NATURAL RESOURCES COMMISSION
Information Bulletin #38
February 1, 2004

SUBJECT: Implementation of the Indiana Groundwater Quality Standards at Coal Mines Regulated under IC 14-34

I. PURPOSE

The purpose of this nonrule policy is to provide guidance and added explanation of rules adopted by the Natural Resources Commission for implementation by the Department of Natural Resources, Division of Reclamation. These rules were given final adoption by the Commission on May 20, 2003 as amendments to 312 IAC 25 and are more particularly described as Legislative Services Document #02-104(F). They help implement the Indiana ground water standards established through the rules adopted by the Water Pollution Control Board that became effective March 6, 2002.

As required by IC 13-18-17-5, an agency with jurisdiction over an activity must adopt rules to apply the ground water quality standards adopted by the Water Pollution Control Board. As described in 327 IAC 2-11-2(b), when adopting rules an agency shall "…ensure that facilities, practices, and activities are designed and managed to eliminate or minimize, to the extent feasible, potential adverse impacts to the existing ground water quality by applying preventative action levels, design standards, a monitoring framework, or other regulatory methods." The amendments to 312 IAC 25 were developed in this context.

The amendments to 312 IAC 25 assist in the implementation of IC 14-34 (the Indiana Surface Mining Control and Reclamation Act or "Indiana SMCRA") governing surface coal mining and reclamation activities. The rules contain criteria for ground water classification, monitoring, and compliance that apply at sites regulated under Indiana SMCRA. This information bulletin has been developed to provide information concerning procedures and issues regarding the implementation of the rule amendments.

The following sections include a discussion of the background for the rulemaking, a section that describes the mines and associated activities that are subject to the rules, ground water classification, standards to be met, the establishment of a ground water management zone (or "GMZ"), the location at which the standards must be met, requirements for additional monitoring wells to serve as early detection wells, and the plans or actions that must occur if a standard is exceeded.

II. REGULATORY FRAMEWORK

The rules and their interpretations were developed within the context of existing state and federal mandates concerning coal mining. The existing program requires compliance with state water quality standards (IC 14-34-10-2(13), 312 IAC 25-6-12(c) and 25-6-76(c)). Coal mine operations are required to minimize disturbances to the prevailing hydrologic balance on the mine site and associated off site areas (IC 14-34-10-2(13)). Further, surface and underground coal mining activities must be planned, conducted, and designed to minimize changes to the prevailing hydrologic balance in the permit area and adjacent areas, to prevent material damage to the hydrologic balance outside the permit area, in order to prevent long term adverse changes in that balance which could result from those activities (312 IAC 25-6-12(a) and 25-6-76(a)). It is clear that this language recognizes the possibility of impacts beyond the permitted area. It is also clear that any such impacts, should they occur, must be minimized and must not materially damage the hydrologic balance outside the permit boundaries.

Indiana SMCRA and rules developed under Indiana SMCRA recognize the potential for impacts to occur beyond the permit area or to uncontrolled properties within the permit area. Existing standards already require replacement of any water supply when used for any legitimate purpose is diminished, contaminated, or interrupted by mining activities. The rules do not grant anyone a right to cause impacts to adjacent or uncontrolled properties. Rather, Indiana SMCRA and rules developed under Indiana SMCRA recognize that a permittee may follow its approved plan, comply with all legal mandates, conduct operations in accordance with best management practices, and yet still have an impact on ground water off-site. Wide-scale off-site impacts in Indiana are very uncommon and, consequently, the rule amendments are not being developed to correct a problem. The rule amendments require that a specific standard be met at a specific distance or location.

Although impacts to water wells off the permitted area do occasionally occur, existing standards at 312 IAC 25-4-33, 25-4-78, 25-6-25, and 25-6-88 adequately address these problems. When an impact does occur, an alternate source of water is provided by the permittee. Moreover, the rule amendments in LSA Document #02-104(F) do not impart a permittee with any additional rights to intentionally or unintentionally cause impacts to adjacent areas and uncontrolled properties. The rights of property owners to take action against a permittee as a result of an impact to their property, beyond requirements imposed by these rule amendments, remain unaffected.

