, specify approved vendors, inspect the premises of the restaurants. Taxpayer also retained the right of first refusal when a licensee or restaurant wished to sell. Taxpayer also provided insurance and was the named "certificate holder" on the policy and is listed as an "Additional Insured/Loss Payee." The Agreement is replete with a plethora of evidence of taxpayer's continual control of its restaurant operations. Licensee must "conform" to taxpayer's control of the menu, i.e., the "manner of preparing and serving the Licensed Products," the food under taxpayer's brand name. Licensee must maintain "uniform and high standards of quality, service, appearance" in all the restaurants. This "maintenance" is "necessary in order to maintain [taxpayer's] public image and widespread consumer acceptance." Everything is within taxpayer's "sole judgment and discretion" regarding suppliers and vendors, plates, napkins, cups, etc. With respect to marketing and advertising, taxpayer has numerous commandments licensee must follow; marketing is essential "to the furtherance of the goodwill and public image of [taxpayer]." With respect to trademark standards, licensee "acknowledges that [taxpayer] is the sole owner of the Trademarks and all goodwill relating thereto;" they are the "sole and exclusive property of [taxpayer's]." Licensee does not acquire any "right, title, interest or claim of ownership in the Trademarks." Licensee's use of Trademarks, any and all goodwill and benefits shall inure solely to the benefit of [taxpayer] and shall be deemed to be the sole property of [taxpayer]."

The transactions here at issue—the receipt of franchise fees from taxpayer's Indiana franchisees—are inextricably related to taxpayer's activities within the state. The receipt of the franchise fees is an amount determined by and directly related to taxpayer's purposeful Indiana activities. It cannot be said that the transactions occurred entirely where the license agreements were signed because, absent the Indiana "connection" and the taxpayer's Indiana activity, the franchise agreements become abstract paper agreements of no value to the taxpayer and of no interest to the Indiana taxing authorities. In addition, the substantial portion of the activities performed in exchange for the franchise fees take place in Indiana.

What taxpayer sells, and what the franchisee purchases, is the right to vigorously exploit the intangible asset within the state of Indiana. Taxpayer's Indiana source income results from the utilization of the intangible within the state of Indiana made possible by the taxpayer's decision to establish a physical presence within the state of Indiana. Taxpayer's income is not derived from entering into theoretical paper franchise agreements created, performed, and executed where the license agreements were signed. Taxpayer's income derives from and is directly linked to its decision to purposely avail itself of an Indiana business opportunity, a decision to recruit and license an unrelated franchisee to operate its trademark restaurants, and the decision by Indiana citizens to patronize those Indiana restaurants. Taxpayer's ability to derive income from its Indiana activities is made possible by the protections, benefits, and opportunities provided by the state of Indiana. Indiana has made it possible for taxpayer to enter into this state and to obtain income from its franchise agreements. Indiana, in turn, is entitled to tax that portion of taxpayer's income attributable to this state.

FINDING

Taxpayer's protest concerning the taxability of royalties received from its franchisee/licensee operating trademark restaurants in Indiana is denied.

II. Penalty-Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty on the entire assessment. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due. Taxpayer stated in its brief that there was no intent to defraud the state, and that its failure to pay the proper amount of tax was due to its interpretation of Indiana's statutes, regulations, and case law.

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

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

Taxpayer has not set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Taxpayer has not provided sufficient evidence to show that its interpretation of the relevant statutes and regulations is valid and reasonable. Therefore, given the totality of all the circumstances, waiver of the penalty on the entire assessment is inappropriate in this particular instance.

FINDING

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

DEPARTMENT OF STATE REVENUE

0220020260.LOF

LETTER OF FINDINGS: 02-0260
Indiana Corporate Income Tax
For the Years 1993 Through 1999

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

ISSUE

I. 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 is entitled to an abatement of the ten-percent negligence penalty imposed subsequent to an audit examination of taxpayer's 1993 through 1999 federal and state income tax returns.

STATEMENT OF FACTS

Taxpayer in its previous incarnation was in the business of leasing trucks, trailers, and other fleet vehicles. Following a corporate reorganization and a transfer of its physical assets to a related partnership entity, taxpayer is now – and at all times during the audit period – merely a passive participant in the partnership which holds these physical assets. Taxpayer is designated as the "general partner."

During 2001, the Department of Revenue (Department) conducted an audit review of taxpayer's 1993 through 1999 federal and state income tax returns. The Department determined – and taxpayer agreed – that taxpayer and the partnership did not have a unitary relationship. Accordingly, a number of adjustments were made to correctly reflect the partnership income received from the non-unitary partner. In addition, the ten-percent negligence penalty was imposed on the ground that taxpayer had consistently failed to report the partnership income properly.

The taxpayer disagreed with the imposition of the penalty and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

DISCUSSION

I. Ten-Percent Negligence Penalty.

Taxpayer requests that the Department exercise its discretion to abate the ten-percent negligence penalty. Taxpayer believes that the request is justified on several grounds. Taxpayer states that it experienced significant turnover of its in-house tax personnel and that its new employees did not understand taxpayer's relationship with the partnership. In addition, taxpayer was involved in a number of acquisitions that complicated the taxpayer's compliance objectives. Further, some of the tax returns submitted during the audit period were prepared by several outside tax service providers also unfamiliar with taxpayer's business operations. Taxpayer maintains that at all times it acted in good faith in preparing its tax returns.

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...."

Without minimizing the difficulties taxpayer experienced in dealing with and managing its own employees, without ignoring the difficulties involved in accurately communicating with multiple outside tax service providers, and without underestimating the apparently complex relationship between itself and the partnership interest, the Department is unable to agree that these are circumstances under which abatement of the negligence penalty is appropriate. Taxpayer – a sophisticated, substantial, and experienced business entity – failed to correctly report its partnership income over a period of at least six years. The Department does not agree that such results are indicative of "ordinary business care and prudence...." Id.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20020307.LOF

LETTER OF FINDINGS NUMBER: 02-0307
Gross Retail & Use Tax
For Years 1998, 1999, 2000

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. Gross Retail and Use Taxes—Business Assets

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-4; IC § 6-2.5-3-6; IC § 6-2.5-3-7; 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4; *Tri-States Double Cola Bottling Company v. Department of State Revenue,* 706 N.E.2d 282 (Ind.Tax 1999)

Taxpayer protests the assessment of use tax on assets purchased for the business where allegedly no gross retail tax was paid at the point of purchase.

II. Penalty—Request for Waiver
Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of the 10% negligence penalty and requests a waiver.

STATEMENT OF FACTS

Taxpayer is a Chinese restaurant offering buffet, menu, and carryout services. Ms. X is the owner and sole shareholder of the corporation. Ms. X engaged the services of a general contractor to renovate an existing building in order to open her business in November of 1998. The general contractor engaged the services of several different businesses to perform the work required. The audit determined that since gross retail tax had not been collected and remitted at the point of purchase of a number of items, taxpayer, owed use tax to the State of Indiana. Additional facts will be supplied as required.

I. Gross Retail and Use Tax—Business assets

DISCUSSION

Taxpayer protests the use tax assessment on assets purchased in order to open a Chinese restaurant where buffet, menu, and carryout services would be available to customers. Taxpayer entered into a contract with a general contractor who used subcontractors to provide materials and services to complete the refurbishing of the building in which the restaurant now resides. Invoices for these items were sent directly to taxpayer. Neither the general contractor nor subcontractors collected and remitted to the State of Indiana gross retail taxes on many items used in renovating the building space for the business. Taxpayer's owner must now pay use tax on these items, four of which are at issue in this protest: a sign purchased from a sign company not registered to collect Indiana gross retail and use tax in 1998; fixtures where the auditor agreed the freight charges were not subject to tax, but the actual purchases were; a carpet sold to taxpayer by a company that was already out of business at the time of the audit; a sound system installed by a Kentucky company (not registered in Indiana to collect and remit Indiana gross retail and use tax) which collected gross retail tax but remitted the amount to the state of Kentucky, not the state of Indiana. Taxpayer also protested an uncredited utility exemption for use of natural gas in food preparation; the audit made that adjustment, as well as the adjustment for the freight charges for the sign. These two adjustments still stand.

Pursuant to IC § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made." Pursuant to IC § 6-2.5-2-1, a "person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state." *See also*, 45 IAC 2.2-2-1. Pursuant to IC §§ 6-2.5-3-1 through 6-2.5-3-7, 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." An exemption is provide in IC § 6-2.5-3-4 if "the property was acquired in a retail transaction and the state gross retail tax" was paid at the time of purchase. Taxpayers are personally liable for the tax. (IC § 6-2.5-3-6). IC § 6-2.5-3-7 provides that a "person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana;" therefore, the presumption of taxability exists until rebutted. *See also*, 45 IAC 2.2-3-4.

Taxpayer did not provide sufficient evidence that the State's gross retail tax was paid by her to the providers of the equipment at issue. The issue in this case is really whether such taxes were collected and remitted to the State of Indiana. If not, taxpayer remains liable for use tax on taxable items where no retail tax has been collected and remitted. See, *Tri-States Double Cola Bottling Co. v. Department of Revenue,* 706 N.E.2d 282, at 286-287.

FINDING

Taxpayer's protest concerning the assessment of use tax on assets purchased for the business, where it cannot be shown that gross retail tax was collected and remitted by authorized retail merchants at the time of purchase, is denied.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty on the entire assessment. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due. Taxpayer stated at the hearing that she totally relied on the expertise of her CPA, and that her failure to pay the proper amount of tax was due to his advice and his interpretations of Indiana's statutes, regulations, and case law.

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

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

Taxpayer has not set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Therefore, given the totality of all the circumstances, waiver of the penalty on the entire assessment is inappropriate in this particular instance.

FINDING

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

DEPARTMENT OF STATE REVENUE

0220020312.LOF

LETTER OF FINDINGS: 02-0312
Indiana Corporate Income Tax
For the Tax Years 1990 through 1999

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

ISSUES

I. Taxpayer's Qualifications to File Under Indiana's Financial Institution Tax: Conducting the Business of a Financial Institution.

Authority: IC 6-5.5 et seq.; IC 6-5.5-1-17(d)(1); IC 6-5.5-1-17(d)(2)(B); IC 6-5.5-3-1; IC 6-8.1-5-1(b); 45 IAC 17-2-1(a); 45 IAC 17-2-4(b), (c); 45 IAC 17-2-4(e)(2); IRS Rev. Rul. 55-540, § 162(4) 1955-2 CB 39; IRS Rev. Proc. 75-21, § 4, 1975-1 CB 715.