III. APPLICABILITY

The rule amendments apply to coal extraction areas where surface and underground coal mining and reclamation permits are issued under Indiana SMCRA. For the purposes of the rule amendments, coal extraction areas include augering, coal processing, coal processing waste disposal, spoil deposition, or underground development waste deposition that occurs after the effective date of the amendments or on which a disposal activity subject to IC 13-19-3-3 has occurred and the area is not fully released from the performance bond required by IC 14-34-6.

IV. GROUND WATER CLASSIFICATION

Ground water must be classified according to 327 IAC 2-11-4 to determine the appropriate narrative and numeric criteria and level of protection that applies to the ground water. The classification of the ground water at the boundary of the GMZ is drinking water class unless it has been classified as limited class ground water or impaired class drinking water by 327 IAC 2-11. It should be noted, the limited class ground water classified according to 327 IAC 2-11-4(d) must meet the requirements found at 327 IAC 2-11-7(b) which include only the constituent concentrations attributable to coal mining, not those associated with the disposal of coal combustion waste. See 327 IAC 2-11-5 through 327 IAC 2-11-8 for further information on the criteria for all ground water, drinking water class ground water, limited class ground water, and impaired drinking water class ground water.

Should a permittee wish to propose a reclassification of ground water, the IDEM Ground Water Section should be contacted to discuss the IDEM procedures, specific information requirements, and the criteria for limited class ground water and impaired drinking water class ground water.

V. STANDARDS

Surface and underground coal mining and reclamation operations must be planned and conducted to prevent violations of the ground water quality standards found in 327 IAC 2-11. Mining and reclamation operations are to be performed to minimize the effects of mining and reclamation on the hydrologic balance in the permit area and adjacent areas and to prevent material damage to the hydrologic balance outside the permit area. Once the ground water has been classified, the monitoring framework has been established, and a plan has been included in the permit application to indicate the location the standards will be met, a demonstration including the measures that will be taken to ensure the protection of the hydrologic balance is to be made.

The standards found in 327 IAC 2-11 are point specific. The rules require that a specific standard be met at a specific distance or location. An exceedance at one point, even if that point is outside the permitted area, may not constitute material damage to the hydrologic balance, a concept that by definition at 312 IAC 25-1-67 involves a hydrologic system existing in an area. Both the rules and this information bulletin have been developed in this context.

VI. GROUND WATER MANAGEMENT ZONE (the “GMZ”)

The point of compliance in 327 IAC 2-11 is the boundary of the ground water management zone (“GMZ”). The standards established by 327 IAC 2-11 must be met at and beyond the GMZ as established in 312 IAC 25-6-12.5(d) and 312 IAC 25-6-76.5(d). The boundary of the GMZ will be established during initial permit review and may be modified in response to changes in operations plans or alterations of permit boundaries throughout the life of the mine. Ground water monitoring plans included in the permit application will provide the manner in which water quality at the GMZ boundary will be measured. The location of the boundary of the GMZ will be based on the location of drinking water wells or a distance from mining related activities identified in subdivision (1) of 312 IAC 12.5(d) or 312 IAC 25-6-76.5(d) of the rules. In general, the GMZ boundary will be established three hundred (300) feet from the edge of:

(1) coal extraction areas;
(2) coal mine processing waste disposal sites if not within coal extraction areas;
(3) areas where coal is extracted by auger mining methods;
(4) locations at which coal is crushed, washed, screened, stored, and loaded at or near the mine site unless the locations are within the coal extraction areas; or
(5) spoil deposition areas.