Taxpayer states that the Department erred in determining that taxpayer did not qualify to report its income as a Financial Institution and in determining that taxpayer should have been filing Indiana Corporation Income Tax Returns for 1990 through 1998.

II. Taxpayer's "Non-Filer" Status

Authority: IC 6-3-4-1; IC 6-8.1-1-1; IC 6-2.1-5-2; IC 6-8.1-5-2(a); IC 6-8.1-5-2(e); Germantown Trust Co. v. Commissioner of Internal Revenue, 309 U.S. 304 (1940); 45 IAC 15-3-2(d)(3); 45 IAC 15-5-7(f); Black's Law Dictionary (7th ed. 1999).

According to taxpayer, even if the Department is correct in determining that it should have been filing Indiana Corporation Income Tax Returns for 1990 through 1998, the Department is statutorily precluded from imposing additional corporate income tax for 1990 through 1997 on the ground that – having filed the FIT returns – taxpayer was a "filer." In addition, taxpayer argues that having accepted the 1990 through 1998 FIT returns, the Department is effectively estopped from belatedly deciding that it should have been paying corporate income tax during those years.

III. Lease Payments Subject to Gross Income Tax.

Authority: IC 6-2.1-2-2(a); Enterprise Leasing v. Indiana Dept. of Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002); Comdisco, Inc. v. Indiana Dept. of Revenue, No. 49T10-9903-TA-19, 2002 Ind. Tax LEXIS 93 (Ind. Tax Dec. 18, 2002); 45 IAC 1-1-10; 45 IAC 1-1-28; 45 IAC 1-1-49; 45 IAC 1-1-162; 45 IAC 1.1-1-3(6); 45 IAC 1.1-1-5; 45 IAC 1.1-1-22; 45 IAC 1.1-1-22(a)(4), (10); 45 IAC 1.1-2-10; 45 IAC 1.1-3-13; 45 IAC 1.1-3-13(b); 45 IAC 1.1-3-13(b)(1).

Taxpayer argues that money it received attributable to gas station lease payments was not subject to Gross Income Tax because the lease payments were not derived from Indiana sources.

IV. Including the Value of Leased Property in Taxpayer's Property Factor – Adjusted Gross Income Tax.

Authority: IC 6-3-2-1(b); IC 6-3-2-1(c); IC 6-3-2-1(l); Enterprise Leasing v. Indiana Dept. of Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002).

Taxpayer maintains that the audit, in calculating its adjusted gross income tax, erred by including in taxpayer's property factor the value of property leased in this state but not used by the taxpayer in this state.

V. Abatement of the Ten-Percent Negligence Penalty.

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

Taxpayer argues that it is entitled to abatement of the ten-percent negligence penalty because its decision to file FIT returns was based upon instructions issued by and decisions made by the Department.

STATEMENT OF FACTS

Taxpayer began filing Indiana tax returns in 1985. In 1990, taxpayer filed an Indiana income tax return reporting and paying corporate income tax. Thereafter, taxpayer concluded that it should be filing Indiana Financial Institution Tax (FIT) returns. Having decided that this was the proper course, in 1992 taxpayer filed another 1990 return but this time filed a FIT return. In a letter accompanying the 1990 FIT return, taxpayer stated it was "changing the 1990 filing status from IT-20s (on a separate basis) to FIT-20 on a unitary basis...." In that letter, taxpayer stated that it "[met] the FIT requirements." As a result of this substitute filing, the Department obligingly sent taxpayer a refund payment.

Taxpayer continued to file FIT returns for 1992 through 1999. Those returns were accepted by Department.

In 2001, the Department conducted an audit of taxpayer's business and tax records. In the report which followed that audit examination, the Department concluded that taxpayer "erroneously filed Financial Institution Franchise Tax Returns" for 1990 through 1999. Having arrived at the conclusion, the Department designated taxpayer as a "non-filer." The "non-filer" designation enabled the Department to go back to 1990, calculate Indiana corporate income taxes for those years, and assess back taxes for 1990 through 1999.

Taxpayer disagreed with the Department's conclusion on multiple grounds and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Taxpayer's Qualifications to File Under Indiana's Financial Institution Tax: Conducting the Business of a Financial Institution.

Taxpayer maintains that it was entitled – at all times relevant – to file FIT returns because taxpayer "derived at least 80 [percent] or more of its gross income (excluding extraordinary income) from making acquiring, selling or servicing loans or extensions of credit and leasing real and personal property that is the economic equivalent of the extension of credit." Taxpayer describes itself as a "multifaceted supplier of financial services to customers in a variety of industries."

According to taxpayer – for purposes of calculating its federal and FIT tax liability – taxpayer received lease payments attributable to an arrangement it had entered into with a trust (hereinafter, the "trust company") and an oil company affiliate. According to taxpayer, this is how the arrangement worked:

1. Oil company affiliate decided to build gas stations.
2. With an eye toward providing long-term financing for those gas stations, taxpayer supplied money to the trust company. Other third-party investors also provided money to the trust company. In actual practice, all of this money was held on a short-term basis by an indenture trust.
3. After oil company affiliate completed construction of the gas stations, it sold all the stations to the trust company. The oil company affiliate used the proceeds to pay off the initial cost of building the gas stations.
4. The oil company affiliate then leased the gas stations back from the trust company. Taxpayer describes this agreement – between the oil company affiliate and the trust company – as a "sales/leaseback."
5. Thereafter, the oil company affiliate made lease payments to the trust company for the right to use and operate the same gas stations it had originally designed, built, and briefly owned.

The issues raised all stem from the lease payments and the manner in which these payments should be treated for FIT and Indiana gross income tax purposes. According to taxpayer, the trust company was a "grantor trust," and – at least for federal income tax purposes – the trust company was entirely transparent; for federal income tax purposes, taxpayer treated the lease payments as if those payments were received directly from the oil company affiliate. For federal income tax purposes, taxpayer was entitled to claim the depreciation on the gas stations and pay no federal income tax on the lease payments. Accordingly, taxpayer argues that it was entitled to be treated as a "Financial Institution" for Indiana tax purposes. The audit disagreed, concluded that taxpayer was not entitled to be treated as a "Financial Institution," and that taxpayer should have been filing Indiana corporate income tax returns.

Indiana imposes a franchise tax, known as the Financial Institution Tax (FIT), on corporations transacting the business of a financial institution inside the state. IC 6-5.5 et seq. The tax is imposed on resident financial institutions, on nonresident financial institutions, and on non-bank entities that transact the business of a financial institution. 45 IAC 17-2-1(a). Non-resident corporations, such as the taxpayer, transacting the business of a financial institution, are included in the FIT when they meet one of the eight tests listed in IC 6-5.5-3-1 whereby the non-resident corporation demonstrates that it has established an economic presence in Indiana. It is not disputed that taxpayer established an "economic presence" within the state because the service stations were located in Indiana.

Because the taxpayer is not conducting the business of a traditionally regulated financial institution as defined in IC 6-5.5-1-17(d)(1), the taxpayer bases its claim to FIT status under the provisions of IC 6-5.5-1-17(d)(2)(B) which grants FIT status to those corporations which obtain 80 percent of their gross income from the "leasing [of] real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes." Id.

That definition is amplified in the Department of Revenue regulations. A corporation is subject to the FIT if it is conducting the business of a financial institution. 45 IAC 17-2-4(b), (c). The benchmark for determining whether the taxpayer is conducting the business of a financial institution is if 80 percent of the corporation's gross income is derived from the economic equivalent of extending credit. Id. The corporation must not only derive 80 percent of its income from garnering interest, that interest must be derived from a lease that is "*not* treated as a lease for federal income tax purposes." 45 IAC 17-2-4(e)(2) (*Emphasis added*). Therefore, to satisfy the 80 percent benchmark, the interest must be both "the economic equivalent of the extension of credit" and from a lease "*not* treated as a lease for the federal income tax purposes." Id.

The taxpayer, looking to qualify as a FIT filer, is required to demonstrate that the transactions from which it derives interest income are not true leases but financing leases. A financing lease appears on the surface to be a lease and may be labeled as such; however in reality it is simply a device which enables the lessor (seller) to retain a security interest in the property until the purchase price is paid by the lessee (buyer). In effect, under a financing lease, the lessor is making a conditional sale to the lessee. IRS Revenue Ruling 55-540 provides the guidelines used in determining the treatment of leases for use in the trade or business of the lessee. Whether a lease agreement is a lease, or in reality a conditional sale, depends on the provisions of the agreement in light of the facts and circumstances existing at the time the agreement was executed. Rev. Rul. 55-540, § 162(4) 1955-2 CB 39. In the "absence of compelling persuasive factors" demonstrating otherwise, a transaction is a conditional sales contract if one or more of the following factors are present:

(1). Portions of the periodic payments are specifically applicable to the equity to be acquired by the lessee;

(2) the lessee acquires title upon a payment of a stated amount of rentals which under the contract the lessee is required to make,

(3) the total amount paid by the lessee for a relatively short period of use constitutes an inordinately large proportion of the total payments required to secure transfer of title,

(4) the rental payments materially exceed the fair rental value,

(5) the property can be acquired under a purchase option at a price which is nominal in relation to the value of the property at the time the option may be exercised or which is a relatively small amount when compared to the total,

(6) some portion of the payments is specifically designated as interest or is otherwise recognizable as the equivalent of interest. Id.

IRS Revenue Procedure 75-21 expands on Revenue Ruling 55-540 by elaborating on the facts and circumstances that indicate whether a transaction is, in contrast to a conditional sale, a true lease. A transaction will constitute a true lease if *all* of the following conditions are met;

(1) The lessor must have a minimum unconditional risk investment in the property at the inception of the transaction,

(2) the lessor must maintain the minimum at risk investment throughout the lease and that risk must remain at the end of the lease,

(3) the minimum at risk investment must be equal to at least 20% of the cost of the property and must remain at 20% throughout the entire lease term,

(4) and, there must be a residual investment of at least 20% at the end of the lease term. Rev. Proc. 75-21, § 4, 1975-1 CB 715.

The taxpayer must meet its burden of proof by demonstrating that the proposed tax assessment, requiring the taxpayer to file under IT-20, is incorrect. IC 6-8.1-5-1(b) states in relevant part that "[t]he 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 person against whom the proposed assessment is made."

The money taxpayer receives from the oil company affiliate – by way of the trust company – is not money received from financing leases. Taxpayer is simply investing money in an entity which provides long-term financing for the construction of gas stations and then holds those gas stations in a sales/leaseback arrangement. Even if the trust company and the sub-trust were taken out of the picture and the Department was to treat taxpayer's income as if it was received directly from the oil company affiliate, the taxpayer would still not be entitled to FIT treatment because these gas station leases are not "conditional sales" of the service stations. There is no indication that any of the money oil company affiliate pays goes to purchasing equity in the station; there is no indication that the oil company affiliate will ever reacquire title to the service station simply by making a stated amount of rental payments. Even after considering or ignoring entirely the relationship and the obligations between all of the participants – the oil company affiliate, taxpayer, the trust company, and the sub-trust – taxpayer is not entitled to FIT status because none of the participants were engaged in "the economic equivalent of extending credit."

There is no indication that taxpayer's interest income is received from transactions which qualify as conditional sales under IRS Revenue Ruling 55-540 or that the income is not simply derived from true leases under Revenue Procedure 75-21. Taxpayer is not in the business of extending credit and may not submit a FIT return.

FINDING

Taxpayer's protest is respectfully denied.

II. Taxpayer's "Non-Filer" Status

Assuming that taxpayer was not entitled to submit FIT returns, taxpayer nonetheless argues that the Department may not assess corporate income taxes for 1990 through 1997 because the three-year statute of limitations has run for those eight years. The audit concluded that the three-year limitations period had not run because – having submitted the incorrect tax returns – taxpayer was a "non-filer;" submission of the incorrect returns did not begin the running of the limitations period.

A. Three-Limitations Period.

The limitations period is defined under IC 6-8.1-5-2(a) which states that, "Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed...." IC 6-8.1-5-2(e) defines certain circumstances under which three-year limitations is tolled. "If a person files a fraudulent, unsigned, or substantially blank return, of if a person does not file a return, there is no time limit within which the department must issue its proposed assessment."

There is no contention taxpayer submitted fraudulent FIT returns. There is no contention taxpayer submitted unsigned or substantially blank returns. Instead, the audit based the assessment on the conclusion that taxpayer did "not file a return." If, as taxpayer contends, the submission of the FIT returns began running the three-year limitation under IC 6-8.1-5-2(a), taxpayer could only be assessed additional taxes for 1998 and 1999.

Taxpayer cites to Germantown Trust Co. v. Commissioner of Internal Revenue, 309 U.S. 304 (1940) in support of its argument, that the filing of the FIT-20 returns started the three-year limitations period. In Germantown Trust, the Court held that the two-year limitations period under Rev. Act. 1932, § 275(a), precluded the Internal Revenue Service from making a deficiency assessment against the petitioner. On behalf of its trust patrons, the petitioner had originally filed a "fiduciary return" but failed to file a corporate return reporting the petitioner's own income. Four years later, the IRS prepared a substitute corporate return and gave notice of the petitioner's tax deficiency. The IRS argued that the filing of the fiduciary return was the equivalent to "no return of the tax" under Rev. Act. 1932, § 275(c) which provided an extended four-year limitations period. The Court rejected the government's contention and agreed with the petitioner because petitioner's fiduciary return "contained all of the data from which a tax could be computed and assessed [even though] it did not purport to state any amount due as tax." Id at 307.

Taxpayer contends that its position is similar to that of the petitioner in Germantown Trust. Taxpayer states that the FIT returns submitted during 1990 through 1997 provided the Department with all the information that was needed for the Department to determine taxpayer should have been filing corporate income tax returns. Taxpayer concludes that because the Department had all the information it needed at the time of the original filings, it cannot at this late date assess the additional income taxes in the face of the three-year limitations period.

The Department must respectfully disagree with taxpayer's conclusion. Even assuming for the moment that the wayward FIT returns contained information sufficient to place the Department on notice that taxpayer should have been filing corporate income tax returns and imposed on the Department the obligation to inform taxpayer of its responsibilities under the Indiana tax laws, the three-year limitations period does not bar the Department from assessing the additional taxes here at issue. Indiana's regulation states that, "The running of the statute of limitations for purposes of assessing unpaid taxes will not start if the taxpayer fails to file a return which is required by any listed tax provision." 45 IAC 15-5-7(f). The term "listed tax" is defined at IC 6-8.1-1-1 which specifically includes "the gross income tax... the adjusted gross income tax... [and] the supplemental net income tax" as three of the state's "listed taxes." Taxpayer had an obligation to file returns and report the three "listed taxes." IC 6-3-4-1 states that, "Returns with respect to taxes imposed by this act *shall be made*...." (*Emphasis added*). *See also* IC 6-2.1-5-2. "Every taxpayer who receives more than one thousand dollars ($1,000) in gross income during a particular taxable year *shall file* with the department an annual gross income tax return." (*Emphasis added*).

Taxpayer does not stand in same shoes as that of the petitioner in Germantown Trust. In that case, the Court was interpreting the applicability of the limitations period set out in Rev. Act. 1932, § 275(a). In this instance, taxpayer incorrectly determined it was entitled to submit FIT returns. However, the submission of the FIT returns did not begin the running of the three-year limitations period because, under 45 IAC 15-5-7(f), taxpayer had an obligation to file corporate income tax returns. For purposes of determining its responsibility under the Indiana corporate tax laws, taxpayer was a "non-filer."

B. Equitable Estoppel.

Taxpayer argues that even if the three-year limitations period was not tolled by the submission of the FIT returns, the Department is nonetheless precluded from assessing the additional taxes because it acquiesced to the taxpayer's 1992 decision and because the Department may not change its position without first having given taxpayer notice of that decision.

Taxpayer points out that it notified the Department of its decision to file FIT returns in 1992, and that the Department "affirmatively approved the filing change by granting [taxpayer] a refund of the income tax paid." In addition, taxpayer points out that the Department's instructions on the corporate income tax returns and the FIT returns specifically instruct the filer to submit either an IT-20 return or an FIT-20 return but that the filer should not submit both. Taxpayer concludes that, "In short, the Department agreed with [taxpayer's] position that it should file financial institutions tax returns."

Essentially, taxpayer argues that it relied on the Department's past acquiescence to the decision to submit FIT returns and that the Department is now estopped from belatedly changing that position. Taxpayer is interposing the defense of "equitable estoppel." 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).

The taxpayer's argument is unwarranted because there is no indication taxpayer sought or received advice from the Department concerning its filing status. There is no indication the Department "agreed" that the taxpayer was entitled to file the FIT returns. There is no indication the Department induced taxpayer into incorrectly believing it was entitled to submit FIT returns. There is no indication that the Department is taking unfair advantage of the taxpayer after having affirmatively misled taxpayer as to its tax liability. Under 45 IAC 15-3-2(d)(3), taxpayer was entitled to seek, obtain, and rely on a ruling from the Department as to its tax status. Taxpayer chose not to do so but made an erroneous decision to submit FIT returns and unilaterally inform the Department that it "[met] the FIT requirements." During the years at issue, taxpayer enjoyed the advantage of owing zero Indiana tax liability. However belatedly, taxpayer must now live with the consequences of that decision.

FINDING

Taxpayer's protest is respectfully denied.

III. Lease Payments Subject to Gross Income Tax.

Taxpayer argues that it did not incur gross income tax liability during the years covered by the audit report. Taxpayer bases this argument on the fact that the audit assessed gross income tax on the rental income taxpayer received from the gas stations located in Indiana. However, taxpayer points out that it did not own the Indiana gas stations but that the trust company owned the gas stations. Taxpayer further states that it did not receive the lease payments but that the trust company received the payments.

Taxpayer sets out a secondary argument. Even if the lease payments were subject to gross income tax, taxpayer concludes that it can only be liable for gross income tax "on an apportioned share of the trust's distributable net income, which during the years 1990 – 1996 was a negative number – *i.e.* a loss."

A. Trust Income.

Taxpayer's wholesale conclusion that trusts are not subject to the state's gross income tax is not well taken.

45 IAC 1-1-162 provides as follows:

Business Trusts. Generally, trusts are not taxpayers under the Gross Income Tax. However, if a trust resembles a corporation in form and has its purpose the conduct of a business, it is considered an association and is taxed as a corporation. A trust with these features is taxable as a corporation:

(1) The trustee(s) exert centralized management over the trust property;
(2) Ownership in the trust is transferable;
(3) The owners' liability is limited to the trust property; or
(4) The trust has perpetual life.

45 IAC 1-1-162 is applicable to the trust company's 1990 through 1998 income but was replaced by 45 IAC 1.1-1-22 which states that for purpose of the state's gross income tax, "taxpayer" includes both "[a] business trust as defined in IC 23-5-1-2." and "[a] fund, account, or trust treated as a corporation under Section 468B of the Internal Revenue Code or its accompanying regulations." 45 IAC 1.1-1-22(a)(4), (10).

45 IAC 1.1-1-22 is relevant to the income received by the trust company during 1999.

Under either the previous or the more current gross income tax regulatory regime, the income received by certain trust arrangements is subject to Indiana gross income tax. The Department must disagree with taxpayer's conclusion that a trust cannot be a "taxpayer" for gross income tax purposes.

B. Distributable Net Income.

Taxpayer argues that even it is subject to gross income tax, it is only subject a tax on the "distributable net income" received from the trust company. Because – according to taxpayer's calculation – the amount of "distributable net income" was a negative number, taxpayer owes no gross income tax.

As the basis for this conclusion, taxpayer cites to 45 IAC 1.1-3-13 which states in part:

Each corporate beneficiary of the trust shall report for gross income tax purposes its proportionate share of the following income:

(1) Distributable net income determined under section 643 of the Internal Revenue Code.
(2) An accumulation distribution determined under Section 665 of the Internal Revenue Code.
(3) Undistributed capital gain, determined without regard to capital losses, not otherwise included in the distributable net income as determined under Section 665 of the Internal Revenue Code. This amount shall be determined before any taxes imposed on the trust attributable to such income. 45 IAC 1.1-3-13(b).

Taxpayer relies exclusively on the "distributable net income" language found under 45 IAC 1.1-3-13(b)(1). However, it is apparent that the regulation did not intend the cited language to be exclusive. Rather the regulation – under certain circumstances – brings both "an accumulation distribution" and "undistributed capital gain" within the purview of the gross income tax.