An exception to this condition will occur when the permit boundary or the extent of property controlled by the permittee is located at a distance less than three hundred (300) feet from areas requiring a GMZ. While the standards will apply at the boundary of the GMZ, ground water monitoring wells will be required at locations within the control of the mining company that are within the GMZ (i.e. less than 300 feet from the mining activities that define the GMZ). To minimize confusion, DOR will refer to those wells established within the GMZ as “interception wells.” Likewise, in the event a drinking water well is located within three hundred (300) feet of areas requiring a GMZ, and there is a likelihood of impact, a monitoring well (interception well) may be required between the drinking water well or wells and the activities that define the GMZ.

For underground mines, the GMZ boundary will normally be established at a distance of three hundred (300) feet from the edge of the area containing the surface effects of the mining operation. These include:

(1) coal mine processing waste disposal sites;
(2) locations at which coal is crushed, washed, screened, stored, and loaded at or near the mine site; or
(3) underground development waste and spoil deposition areas.

As with the surface mines, a monitoring well will be required within the GMZ when the GMZ boundary falls on uncontrolled properties. When coal refuse is disposed in the underground works, the GMZ boundary will be modified to incorporate any area in which this activity occurred.

VII. Effective Date

This information bulletin is effective February 1, 2004.

DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #22
January 2004

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

SUBJECT: Delivery and Installation Charges Subject to Indiana Sales and Use Tax

I. INTRODUCTION

Effective January 1, 2004, Indiana enacted legislation to bring Indiana's sales and use tax statutes into conformity with the Streamlined Sales and Use Tax Agreement.

II. STATUTORY CHANGES

P.L.257-2003 amended IC 6-2.5-1-5 concerning the definition of "gross retail income". The amendment includes delivery and installation in the definition of gross retail income.

III. DELIVERY CHARGES

Delivery charges are now included in gross retail income and subject to tax regardless of shipping terms. Delivery that is made by or on the behalf of the seller of tangible personal property will be taxable whether or not the delivery charge is separately stated.

IV. INSTALLATION CHARGES

A. An installation charge is defined as a charge to add something new or different to tangible personal property. Before January 1, 2004, installation charges that were separately stated were generally not subject to Indiana sales tax. Effective January 1, 2004, installation charges by a seller to install tangible personal property are subject to Indiana sales tax, even if the installation charges are separately stated.

B. Installation charges billed and furnished by a third party are exempt.

C. If the tangible personal property that is sold is not subject to sales tax because of an available exemption, then the installation charges will not be subject to sales tax.

D. Charges to incorporate tangible personal property into a permanent attachment to real property are not subject to sales tax. An improvement to realty takes place whenever tangible personal property is permanently attached to land or attached to a structure that is permanently attached to land. Such charges are not subject to sales tax regardless of whether the contract is a "lump sum" contract or a "time and materials" contract.

    1. Examples of non-taxable installations that constitute improvements to realty are: doors, garage doors, garage door openers, windows, cabinets, garbage disposals, water heaters, water softeners, alarms, furnaces, central air conditioning units, gutters, and carpeting.

    2. Examples of taxable installations that do not constitute improvements to realty are: personal computers, home stereos, televisions, refrigerators, stoves, dishwashers, garbage compactors, washers, dryers, and window air conditioning units.

    NOTE: The purchase and installation of new home appliances does not constitute repair or replacement per Section V below.

Example 1. A department store sells drapes and charges to install them. The drapes are taxable and the installation charge is also taxable.

Example 2. A department store sells blinds, but an independent contractor does the installation and bills the customer directly. The installation charge is not taxable because it is not part of the sales price.

Example 3. A store sells and installs modular workstations. Two separate contracts are drawn up by the store. One contract is for the sale of the workstations, and one for the installation. Sales tax applies to both the sale and the installation. Separate invoices do not make the installation exempt.

Example 4. An individual purchases running boards for their truck from an auto parts dealer and takes them to an unrelated dealership to have them installed. The charge to install the running boards is not taxable because the transaction between the dealership and the individual did not include the sale of the property being installed.

Example 5. An individual takes their car to a dealership to have a sunroof added to their car. The installation charges are taxable even if they are separately stated because it is an addition to tangible personal property.