In addition, the cited regulation applies only to the income taxpayer received from the trust company during 1999. The taxpayer has not fully developed its "distributable net income" argument regarding the 1990 through 1998 assessments.

The Department is unable to agree with taxpayer's conclusion that it was subject to gross income tax only on the distributable net income tax received from the trust company during 1990 through 1999.

C. Indiana Source Income.

Taxpayer argues that the money it received – attributable to lease payments for Indiana gas stations – was not Indiana source income for gross income tax purposes.

In support, taxpayer cites to Enterprise Leasing v. Indiana Dept. of Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002). In that case, the Tax Court found that an out-of-state company did not receive Indiana source income when it rented Indiana-titled cars to its customers; therefore, the rental income was "not subject to Indiana's gross income tax." Id. at 1292.

In addition, taxpayer cites to Comdisco, Inc. v. Indiana Dept. of Revenue, No. 49T10-9903-TA-19, 2002 Ind. Tax LEXIS 93 (Ind. Tax Dec. 18, 2002), in which the court found that income received from leasing "high technology and medical equipment" to customers within Indiana was not subject to gross income tax. Id. at *5.

IC 6-2.1-2-2(a) imposes the gross income on the receipt of "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or domiciliary or Indiana." However, the Tax Court has found that certain rental income received from Indiana customers is not Indiana source income for gross income tax purposes.

In Enterprise, the court found that that money received from renting Indiana titled cars was not Indiana source income because it was not the petitioners who decided to register and operate the cars within the state. Enterprise 779 N.E.2d at 1291. Rather, it was the decision of the individual customers to register and operate the cars in Indiana. Id. The petitioners' activities in sending the cars to its customers "did not rise to the level of 'active participation' in the 'ownership, leasing' or rental' of property in Indiana." Id. The court determined that the "critical transaction" occurred related to the leasing of the cars occurred at the petitioners' out-of-state location. Id. at 1230.

Similarly, in Comdisco the court found that the petitioners' only Indiana activity was "ownership of high technology equipment that [was] located pursuant to the lessees' direction." Comdisco, 2002 Ind. Tax LEXIS 93 at *22.

The Department does not find that the decisions in Comdisco and Enterprise are dispositive of the question of whether lease payments received from gas stations located within Indiana are subject to gross income tax. In both those cases, the fact that the tangible personal property happened to be located within Indiana was unrelated to the "critical transaction" which formed the basis for the petitioners' income. In taxpayer's situation, the lease payments are derived from real property located within this state. The connection between Indiana and the leased gas stations is inherent in the nature of real property and is not simply the result of sheer happenstance or the lessees' unilateral decisions to locate the gas station within Indiana. The connection between the Indiana gas stations and the lease payments cannot be avoided by the fact that the lease agreements were executed at an out-of-state location or that the lease payments were directed to an out-of-state location.

Taxpayer's argument to the contrary, the analysis seems fairly straightforward. 45 IAC 1-1-49 states that, "[A] taxpayer may establish a 'business situs' in ways including, but not limited to, the following: (6) Ownership, leasing, rental or other operation of income producing (real or personal)." *See* 45 IAC 1.1-1-3(6). Taxpayer receives lease income attributable to gas stations located within Indiana. 45 IAC 1-1-28 provides that the income derived from "the lease or rental or real or tangible personal property, whether actually or constructively received are taxable at the high rate...." *See* 45 IAC 1.1-2-10. Income which is "constructively received" includes "items of gross income which are not actually received by the taxpayer but which are credited to him, available for his benefit, or represent income to which he is entitled." 45 IAC 1-1-10; *See* 45 IAC 1.1-1-5.

By means of its arrangement with the trust company and the oil company, taxpayer received income attributable to the leasing of gas stations located within Indiana. The Department disagrees with taxpayer's conclusion that it did not receive Indiana source income and that the income is not subject to the state's gross income tax.

FINDING

Taxpayer's protest is denied.

IV. Including the Value of Leased Property in Taxpayer's Property Factor – Adjusted Gross Income Tax.

Taxpayer argues that the audit review miscalculated its adjusted gross income tax liability by including the value of the leased gas station in its property factor.

Indiana imposes the adjusted gross income tax on each corporation's adjusted gross income derived from sources within this state. IC 6-3-2-1(b). Where a corporation – such as taxpayer – receives income from both Indiana and out-of-state sources, the amount of tax is determined by the apportionment formula set out in IC 6-3-2-1(b). That formula operates by multiplying taxpayer's total business income by a fraction composed of a property factor, a payroll factor, and a sales factor. IC 6-3-2-1(b). In this instance, taxpayer argues that the gas station properties should not have been included in the property factor.

The property factor is a fraction, "the numerator of which is the average value of the taxpayer's real and tangible personal property owned and rented and used in this state during the taxable year...." IC 6-3-2-1(c). Under taxpayer's calculation, reducing the property factor numerator to "zero" would have the effect of reducing taxpayer's adjusted gross income tax liability to "zero." Taxpayer argues that it did not "use" the Indiana gas stations and points to the Tax Court's decision in Enterprise 779 N.E.2d at 1294 to support its argument that the gas stations should be excluded from the property factor numerator.

Setting aside the question of whether the Enterprise decision – dealing with the issue of whether the value of rental cars should be included in the property factor numerator – is relevant to the real property at issue here, the Department concludes the audit was correct in apportioning taxpayer's income based, in part, on the value of the leased gas stations. Clearly, taxpayer received income attributable to the Indiana gas station locations. Taxpayer's contention that these gas station properties should be eliminated from the apportionment factors would have the effect of eliminating taxpayer's Indiana income tax liability on the ground that it did not "use" these properties. The Department finds little support for such a result in fact, law, or common sense.

IC 6-3-2-2(l) provides as follows:

If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or *the department may require* in respect to all or any part of the taxpayer's business, if reasonable... (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana...." (*Emphasis added*).

The Department does not agree with the notion that disregarding entirely the value of the gas station properties would "fairly represent the taxpayer's income." The audit's decision to include the value of Indiana properties was entirely appropriate in order to "fairly represent the taxpayer's income derived from sources with the state of Indiana...." Id.

FINDING

Taxpayer's protest is respectfully denied.

V. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer maintains that the ten-percent negligence penalty should be abated because based upon "instructions issued by the Department, the actions of the Department and the relevant facts" its tax reporting was not negligent.

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...."

Although unwilling to agree that the taxpayer's tax reporting errors were the result of actions or instructions attributable to the Indiana Department of Revenue, 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

4320020336.LOF

LETTER OF FINDINGS NUMBER: 02-0336
Underground Storage Tank Fee
For the Years 1991-2002

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

ISSUES

I. Underground Storage Tank Fee-Imposition

Authority: IC 13-23-12-1, IC 13-12-12-4, IC 6-8.1-1-1, IC 6-8.1-5-1 (b).

The taxpayer protests the imposition of the underground storage tank fees.

II. Tax Administration-Statute of Limitations

Authority: IC 6-8.1-5-2(a), IC 6-8.1-5-2(e).

The taxpayer contends that certain assessments are barred by the Statute of Limitations.

III. Tax Administration-Penalties

Authority: IC 13-23-12-7(a), IC 8.1-5-2(a), 45 IAC 15-11-2 (b).

The taxpayer protests the imposition of penalties.

STATEMENT OF FACTS

The taxpayer is an out-of-state corporation with underground storage tanks at facilities in Indiana. After a review of the taxpayer's payment of underground storage tank fees, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional underground storage tank fees, interest, and penalty. The taxpayer protested the imposition of the fees, interest, and penalty. A hearing was held and this Letter of Findings results.

I. Underground Storage Tank Fee-Imposition

DISCUSSION

IC 13-23-12-1 imposes a fee on underground storage tanks that have not been closed before July 1 of any year. Although the Indiana Department of Environmental Management, hereinafter referred to as IDEM, administers the state regulation of underground storage tanks, IC 13-12-12-4 mandates that the department collect and deposit the underground storage tank fees. IC 6-8.1-1-1 defines "listed tax" to include "any other tax or fee that the department is required to collect or administer." Since the department pursuant to statute must collect the underground storage tank fees, these fees constitute listed taxes. All of the laws and regulations concerning the department's collection of listed taxes apply to the department's collection of the underground storage tank fees. All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The taxpayer argued that several of the underground storage tanks were closed during the time period of the assessment. Pursuant to the imposition statute, there is no fee unless there is an operational underground storage tank. The taxpayer presented substantial evidence that several underground storage tanks were closed. Therefore, the taxpayer would not owe the fees assessed after the closure of the underground storage tanks. The specific tanks and the dates of closure follow.

Facility Number	Date of Closure
009482	8/12/1999
002111	12/20/1999
002107	8/12/1999
00406	8/16/1999
10945	4/04/2000
24040	8/08/1999
24041	8/19/1999

The taxpayer also argues that during the assessment period, it did not own, lease, or operate underground storage tanks at facility numbers 24042, 002110, and 002109. The taxpayer did not provide documentation adequate to sustain its burden of proving that it did not own, operate, or lease underground storage tanks at facility numbers 002110 and 002109. The taxpayer did provide documentation adequate to sustain its burden of proving that it did not own, operate, or lease underground storage tanks at facility number 24042.

FINDING

The taxpayer's protest to underground storage tank fees assessed on underground storage tanks after their closing is sustained. The taxpayer's protest to the underground storage fees assessed on facility 24042 is sustained. The taxpayer's other protests are denied.

II. Tax Administration-Statute of Limitations

DISCUSSION

IC 6-8.1-5-2(a) limits the time in which the department may issue a proposed assessment as follows:

> Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed, or any of the following:
>
> (1) the due date of the return;...

The taxpayer argues that the department violated the Statute of Limitations by levying the proposed assessments more than three (3) years after the due dates of the returns. The department agrees that it waited more than three years from the due dates of the returns to file many of the assessments. The department's delay in the issuance of the assessments is not, however, a fatal error in this situation pursuant to the provisions of IC 6-8.1-5-2(e) as follows:

> If a person files a fraudulent, unsigned, or substantially blank return, or if a person does not file a return, there is no time limit within which the department must issue its proposed assessment.

In this case, the taxpayer did not file a return for any of the individual proposed assessments protested in this cause. The taxpayer argues that it did file some returns and that should start the statute running on every underground storage tank fee. The taxpayer errs in this conclusion. The taxable event at issue is the annual fee due for each underground storage tank. Returns must be filed and taxes paid for each taxable event. Any return filed and fee paid merely starts the running of the Statute of Limitations on future proposed assessments by the department relating to that particular taxable event. None of the department's proposed assessments are for taxable events for which the taxpayer filed a return or paid the fee. Therefore, the Statute of Limitations does not bar these assessments.

FINDING

The taxpayer's protest is denied.

III. Tax Administration-Penalties

DISCUSSION

Two types of penalties were imposed in this case. The taxpayer protests both impositions of penalty. The first is an IDEM penalty in the amount of six thousand dollars ($6,000) imposed pursuant to IC 13-23-12-7(a) as follows:

An owner of an underground storage tank who:

(1) is required to pay the fee under section 1 of this chapter; and

(2) fails to pay the fee when due as established under section 2 of this chapter; shall be assessed a penalty of not more than two thousand dollars ($2,000) per underground storage tank for each year that passes after the fee becomes due and before the fee is paid.

IDEM is granted great discretion in determining whether this penalty applies in any situation and how much the penalty should be. The taxpayer did not provide any documentation indicating that IDEM abused its discretion in the imposition of this penalty. Therefore, the imposition of the IDEM penalty is appropriate in this matter.

The taxpayer also 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.

The filing of some returns and payment of some underground storage tank fees indicates that the taxpayer was aware of its duty to file returns and pay the fees. Through its inattention to the duties imposed upon it by the Indiana Code, the taxpayer repeatedly breached this duty. These breaches of the taxpayer's duty constitute negligence.

FINDING

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

DEPARTMENT OF STATE REVENUE

0420020339.LOF

LETTER OF FINDINGS NUMBER: 02-0339
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-Accommodation Sales

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-2-1, IC 6-2.5-4-4(a), *Park 100 Development v. Indiana Department of State Revenue*, 429 N.E.2d 220, (Ind. 1981).

STATEMENT OF FACTS

The taxpayer is an Indiana corporation which provides specialized, technical computer training services. In some instances, the taxpayer provides the facility but not the trainer. In those instances, the clients provide their own trainer. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use taxes. The taxpayer protested the imposition of sales tax on the fees paid for use of the facilities when the taxpayer did not provide the trainer. A hearing was held on this issue.

I. Sales and Use Tax-Accommodation Sales

DISCUSSION

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b). Indiana imposes an excise tax, the sales tax, on sales of tangible personal property by retail merchants in retail transactions. Purchasers are liable for the sales tax that the retail merchants collect and remit to the state. IC 6-2.5-2-1. There is no sales tax imposed on services unless the law specifically defines the provision of a particular service as a retail transaction subject to the sales tax. It is well established that laws imposing a tax are strictly construed against the department unless an exemption statute is being interpreted. *Park 100 Development v. Indiana Department of State Revenue*, 429 N.E.2d 220, (Ind. 1981).

In the taxpayer's situation, the department found that the taxpayer's provision of training services in its facilities were the provision of services not subject to the sales tax. The department imposed the sales tax on the taxpayer's sales to clients who provided their own instructors. The department based its assessment on the definition of leasing accommodations as a retail transaction subject to sales tax at IC 6-2.5-4-4(a) as follows:

> A person is a retail merchant making a retail transaction when the person rents or furnishes rooms, lodgings, or other accommodations, such as booths, display spaces, banquet facilities, and cubicles or spaces used for adult relaxation, massage, modeling, dancing, or other entertainment to another person: (1) if those rooms, lodgings, or accommodations are rented or furnished for periods of less than thirty (30) days; and (2) if the rooms, lodgings, and accommodations are located in a hotel, motel, inn, tourist camp, tourist cabin, gymnasium, hall, coliseum, or other place, where rooms, lodgings, or accommodations are regularly furnished for consideration.

The taxpayer contends that even when it does not provide the instructor, it is actually providing a service and selling its technical computer knowledge rather than leasing an accommodation subject to sales tax. The taxpayer bases this contention on the comparison of its agreement with its clients to leases at typical conference centers in the same geographic area. The taxpayer's rates for a day are significantly above those documented in the file at other area conference centers. The taxpayer contends that these higher rates reflect that the contract is actually for the provision of services and sale of its computer knowledge at the taxpayer's location rather than the lease of a meeting facility.

The taxpayer's argument is unpersuasive. Although their higher rates reflect the greater services involved in the set up of the equipment provided with the rental accommodation, this is a quantitative difference. It does not change the basic character of the contract from the rental of a room with equipment ready to operate.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20020433.LOF

LETTER OF FINDINGS NUMBER: 02-0433
SALES AND USE TAX
For Years 1999 and 2000

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. Sales & Use Tax – Public transportation exemption

Authority: IC 6-2.5-5-27; *Panhandle Eastern Pipeline Co. v. Indiana Dept. of State Revenue*, 741 N.E.2d 816 (Ind. Tax Ct. 2001); *Indiana Waste Systems of Indiana, Inc. v. Indiana Dept. of State Revenue*, 644 N.E.2d 960 (Ind. Tax Ct. 1994).

Taxpayer protests the imposition of gross retail tax on purchases made that, in the opinion of taxpayer, fall under the public transportation exemption.

STATEMENT OF FACTS

Taxpayer is in the grain-handling business. Its activities include, but are not limited to, the drying, storing, and hauling of grain. Taxpayer is also engaged in the purchase and resale of grain, lime, rock, chemicals, and fertilizer. A significant portion of taxpayer's revenue is derived from the transportation of tomatoes for a third party.

DISCUSSION

I. Sales & Use Tax – Public transportation exemption

Taxpayer believes that the transactions in question are exempt from state gross retail tax under IC 6-2.5-5-27. This statute provides that transactions involving 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. IC 6-2.5-5-27. Taxpayer is attempting to apply this statute to transactions that concerned its truck hauling activities.

In *Panhandle Eastern Pipeline Co. v. Indiana Dept. of State Revenue*, 741 N.E.2d 816 (Ind. Tax Ct. 2001), the court set out what the Department extrapolates to be a two-pronged test to determine if a particular business qualifies for the public transportation exemption. The language used by the court in *Panhandle* reads as follows:

> 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.

The two-pronged test the Department extrapolates is as follows:

1. The taxpayer must be predominately engaged in public transportation of the property of another; and
2. The taxpayer's property must be predominately used for providing public transportation.

The Department conceded that taxpayer meets the second prong of the test; the equipment at issue is predominately used for the provision of public transportation. This protest concerns the first prong of the test; namely whether or not taxpayer is *predominately engaged* in public transportation of another (emphasis added). *Panhandle* stands for the notion that the taxpayer is either entitled to a complete exemption from taxation or no exemption at all – there are no partial exemptions.

In this instance, the key analysis to be undertaken then is, at what point does a taxpayer's business become predominately engaged in public transportation? The Department and the taxpayer give very different yet plausible measuring sticks that reach different results.

The Department contends the benchmark should be the taxpayer's gross income. In the tax years in question, taxpayer's gross income from the transportation of the property of another as compared to its total revenues from all activities was 24% and 21% respectively.

On the other hand, taxpayer contends the true measure of its business is "transportation miles traveled." This factor looks solely at the number of miles that the trucks were used for hauling and takes the miles traveled for the benefit of another and compares it with total miles hauled. In 1999 and 2000, those ratios were 82% and 72% respectively.

The figures from which these ratios are derived, in both situations, are uncontested. It is also uncontested that if the Department's analysis is accepted, the taxpayer is not exempt; whereas if the taxpayer's analysis is accepted, it would be exempt.

The Court in *Panhandle* doesn't give any clear guidance as to what factors should be considered when determining if a taxpayer's business is predominately engaged in public transportation. As it is, the potential factors are virtually limitless.

The Department's position rests upon an analysis of the taxpayer's hauling business for others as a function of its overall business activities (e.g. the selling of grain produces revenues that, though unrelated to the process of hauling, are factored into the analysis). Alternatively, taxpayer's position rests upon an analysis of the taxpayer's hauling business for others as a function of its overall hauling business, absent any consideration of its other business activities (i.e. any revenues from activities such as the selling of grain are completely ignored).

The statute in question (IC 6-2.5-5-27) makes no reference to the business of the taxpayer as a whole. An argument could be made, however, that the first prong of the *Panhandle* test requires such an analysis. In *Indiana Waste Systems of Indiana, Inc. v. Indiana Dept. of State Revenue*, 644 N.E.2d 960 (Ind. Tax Ct. 1994), the court found against the taxpayer because its public transportation revenue equaled 17.7% or less of its gross revenue on a yearly basis:

> Waste Management's maximum annual revenue from public transportation was 17.7 percent of its total revenue, and therefore, the remaining 80 plus percent of its revenue came from non-public transportation.

In finding that the taxpayer was not entitled to the public transportation exemption, the court analyzed the business of a taxpayer that was exclusively in the transportation business. The case turned on whether or not the equipment was "predominately used" in public or non-public transportation. And while that issue is not contested here, the analysis is still relevant for determining whether or not a taxpayer is "predominately engaged" in the transportation of property of another.

Taxpayer's "miles traveled" position serves taxpayer well in satisfying the second (predominately used) prong of the public transportation test. Through it, taxpayer has demonstrated that when its trucks are used to haul property, about three times out of four it does so with a third party's property. This shows that taxpayer's equipment is "predominately used" in public transportation. But the Department is in agreement on this issue, and it does nothing to show that taxpayer is "predominately engaged" in the business of public transportation.

The plain language of *Panhandle* is that the taxpayer must be predominately engaged in the transportation of the property of another. For one to be predominately engaged in something implies a look at the big picture – are the majority of taxpayer's activities considered public transportation? The answer, in this instance, is no.

During the tax years in question, taxpayer never reported more than 24% of its income from activities deemed to be public transportation. The majority of its income – the bulk of the remaining 76% **-** comes from the selling of grain and other related activities. Therefore, taxpayer is more appropriately classified as being predominately engaged in grain sales, not public transportation, and therefore taxpayer fails the first prong of the test.

FINDINGS

The taxpayer is respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20020508.LOF

LETTER OF FINDINGS NUMBER: 02-0508
SALES/USE TAX
For Years 1999 and 2000

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. Use Tax – Definition of a contractor

Authority: 45 IAC 2.2-3-7(a)

Taxpayer protests it being defined as a contractor as stated in the statutes.