V. REPAIR/REPLACEMENT CHARGES

Repair Charges. Repair charges are charges to restore an item so that it can be used for its original purpose. Separately stated charges for repair services are not taxable. Labor charges for replacement items are also not subject to sales tax.

Example 6. The charge to reupholster a sofa is $500 ($200 material, $300 labor). The labor is for removing the old fabric and replacing it with new fabric. Since the sofa is being restored to its original form, tax will only be charged on the $200 for material,

if the material and labor charges are separately stated.
Example 7. A person takes their car to be repaired as the result of an automobile accident. The repair or replacement of fenders, auto glass (etc) will require that the sales tax be paid on the materials that are replaced or repaired, but the labor will be exempt if it is separately stated.
Replacement Charges. Replacement charges are charges for replacing an item that is part of another item of tangible personal property. Charges to install replacement items are exempt from tax if they are separately stated. Replacement charges will not be subject to tax even if the replacement item were to be considered an "upgrade." In order to be considered an upgrade, an item must be of the exact same nature as the item it is replacing.
Example 8. A person has the oil and filter changed on their car. The oil and filter are taxable, but the charge to install them is exempt if it is separately stated.
Example 9. A person has the heating element on a clothes dryer replaced. The heating element is taxable, but the labor to install the element is exempt if separately stated.
Example 10. A person has a new set of after market wheels installed on their car. The installation charges are not subject to tax because the wheels are considered an upgrade.
Example 11. A person has a new car stereo with a cd player installed in their car. The original stereo did not have a cd player. The charges to install the new stereo with a cd player would not be subject to sales tax because the new stereo is still of the exact same nature as the car's original stereo even though it has additional capabilities.
Example 12. A person has a subwoofer installed in their car. The charges to install the subwoofer are subject to sales tax because it is additional equipment and not a replacement or upgrade.
Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:
MS. ALENE KAPPEL
DOCKET NO. 29-2002-0180

PROPOSED ORDER

The Criminal Investigation Division of the Indiana Department of Revenue conducted an investigation of the Boys and Girls Club of Indianapolis. As a result of the investigation, on March 27, 2002, the Petitioner was prohibited from having any involvement with charity gaming in Indiana for a period of ten (10) years. The Petitioner, Alene Kappel, was represented by Fred D. Scott, Counselor at Law, 55 Monument Circle, Indianapolis, Indiana 46204. Attorney Steve Carpenter, appeared on behalf of the Indiana Department of State Revenue.

FINDINGS OF FACTS

1) Petitioner protested the Department's proposed actions on April 1, 2002.
2) The Department acknowledged, by certified mail return receipt requested, the Petitioner's appeal in a letter dated April 2, 2002.
3) The Department contacted the Petitioner a second time regarding setting a hearing on May 10, 2002.
4) Petitioners hearing set for July 25, 2002 was continued.
5) The Department on December 30, 2002 contacted the Petitioner again in regards to setting a hearing date and time.
6) On January 9, 2003 Petitioner's counsel advised the Department that his client wishes to continue her appeal.
7) On January 25, 2003 the Petitioner's hearing was set for February 19, 2003.
8) Once again the Petitioner's hearing was postponed.
9) The Department sent Petitioner a letter dated May 21, 2003 regarding the legislative changes that directly affected the procedures governing the administrative hearing.
10) Pursuant to IC 4-21.5-3-1, notice was given to Petitioner's counsel on September 4, 2003 regarding a possible dismissal of her appeal if no response was received by the Department on or before November 7, 2003.
11) Petitioner's counsel 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 pursuant to IC 4-21.5-3-24.