II. Use Tax – Violative of the Constitution

Authority: None cited

Taxpayer asserts that the disparate treatment of tools and machinery as determined according to the location where the project is undertaken violates the Constitution.

III. Use Tax – Imposition of the use tax on the purchase of items used in the digging of wells

Authority: § 6-2.5-3-2; 45 IAC 2.2-3-12(c)

Taxpayer asserts that, because its customers are exempt from gross retail tax, it should share in that exempt status.

IV. Use Tax – Disparity of treatment of oil and water extraction

Authority: § 6-2.5-4-5

Taxpayer claims that those taxpayers in the business of extracting water are treated differently from those taxpayers that extract oil.

STATEMENT OF FACTS

Taxpayer is in the business of drilling water wells and installing pumps and plumbing for residences, farms, and commercial entities in order to provide water for livestock and human consumption. It also repairs and replaces equipment that is used to extract water from the ground. Taxpayer performs lump sum contracts and time and material contracts.

DISCUSSION

I. Use Tax – Definition of a contractor

In both its written appeal and at the hearing, taxpayer denies that it fits the definition of a contractor as defined in the statutes without any explanation as to why the definition fails.

45 IAC 2.2-3-7(a) gives a definition of a contractor for use in the sales and use tax scheme. It states:

> (a) **Contractors**. For purposes of this regulation [45 IAC 2.2] "contractor" means 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. (Emphasis added).

Presumably, taxpayer's argument is that because well digging is not one of the enumerated examples of activities within the purview of what constitutes a "contractor," it ipso facto must not be one. Such is not the case, however, as the italicized wording of the statute indicates that the list is not all-inclusive.

Activities such as carpentry, roofing, electrical work, and especially plumbing and excavating, all point to the same overall goal – the production of a finished product of a structure attached to real property that is suitable to its inhabitant. Well digging would very much lend itself to being included in that list, as the digging of a well leads to the habitability of the structure. Therefore, the digging of wells is within the activities contemplated by the language "including but not limited to."

Also, taxpayer is engaged in the well-digging business. Its products and services are used by its customers to extract water from the ground. The wells become a part of the real property of the customer, be it a residence, farm, commercial building, etc. Therefore, through its conversion of water-extracting products along with services that ultimately bring water to its customers, taxpayer is converting construction material into realty. Taxpayer presents no evidence to refute this notion.

Taxpayer also points to the fact that its customers are involved in the process of "extracting" water from the earth. Extracting is also absent from the list of enumerated activities in the statutory definition of a contractor. In this case, it is unnecessary to decide whether or not the process of extracting is contemplated by the "including but not limited to" language, because the argument is invalid on its face. Taxpayer may not make use of its customers arguments in this situation. It is taxpayer's customers that undertake the extraction of water from the ground, not the taxpayer itself. Therefore, taxpayer may not make use of this argument.

FINDINGS

The taxpayer is respectfully denied.

II. Use Tax – Violative of the Constitution

DISCUSSION

The taxpayer apparently believes that the sales and use tax statutes are violative of the Constitution. Taxpayer doesn't state which statutes in particular are unconstitutional, nor does it name a particular clause of the Constitution that is being violated. Therefore, given the paucity of taxpayer's argument, the presumption of constitutionality afforded state statutes, and the fact that an administrative hearing in the Indiana Department of Revenue is not the proper forum to challenge the constitutionality of tax statutes, the Department must decline to address this issue.

FINDINGS

The taxpayer is respectfully denied.

III. Use Tax – Imposition of the use tax on the purchase of items used in the digging of wells

DISCUSSION

A use tax is assessed under § 6-2.5-3-2, which reads:

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

Taxpayer purchased tools, equipment, repair parts, fuel, etc., that were used during construction and for which taxpayer neither paid Indiana gross retail tax nor remitted use tax to the Department. Taxpayer claims that, because its customers are exempt, it too should be exempt from use tax.

The Department need not reach a conclusion concerning the validity of the claim that taxpayer's customers are exempt from use tax, regardless of the theory that taxpayer espouses. The fact is that 45 IAC 2.2-3-12(c) already speaks to the issue:

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

The outcome is clear. Taxpayer may not make use of its customers' exemptions under these circumstances.

FINDINGS

The taxpayer is respectfully denied.

IV. Use Tax – Disparity of treatment of oil and water extraction

Taxpayer believes that those companies engaged in the business of water extraction are unfairly treated from those companies engaged in the business of oil extraction. Taxpayer cites to no specific deferential treatment upon which to base its claim.

The only statute that appears on point is § 6-2.5-4-5, which defines the term "power subsidiary." These statutes would seemingly only apply to the transaction between the taxpayer and its customers – transactions that are not at issue under the circumstances. The transactions at issue here are the purchases of equipment by the taxpayer from retail merchants. The taxpayer's customers don't enter the equation.

Finally, because such a disparate treatment argument lends itself to a Constitutional analysis, an administrative hearing is an inappropriate forum to entertain such arguments, as was mentioned in Issue II above.

FINDINGS

The taxpayer is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220020510.LOF

LETTER OF FINDINGS: 02-0510
Indiana Corporate Income Tax
For the Tax Years 1999, 2000, and 2001

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

ISSUES

I. Sale of Inventory Held in Consignment – Gross Income Tax.

Authority: IC 6-2.1-1-13; IC 6-2.1-2-2; IC 6-2.1-3-3; Reynolds Metals Co. v. Indiana Dept. of State Revenue, 433 N.E.2d 1 (Ind. App. 1982); 45 IAC 1.1-1-3(a).

Taxpayer argues that the income received from the sales of inventory held on consignment within Indiana was not subject to gross income tax.

II. Abatement of the Ten-Percent Negligence Penalty.

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

Taxpayer maintains that the Department of Revenue (Department) should exercise its discretion and abate the ten-percent negligence penalty assessed at the time of the audit examination.

STATEMENT OF FACTS

Taxpayer is an Illinois based company in the business of manufacturing and selling telephone equipment. Taxpayer maintains an inventory of equipment at two of its Indiana customers' locations. Taxpayer also has an Indiana based employee who deals with its Indiana customers. The Department conducted an audit of taxpayer's federal and state income tax returns. The audit review resulted in a number of adjustments. The taxpayer disagreed with one of the gross income tax adjustments and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer challenged the basis for the gross income tax adjustment. This Letter of Findings results.

DISCUSSION

I. Sale of Inventory Held in Consignment – Gross Income Tax.

Taxpayer sells its telephone equipment to various Indiana customers. In order to facilitate sales to two of its major Indiana customers, taxpayer maintains an inventory of equipment at the location of the two Indiana customers. Taxpayer ships its equipment to the customers and retains ownership of the equipment until the customers have need of that equipment. The inventory arrangement has both a formal, contractual component and is also based upon long-standing extra-contractual understandings with the two major customers.

The taxpayer and the two customers agree in advance on what items should be maintained in inventory. The two customers are able to remove equipment from inventory on an "as-needed" basis. The customers do not need to obtain permission from the taxpayer before removing equipment from inventory. With the first of these customers, taxpayer makes a monthly reconciliation of the equipment held in inventory. Thereafter, taxpayer bills that particular customer for the amount of equipment used. With the second Indiana customer, transfers of equipment are electronically recorded and reconciled. Billing occurs on a continuing basis with the second customer.

Although taxpayer retains ownership of the equipment until removed from inventory, the two Indiana customers bear the risk of loss while the equipment is stored at the taxpayers' warehouses.

By contract, the customers are required to eventually purchase all of the equipment placed into inventory at the customers' locations. In practice and in order to maintain a good customer relationship, equipment which is not eventually acquired and used by the customers, is returned to taxpayer.

The audit determined that taxpayer should have been paying gross income tax on the money earned from the in-state inventory sales. Taxpayer disagrees arguing that these are interstate Illinois-to-Indiana sales, that the sales are conducted in interstate commerce, and the income is exempt from Indiana gross income tax.

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

In addition to the specific exemptions allowed within the gross income tax scheme, IC 6-2.1-3-3 codifies the constitutional limits placed upon the individual states by the Interstate Commerce Clause. U.S. Const. art. I, § 8. Specifically, IC 6-2.1-3-3 provides, "Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing the gross income by the Unites States Constitution."

In support of its argument that the income is exempt, taxpayer relies on <u>Reynolds Metals Co. v. Indiana Dept. of State Revenue</u>, 433 N.E.2d 1 (Ind. App. 1982). In that case, the court found that the income Virginia-based Reynolds received from consignment sales was not subject to Indiana gross income tax. <u>Id</u>. at 18. Specifically, taxpayer points to the court's statement that, "The mere maintenance of a security interest in goods located within the state is not sufficient nexus with [Indiana] to justify the imposition of tax upon the secured party...." <u>Id</u>. Taxpayer argues that it is entitled to the same tax treatment as Reynolds; taxpayer states that, "these sales from the consignment inventory are in form no different than the sales [taxpayer] makes these customers which do not come out of that consignment inventory."

However, the court in <u>Reynolds</u> found that the income was exempt because "[t]he products were shipped, upon order for a stated price, warehoused in consignee's warehouse, (not Reynolds') and insured by the consignee who paid the property tax, and the consignee was given power under the contract and the UCC to defeat Reynolds' title by sale to any person it desired in the normal course of business in its own name, at a price suitable to the consignee." <u>Id</u>. The facts in the <u>Reynolds</u> case are not identical to the taxpayer's own inventory-transactions. In <u>Reynolds</u>, the out-of-state petitioner was transferring the property to Indiana distributors which – in turn – sold the property to Indiana customers. However, taxpayer does not place the telephone equipment at the two Indiana locations in order to allow the two Indiana customers to sell the equipment to third-parties. Taxpayer maintains an inventory of equipment inside Indiana and sells that equipment to the two Indiana customers. The taxpayer does not merely retain a security interest in the property; taxpayer owns the equipment until such time as the Indiana customer decides it needs the equipment. Taxpayer maintains the inventory, the Indiana customers take the equipment out of inventory, and the customers pay for the equipment. Unlike <u>Reynolds</u>, taxpayer is not simply maintaining a transitory security interest in the equipment; taxpayer owns the equipment stored in Indiana until the time arrives that the customers have need of the equipment and remove the equipment from the inventory of available goods.

By placing the equipment on consignment at the Indiana locations, taxpayer has established an Indiana "business situs." 45 IAC 1.1-1-3(a) states that, "A 'business situs' arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile." Among other activities, an out-of-state entity may establish an Indiana business situs by "[m]aintenance of an inventory or stocks of goods for sale, distribution, or manufacture." Taxpayer's Indiana business situs is based upon its consignment inventory of telephone equipment over which its exercises possession and control.

Because taxpayer has maintained an inventory of telephone equipment within Indiana, it has established a "business situs." When taxpayer was paid for the equipment in that inventory, taxpayer received "taxable gross income derived from activities... within Indiana...." IC 6-2.1-2-2(a)(2).

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer requests that the Department abate the ten-percent negligence. Taxpayer maintains that it acted in good faith depending on the expertise provided by third-party tax preparers and on the Reynolds decision.

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 agrees that taxpayer's failure to report income received from Indiana consignment sales was not the result of a "failure to use such 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 sustained.

DEPARTMENT OF STATE REVENUE

0420030076.LOF

LETTER OF FINDINGS: 03-0076
Indiana Sales and Use Tax
For 1999, 2000, and 2001

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

ISSUE

I. Leased Automobiles – Sales and Use Tax.

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2; IC 6-18-2-1(a); Hi-Way Dispatch, Inc. v. Indiana Dept. of State Revenue, 756 N.E.2d 587 (Ind. Tax Ct. 2001); 45 IAC 2.2-3-5(b); 45 IAC 2.2-4-27(a); 45 IAC 2.2-4-27(b); 45 IAC 2.2-4-27(c); Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that it was not required to collect Indiana sales tax at the time it leased cars to Indiana residents.

STATEMENT OF FACTS

Taxpayer is an out-of-state automobile dealer. Taxpayer sells used cars and also leases used cars. The vehicles are leased to both Indiana and out-of-state residents. Taxpayer retains the leases during the life-time of the agreements. Taxpayer states that before 1999, it was unaware that it was required to collect Indiana sales tax for lease transactions made with Indiana residents. After 1999, taxpayer registered to collect Indiana sales tax. However, taxpayer did not collect sales tax from all Indiana lessees. In some instances, the Indiana lessees apparently chose to register their vehicles in taxpayer's home state. In those instances, the taxpayer collected that home state's sales tax.

The Indiana Department of Revenue conducted a review of taxpayer's business records and concluded that taxpayer should have been collecting sales tax on lease payments received from Indiana residents. Taxpayer disagreed with this conclusion, submitted a protest to that effect, an administrative hearing was conducted during which taxpayer explained the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. Leased Automobiles – Sales and Use Tax.

The issue is whether taxpayer should have been collecting sales on vehicles purchased by Indiana residents but which were purportedly registered at the out-of-state location. In addition, the issue is whether taxpayer should be assessed additional sales tax on leases entered into with Indiana residents before the time taxpayer registered with Indiana to collect the tax.

Taxpayer also sets out a secondary argument. Taxpayer maintains that officials with both the Indiana Motor Vehicle Department and the Department of Revenue (Department) misinformed the taxpayer leading it to believe that it was not required to collect sales tax on leases with Indiana residents when those vehicles were registered at the out-of-state location.

A. Automobile Leases.

Indiana imposes a sales tax on retail transactions, IC 6-2.5-2-1, and a complementary use tax on tangible personal property that is stored, used, or consumed within the state. IC 6-2.5-3-2.

The regulation states that money received from leasing automobiles is subject to sales tax. "In general, the gross receipts from renting or leasing tangible personal property are taxable." 45 IAC 2.2-4-27(a). For purposes of determining the applicability of the tax, the lessor is designated as a "retail merchant," and the lease arrangement is designated as a "retail transaction." 45 IAC 2.2-4-27(b). In addition, the regulation makes no distinction between in-state and out-of-state lessors. "Every person engaged in the business of the rental or leasing of tangible personal property... shall be deemed to be a retail merchant in respect thereto and such rental or leasing transaction shall constitute a retail transaction subject to the state gross retail tax on the amount of the actual receipts from such rental or leasing." Id. The in-state or out-of-state lessor is specifically charged with the responsibility of collecting the use tax. "The lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts as agent for the state of Indiana." 45 IAC 2.2-4-27(c).

Therefore, because taxpayer was leasing vehicles to Indiana residents, taxpayer was a "retail merchant" engaging in "retail transactions" and had the responsibility of collecting Indiana sales tax. "The sale of any vehicle required to be licensed by the state for highway use in Indiana shall constitute selling at retail and shall be subject to the sales or use tax unless such purchaser is entitled to one of more... exemption[]." 45 IAC 2.2-3-5(b).

IC 6-18-2-1(a) requires that all Indiana residents – with certain limited exceptions – must register their vehicles with this state. "Within sixty (60) days of becoming an Indiana resident, a person must register all motor vehicles owned by the person that (1) are subject to the motor vehicle excise tax under IC 6-6-5; and (2) will be operated in Indiana." Therefore, when the taxpayer leases a car to an Indiana resident – and the vehicle is used in this state – the taxpayer must collect the sales tax on the lease payments. The only possible exception would be under a set of circumstances in which the Indiana lessee leases a vehicle that is not used in Indiana and is not subject to the state's motor vehicle excise tax.

B. Equitable Estoppel.

Nonetheless, taxpayer argues that the additional assessment of previously uncollected sales tax cannot stand because taxpayer – with the best of intentions – relied to his detriment on the erroneous advice provided by both the Department and the Indiana Bureau of Motor Vehicles. According to taxpayer, it consulted with nearby state officials who advised taxpayer that – as an out-of-state business – it was not necessary to collect sales tax. In addition, taxpayer was purportedly informed that it was unnecessary to collect sales tax from Indiana residents when the subject vehicles were licensed outside
Indiana. In effect, taxpayer is setting out an equitable estoppel argument; because the taxpayer depended on the state to provide correct sales tax information and to clarify any incorrect information, the Department may not now belatedly require that taxpayer pay previously uncollected sales tax.

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 argues that the Indiana officials induced taxpayer into believing it was not necessary to collect sales tax from Indiana residents. Taxpayer maintains that, after having relied upon repeated statements of qualified state representatives, 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 both the Department and the Indiana Bureau of Motor Vehicles to its detriment – the Department does not conclude that the incorrect advice ever threatened the public's interest. Taxpayer may indeed have relied in good faith upon the incorrect advice offered by state officials; nonetheless, the Department is in no position to abate the sales tax assessment on the ground that taxpayer received misleading or incorrect information.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220030187P.LOF

LETTER OF FINDINGS NUMBER: 03-0187P
Income Tax
Periods Ending November 1, 1997 Through October 30, 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. Tax Administration – Penalty

Authority: IC 6-8.1-5-1; 45 IAC 15-11-2

The taxpayer protests the assessment of a penalty.

STATEMENT OF FACTS

The taxpayer operates retail jewelry stores in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty assessment be abated. The taxpayer states,

We respectfully request an abatement of the penalty amounts due to reasonable cause and timely payment/filing history.

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 auditor contends that the taxpayer was negligent since it failed to accurately report taxable income. Under IC 6-8.1-5-1 the burden of proof is on the taxpayer and the Department's assessment is considered as *prima facie* valid. The taxpayer offers no arguments or evidence, and merely asserts "reasonable cause." As such, the taxpayer's penalty protest is denied.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0320030200P.LOF

LETTER OF FINDINGS NUMBER: 03-0200P
Withholding Tax
For the Month January 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 superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Bad Check Penalty

Authority: IC 6-8.1-10-5

The taxpayer protests the bad check penalty.

STATEMENT OF FACTS

The bad check penalty was assessed on a returned check resulting from a withholding tax return filed for the month of January 2003.

The taxpayer is a small corporation.

I. Tax Administration – Bad Check Penalty

DISCUSSION

The taxpayer requests waiver of the 100% bad check penalty as the error was unintentional and the result of the taxpayer failing to sign the original check that was sent to the Department for payment of the monthly withholding taxes. Furthermore, the taxpayer states the taxpayer did not receive the original notice.

The Department points out that the point of contention for the 100% bad check penalty is whether or not the taxpayer received the original notice sent by the Department on March 10, 2003. The taxpayer says the original notice was not received. Department records indicate the notice was sent to the correct address. According to statutory regulations, if Department records indicate the billing is sent to the correct address, the mailing of the billing is considered legally valid.

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

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

The Department finds the taxpayer was inattentive to tax duties as Department records indicate the original notice was sent to the taxpayer and the taxpayer did not respond to the billing until the 100 % penalty Demand Notice was sent to the taxpayer. Inattention is negligence and negligence is subject to 100% 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

0320030210P.LOF

LETTER OF FINDINGS NUMBER: 03-0210P
Withholding Tax
For the Month of May 2001

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed for the late filing of the monthly withholding tax return for May 2001.

The taxpayer is a corporation domiciled in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be waived as the Department took too much time, almost two years, in sending the original proposed assessment to the taxpayer. Because of the lengthy time, the taxpayer was unable to review the filing records as the filing records are in storage at the taxpayer's place of business and it is difficult for the taxpayer to access the records needed to research the discrepancy.

The Department points out the statute of limitations is three years in this instance both for the taxpayer and the Department. As the Department sent the notice within the three year period, the notice is legally deemed to be timely sent.

The burden of proof in this situation is on the taxpayer. It is the taxpayer's responsibility to provide the records which will support the taxpayer's contention the penalty should be waived. Nevertheless, the Department does have the records and the records show the taxpayer filed three days late.

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 of 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

0220030262P.LOF

LETTER OF FINDINGS NUMBER: 03-0262P
Income Tax
Calendar Year 2001

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late filing of a "no activity" income tax return for the calendar year 2001.

The taxpayer is a company located in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the late penalty should be waived as the error was the result of an assumption. The attorney in question filed with the Secretary of State papers for the initiation of the company. The attorney assumed the Secretary of State's papers would suffice as there was no transfer of assets to the taxpayer until the following year. This situation resulted in the income tax return being filed late by the taxpayer's accountant.

The Department points out that the State of Indiana's regulations require the filing of an income tax return for a tax year where there is no tax liability.

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

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

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

42-20030271.LOF

LETTER OF FINDINGS NUMBER: 03-0271 IRP & IFTA
International Registration Plan (IRP)
International Fuel Tax Agreement (IFTA)
For Years 1996, 1997, AND 1998

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

ISSUES

I. IRP – Assessment

Authority: 1999 IRP Information Handbook; IRP 232

Registrant protests auditor's classification of his records as "Inadequate," and the resulting assessments.