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: November 17, 2003

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Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:

MS. BESSIE P. CLARK

DOCKET NO. 29-2002-0181

PROPOSED ORDER

The Criminal Investigation Division of the Indiana Department of Revenue conducted an investigation of the Boys and Girls Club of Indianapolis. As a result of the investigation, on March 27, 2002, the Petitioner was prohibited from having any involvement with charity gaming in Indiana for a period of ten (10) years. The Petitioner, Bessie P. Clark, was represented by Fred D. Scott, Counselor at Law, 55 Monument Circle, Indianapolis, Indiana 46204. Attorney Steve Carpenter, appeared on behalf of the Indiana Department of State Revenue.

FINDINGS OF FACTS

1) Petitioner protested the Department's proposed actions on April 1, 2002.

2) The Department acknowledged, by certified mail return receipt requested, the Petitioner's appeal in a letter dated April 2, 2002.

3) The Department contacted the Petitioner a second time regarding setting a hearing on May 10, 2002.

4) Petitioners hearing set for July 25, 2002 was continued.

5) The Department on December 30, 2002 contacted the Petitioner again in regards to setting a hearing date and time.

6) On January 9, 2003 Petitioner's counsel advised the Department that his client wishes to continue her appeal.

7) On January 25, 2003 the Petitioner's hearing was set for February 19, 2003.

8) Once again the Petitioner's hearing was postponed.

9) The Department sent Petitioner a letter dated May 21, 2003 regarding the legislative changes that directly affected the

procedures governing the administrative hearing.

10) Pursuant to IC 4-21.5-3-1, notice was given to Petitioner's counsel on September 4, 2003 regarding a possible dismissal of her appeal if no response was received by the Department on or before November 7, 2003.

11) Petitioner's counsel 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 pursuant to IC 4-21.5-3-24.

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: November 17, 2003

Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:
MS. CHRISTINE F. SCHAPKER
DOCKET NO. 29-2002-0182

PROPOSED ORDER

The Criminal Investigation Division of the Indiana Department of Revenue conducted an investigation of the Boys and Girls Club of Indianapolis. As a result of the investigation, on March 27, 2002, the Petitioner was prohibited from having any involvement with charity gaming in Indiana for a period of ten (10) years. The Petitioner, Christine F. Schapker, was represented by Fred D. Scott, Counselor at Law, 55 Monument Circle, Indianapolis, Indiana 46204. Attorney Steve Carpenter, appeared on behalf of the Indiana Department of State Revenue.

FINDINGS OF FACTS

1) Petitioner protested the Department's proposed actions on April 1, 2002.
2) The Department acknowledged, by certified mail return receipt requested, the Petitioner's appeal in a letter dated April 2, 2002.
3) The Department contacted the Petitioner a second time regarding setting a hearing on May 10, 2002.
4) Petitioners hearing set for July 25, 2002 was continued.
5) The Department on December 30, 2002 contacted the Petitioner again in regards to setting a hearing date and time.
6) On January 9, 2003 Petitioner's counsel advised the Department that his client wishes to continue her appeal.
7) On January 25, 2003 the Petitioner's hearing was set for February 19, 2003.
8) Once again the Petitioner's hearing was postponed.
9) The Department sent Petitioner a letter dated May 21, 2003 regarding the legislative changes that directly affected the procedures governing the administrative hearing.
10) Pursuant to IC 4-21.5-3-1, notice was given to Petitioner's counsel on September 4, 2003 regarding a possible dismissal of her appeal if no response was received by the Department on or before November 7, 2003.
11) Petitioner's counsel 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 pursuant to IC 4-21.5-3-24.
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: November 17, 2003

Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:
LATIN AMERICAN SPORTS CLUB, INC.
DOCKET NO. 29-2002-0379

PROPOSED ORDER

The Criminal Investigation Division of the Indiana Department of Revenue conducted an investigation of the Latin American Sports Club, Inc. As a result of the investigation, on January 7, 2002, the Petitioner was assessed civil penalties of four thousand five hundred dollars ($4,500). The Petitioner, Latin American Sports Club, Inc., was represented by Charles F. Leonard of Tremper, Bechert, Leonard & Terrill, 800 South Calhoun Street, Fort Wayne, Indiana 46802. Attorney Steve Carpenter, appeared on behalf of the Indiana Department of State Revenue.