II. IFTA – Assessment

Authority: IFTA.VII.R700; IFTA A550

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

STATEMENT OF FACTS

The Registrant/taxpayer owned and operated three road tractors during the audit period. Two of the road tractors were leased throughout the audit period and one was not leased. The registrant/taxpayer used the non-leased road tractor to perform transportation services for an Indiana oil company. The auditor determined that registrant/taxpayer's records for the audit were "non-existent" and deemed taxpayer/registrant's record keeping as inadequate for apportionment of mileage between the jurisdictions and to establish fuel tax liabilities. The auditor made both IRP and IFTA assessments. Registrant/taxpayer is protesting these adjustments and has provided documentation related to all three vehicles in the form of summaries of mileage and fuel used by them.

I. IRP – Assessment

DISCUSSION

For the IRP audit, registrant presented no mileage records relevant to the audit period and the auditor consequently found registrant's records inadequate and made appropriate assessments. These assessments were made both on fleet 1, the two leased vehicles, and fleet 2, the unleased vehicle. The assessments were based upon monthly statements prepared by the company who leased the vehicles (fleet 1) and based on the number of trips made to each known location which were identified from records supplied by the customer of registrant (fleet 2).

The 1999 IRP Information Handbook addresses this issue at IRP 232, which states:

"Operational Records" means documents supporting miles traveled in each jurisdiction and total miles traveled such as fuel reports, trip sheets and logs.

The reference on record keeping requirements is amplified on page 21, which states in relevant part:

Your operational records must be documents that support the miles traveled in each jurisdiction, and the total miles traveled.

Registrant protested the auditor's report that the registrant's recordkeeping was insufficient and the auditor's consequent assessment for IRP fees.

The additional documentation submitted by the registrant pursuant to this protest does not overcome this finding. The records submitted provide summaries that differ from the audit's conclusions, but they are simply summaries without required supporting documentation- such as fuel reports, trip sheets and logs- to sustain a reversal or revision of the audit's assessment.

FINDINGS

Registrant protest denied.

II. IFTA – Assessment

DISCUSSION

The department, pursuant to an IFTA audit, requested taxpayer records pursuant to IFTA Article VII, R700 requirements. After the assessment, taxpayer submitted a protest to the audit findings and assessment and provided additional documentation for review. For IFTA reporting purposes, the taxpayer was not responsible for the two leased vehicles (per the lease agreement). He was responsible for reporting the non-leased vehicle. The taxpayer failed to present any records to substantiate the reported information for the non-leased vehicle. The audit assessment relied on the records supplied by the customer of the taxpayer.

Taxpayer argues that by its calculations the fuel consumption used in the audit determination was incorrect. IFTA article A550 requires that in the absence of adequate records, a standard 4.00 MPG rate can be used to compute total fuel consumption. The auditor chose to use an average MPG of the leased vehicles (which had sufficient documentation to establish their MPG) to apply to the third vehicle, for which no records were available. This resulted in a MPG better for the taxpayer than the 4 MPG required by A550, yet taxpayer insisted that based on differences in the types of vehicles and loads carried by the third vehicle, its mileage should have been rated even better. Department would note that sufficient documentation would resolve this issue, and absent this the audit determination stands.

Taxpayer has presented summary documents to establish a lower assessment. Taxpayer does not cite any IFTA provisions to support the claim that summary documents can substitute for required source documentation. Taxpayer's arguments and evidence fail to provide proof that the assessment was either erroneous or excessive.

FINDINGS

Taxpayer protest denied.

DEPARTMENT OF STATE REVENUE

1020030306P.LOF

LETTER OF FINDINGS NUMBER: 03-0306P
Tax Administration—Penalty
Tax Administration—Interest
For the Years 1998-2000

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—Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests the 10% negligence penalty.

II. Tax Administration—Interest

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

Taxpayer protests the interest amount levied upon the base use tax owed to the Department.

STATEMENT OF FACTS

The penalty was proposed in the first instance because the auditor determined taxpayer had not reported any of his gross retail sales for the Marion County Food and Beverage Tax. Taxpayer argued in his protest letter that he had collected the tax, but did not know where to send it. Taxpayer submitted no evidence showing he had made a good-faith effort to determine where to send the collected tax.

Taxpayer is a retail vendor with a booth at the Indiana State Fair during the audit years at issue.

I. Tax Administration-Penalty

DISCUSSION

Penalty assessments depend on a number of factors outlined in the regulation cited *supra*, and can be waived based on a showing of sufficient cause:

> 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 did not act with reasonable care in that taxpayer did not report gross retail sales for the Marion County Food and Beverage Tax. Taxpayer did not remit the sales tax collected. Taxpayer admits he did not remit the collected tax; that admission is an admission of negligence. The Department denies taxpayer's request to abate the 10% penalty assessment.

FINDING

Taxpayer's request to abate the 10% negligence penalty is denied.

II. Tax Administration—Interest

DISCUSSION

Interest is imposed by the statute cited *supra*, and cannot be waived.

FINDING

Taxpayer's request to abate the interest assessment is denied.

DEPARTMENT OF STATE REVENUE

0420030311P.LOF

LETTER OF FINDINGS NUMBER: 03-0311P
Tax Administration—Penalty
Tax Administration—Interest
For the Years 1999-2001

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—Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests the 10% negligence penalty.

II. Tax Administration—Interest

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

Taxpayer protests the interest amount levied upon the base use tax owed to the Department.

STATEMENT OF FACTS

The penalty was proposed in the first instance because the auditor determined taxpayer had charged, remitted gross retail taxes on sales of windows, glass, and mirrors during the audit years at issue. Taxpayer argues she did not charge sales tax because she received misinformation from the Department.

Taxpayer does window replacements and repairs for residential and business customers in Indiana, Illinois, and Texas.

I. Tax Administration-Penalty

DISCUSSION

Penalty assessments depend on a number of factors outlined in the statute and regulation cited *supra*, and can be waived based on a showing of sufficient cause:

> 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 did not act with reasonable care in that taxpayer did not charge, collect, and remit gross retail taxes on windows, glass, and mirrors sold to customers. Taxpayer did not remit the sales tax collected. Taxpayer alleges she was misinformed; however, taxpayer also admits she did not collect the taxes due on gross retail sales; that admission is an admission of negligence. The Department denies taxpayer's request to abate the 10% penalty assessment.

FINDING

Taxpayer's request to abate the 10% negligence penalty is denied.

II. Tax Administration—Interest

DISCUSSION

Interest is imposed by the statute cited *supra*, and cannot be waived.

FINDING

Taxpayer's request to abate the interest assessment is denied.

DEPARTMENT OF STATE REVENUE

0320030316P.LOF

LETTER OF FINDINGS NUMBER: 03-0316P
Withholding Tax
For the Months of December 2002 and January 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 superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed for the late filing of monthly withholding tax returns for the period December 2002 and January 2003.

The taxpayer is a corporation domiciled in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be waived as the error is the result of a shortage of personnel.

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 of 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

0420030326P.LOF

LETTER OF FINDINGS NUMBER: 03-0326P
Sales & Use Tax
For the month of February 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 superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late filing of a monthly sales tax return for the month of February 2003.

The taxpayer is a company located in Indianapolis.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the late penalty should be waived as the error was the Post Office's error and not the taxpayer. The taxpayer mailed the tax return on the due date. The taxpayer says the Post Office erred as the Post Office put the next day's date on the mailing resulting in the return being one day late.

State of Indiana tax regulations require the Department to follow the federal postmark in determining timeliness of a particular mailing. In the instant case, the postmark shows the tax return was mailed one day late, and therefore, the Department considers the mailing a late filing. 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 of 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

04980558.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 98-0558
Sales and Use Tax
For the Years 1995, 1996, 1997

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

ISSUE

I. Sales and Use Tax- Manufacturing Exemption

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-3, 45 IAC 2.2-5-10 (c), Gross Income Tax Division v. National Bank and Trust Co., 79 N.E. 2d 651 (Ind. 1948), Indiana Department of Revenue v. Cave Stone, 457 N.E. 2d 520 (Ind. 1983).

The taxpayer protests the assessment of use tax on three items.

STATEMENT OF FACTS

The taxpayer is engaged in the processing of food products. Its customer is a major fast food chain. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional use tax, interest and penalty after an audit. The taxpayer protested the assessment and a hearing was held.

I. Sales and Use Tax-Manufacturing Exemption

DISCUSSION

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used or consumed in Indiana. A number of exemptions are available from use tax. All exemptions must be strictly construed against the party claiming the exemption. Gross Income Tax Division v. National Bank and Trust Co., 79 N.E. 2d 651 (Ind. 1948). IC 6-2.5-5-3 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."

The taxpayer protests the assessment of use tax on a laser printer, a conveyor belt and the flour corn machine used during the packaging of the product. The first issue to be determined is whether or not these items are used during or after the production process. 45 IAC 2.2-5-8 (d) defines the production process 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 items are packged in small groupings within plastic wrap to maintain freshness. The groupings wrapped in plastic are then transported to the boxing area on conveyer belts. The boxes are assembled and moved on a conveyor belt to the packaging area where the product is inserted. The flour corn machine is a mechanical device that presses the product during placement into the cardboard boxes. The laser prints information such as weight, count, supplier, run number and date directly onto the box. This information is not for the taxpayer's internal inventory control. Rather, the customer restaurants require the information so they know exactly what foodstuffs they are receiving and when and where the foodstuffs were produced, allow discussion of the quality of the product and to accommodate a recall if necessary. The customer restaurants are the final consumers of the product. They do not resell the plastic wrapped small groupings of the product. The restaurants take the product out of the plastic wrapping and serve them as part of a meal to their patrons. After the information is printed on the assembled and filled box, the taxpayer has completed the required packaging or production as defined in the regulation. Each of the items in the taxpayer's protest is used during the production process.

Secondly, it must be determined if the protested items qualify for exemption as directly used in the direct production of the taxpayer's product.

In Indiana Department of Revenue v. Cave Stone, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on foodstuffs and required packaging property during the production process.

Each of the protested items has a direct effect on the production of the taxpayer's final product. The processed food would not be marketable to the taxpayer's customers, the fast food restaurants, if the protested items did not perform their functions in the packaging of the foodstuffs. Each of the protested items is necessary and essential in the production of the taxpayer's final product.

FINDING

The taxpayer's protest is sustained.