FINDINGS OF FACTS

1) The Criminal Investigation Division of the Indiana Department of Revenue conducted an investigation of the Latin American Sports Club, Inc. on January 2, 2002.
2) As a result of the investigation, on July 11, 2002, the Petitioner was assessed civil penalties of four thousand five hundred dollars ($4,500).
3) Petitioner protested the Department's proposed actions on August 1, 2002.
4) The Department acknowledged the Petitioner's appeal in a letter dated August 7, 2002.
5) The Department contacted the Petitioner a second time regarding setting a hearing on August 29, 2002.
6) On October 2, 2002, the Petitioner requested that the Department contact his attorney Charles F. Leonard.
7) The Department sent a letter addressed to Petitioner's Attorney on October 8, 2002 in regards to setting a hearing date and time. Copies of all prior correspondence were also sent in that same letter.
8) The Department sent Petitioner's Attorney a letter dated May 21, 2003 regarding the legislative changes that directly affected the procedures governing the administrative hearing.
9) Pursuant to IC 4-21.5-3-1, notice was given to Petitioner's counsel on September 4, 2003 regarding a possible dismissal of the appeal if no response was received by the Department on or before November 7, 2003.
10) Petitioner's counsel 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 pursuant to IC 4-21.5-3-24.

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: November 24, 2003

Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

02-990653.LOF

LETTER OF FINDINGS NUMBER: 99-0653
ADJUSTED GROSS INCOME TAX
For Years 1995, 1996, and 1997

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

ISSUES

I. Adjusted Gross Income Tax—Holding companies as part of a unitary business

Authority: 45 IAC 3.1-1-153(c); 45 IAC 3.1-1-153(b); *Allied-Signal Inc. v. Director, Div.. of Taxation*, 504 U.S. 768 (1992); *F.W. Woolworth v. Taxation and Revenue Dep't. of New Mexico*, 458 U.S. 354 (1982); *Asarco, Inc. v. Idaho State Tax Comm'n.*, 458 U.S. 307 (1982); *Exxon Corp. v. Dep't. of Revenue of Wisconsin*, 447 U.S. 207 (1982); *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n.19 (1983)

Taxpayer, an out-of-state corporation, protests the imposition of the adjusted gross income tax on distributions it received from an Indiana partnership.

STATEMENT OF FACTS

Taxpayer, an out-of-state corporation, is a general partner in an Indiana general partnership (hereafter "partnership"). The partnership is a joint venture between two corporations and is engaged in the business of the manufacture and wholesale distribution of agrichemicals used by the agricultural industry. Taxpayer has a 34% interest in the partnership.

DISCUSSION

I. Gross Income Tax—Partnership income in a unitary or non-unitary business

The audit determined that there was no unitary relationship between taxpayer and the partnership and that the partnership's "income" was entirely attributable to the partnership's home state (Indiana) under 45 IAC 3.1-1-153(c). Taxpayer maintains that there is a unitary relationship and that, as a result, the partnership's "income" should be apportioned.

45 IAC 3.1-1-153(b) determines whether or not a unitary relationship exists between a taxpayer and its partnership interests. In part, the regulation states that if a "corporate partner's activities and partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula...." Taxpayer must demonstrate that the relationship between itself and the holding company partnership exhibits the characteristics of a unitary relationship.

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

45 IAC 3.1-1-153(b) gives no indication of the precise degree of ownership required to demonstrate common ownership. However, the record indicates that taxpayer owns 34 percent of the holding company partnership. Therefore, the evidence does not establish a significant amount of common ownership between the parties.

The second relevant criteria is that of common management. Common management is demonstrated when the parent company provides a management role that is "grounded in [the parent company's] own operational expertise and its overall operational strategy." *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180, n.19 (1983). Taxpayer has offered no proof to indicate common management. Rather, taxpayer has merely asserted that, as a general partner, it should be taken for granted that taxpayer participates in the management functions of the partnership. It is true that taxpayer is allotted an equal share of seats on the board of directors of the partnership as that of its corporate partner. However, mere participation in management does not suffice to show common management. Finally, there is nothing to indicate what decisions were made by the partnership or what degree of involvement taxpayer has in the day-to-day operation of the partnership's business.

The third relevant criteria is that of common operation or use. There is no question that taxpayer operates and uses the partnership. However, there is little or no substantive information regarding the degree or extent to which taxpayer either operates or uses the partnership and no basis presented to conclude that there is *common* operation or use.

Regardless of the relevance of the three criteria and to what degree taxpayer can demonstrate its compliance with those criteria, taxpayer is entitled to a consideration of whether requiring taxpayer to employ the standard apportionment formula accurately portrays taxpayer's Indiana adjusted gross income or whether, by doing so, taxpayer's Indiana income is distorted. IC 6-3-2-2(p). However, taxpayer has not proffered any formulae that would potentially more accurately portray taxpayer's income.

FINDINGS

The taxpayer is respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20000202.LOF

LETTER OF FINDINGS NUMBER: 00-0202
Sales and Use Tax
For The Period: 1996-1998

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

ISSUES

I. Sales/Use Tax: Labels

Authority: IC 6-2.5-5-9(d); IC 6-2.5-5-6; 45 IAC 2.2-5-14; 45 IAC 2.2-5-8(d)

The taxpayer protests the taxation of labels.

II. Sales/Use Tax: Pricing Equipment

Authority: IC 6-2.5-5-6; 45 IAC 2.2-5-14

The taxpayer protests the taxation of pricing equipment.

III. Tax Administration: Penalty

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

The taxpayer protests the imposition of a negligence penalty.

STATEMENT OF FACTS

The taxpayer is a wholesaler in the film photo processing business. The taxpayer develops film that was dropped off by customers at various retail stores (e.g., drug stores). After the film is processed, it is sent back to the retail store. The taxpayer has development centers around the country where film is processed.

I. Sales/Use Tax: Labels

DISCUSSION

As noted, the taxpayer is in the photofinishing business. The portion of the taxpayer's business at issue involves the following: (1) customers drop off film at a retail store (that is, customers drop off their film rolls at a store and fill out an envelope (wherein the film is placed)); (2) the store in turn forwards the film for processing to the taxpayer; (3) the taxpayer receives the store's "dealer bag" (the individual film is still in its envelope); (4) the taxpayer splices the film with other film rolls and bar codes the film for identification; (5) the taxpayer then begins the film development process; (6) the film print and negatives are placed in a wallet and put back in the envelope—labels are placed on the envelopes "to communicate information to the consumer"; (7) the prints and negative are sent back to the retail store.

The taxpayer argues that the labels are packaging material and are tax exempt under the Indiana Code. The relevant statute is IC 6-2.5-5-9(d), which governs wrapping materials, and states:

> (d) Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds.

IC 6-2.5-5-6 and 45 IAC 2.2-5-14 are also of import, since both require tangible personal property to be incorporated into the final product in order to be exempt. The former statute stating that "incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business" is required for exemption, and the latter regulation stating in pertinent part "material must be physically incorporated into and become a component of the finished product." Additionally, 45 IAC 2.2-5-8(d) notes that the production process is an integrated series of steps that "ends at the point that the production has altered the item to its completed form, *including packaging*, if required." (*Emphasis* added) The issue then is whether the labels become a material part of the finished product.

The taxpayer's envelopes are not part of the production process and are not part of the finished product. In terms of chronology (pre-production, production, post-production), the envelopes are *pre-production* (i.e., the customer puts the roll of film into an envelope at a retail store, long before the actual production process starts—the production being the taxpayer's business of developing film), and then at the end of production (post-production) the envelopes are used to ship the finished products back to the retail store. The envelopes (and the labels affixed to the envelopes) are not incorporated into, nor are they a component, of the prints. Thus the labels are not part of production, and are therefore taxable.

FINDING

Taxpayer's protest is denied.

II. Sales/Use Tax: Pricing Equipment

The taxpayer also protests the taxation of pricing equipment. The taxpayer argues that the pricing equipment is part and parcel of its production process:

> Pricing occurs before the sorting process, which is where photographs are sorted and inserted into the appropriate dealer envelope. … Since pricing occurs before sorting, we feel that pricing should be considered an integral part of an integrated manufacturing process.

Taxpayer describes the pricing machinery as scanning/reading bar codes and then printing the appropriate price to be affixed to the envelope.

Since, under IC 6-2.5-5-6 and 45 IAC 2.2-5-14, the price does not become incorporated as a material part of the taxpayer's product, the taxpayer is not entitled to the exemption. The pricing station does not perform any packaging functions that are exempt in the direct production process.

FINDING

The taxpayer's protest is denied.

III. Tax Administration: Penalty

DISCUSSION

The Department imposed a 10% negligence penalty (IC 6-8.1-10-2.1), which the taxpayer argues should be abated. The taxpayer states that the "underpayment of tax was due to [a] clerical error in the normal course of business." The taxpayer also argues that given the size of its organization "a certain amount of error can be expected."

The statutory authority for the penalty is IC 6-8.1-10-2.1, which provides, in pertinent part, that:

> If a person subject to the penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to *reasonable cause* and not due to willful neglect, the department shall waive the penalty. (*Emphasis* added)

Beyond the above statements of clerical error and organizational size, the taxpayer did not elaborate on how the failure to properly accrue use tax was due to reasonable cause. 45 IAC 15-11-2(c) requires for abatement for "reasonable cause" that the taxpayer demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty...." The taxpayer has failed to meet its burden of demonstrating that the underpayments were due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20000220.LOF

LETTER OF FINDINGS NUMBER: 00-0220
Sales and Use Tax
For The Period: 1996-1998

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

ISSUES

I. Sales/Use Tax: Lump Sum Contracts

Authority: 45 IAC 2.2-4-26(a)

The taxpayer protests the imposition of tax on a contract that it characterizes as a lump sum contract.

II. Sales/Use Tax: Application Server Kit

Authority: 45 IAC 2.2-5-8(c)(5)

The taxpayer protests the taxation of a computer and its software.

III. Sales/Use Tax: Pricing Station

Authority: IC 6-2.5-5-3(b); IC 6-2.5-5-6; 45 IAC 2.2-5-14

The taxpayer protests the taxation of a pricing station.

STATEMENT OF FACTS

The taxpayer is a wholesaler in the photo processing business. The taxpayer has development centers around the country where film is processed.

I. Sales/Use Tax: Lump Sum Contracts

DISCUSSION

The taxpayer protests the taxation of a lump sum contract for heating and air conditioning work done at an Indiana facility. Taxpayer has provided the Department with the heating and air conditioning company's specifications and estimates for the work. The document states that:

All materials, labor, *taxes*, permits and support equipment for the sum of [a price is given] … (Emphasis added)

Taxpayer in its protest letter then cites 45 IAC 2.2-4-26(a):

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

In other words, the contractor is responsible and liable for the payment of sales tax in a "lump sum" contract. The documentation submitted by the taxpayer evidences that the contract was a lump sum contract.

FINDING

Taxpayer's protest is sustained.

II. Sales/Use Tax: Application Server Kit

The taxpayer also protests the taxation of an "application server kit"—i.e., a computer and the "software that enables the processing of APS (Advanced Photo System) film by passing information between different pieces of manufacturing equipment." (The information passed by APS to the equipment can be information like classic, wide, or panoramic).

45 IAC 2.2-5-8(c)(5) states that computer equipment (including related terminals, printer, and memory, data storage, and input/output devices) is exempt if used in a manner "integral and essential" in the "integrated production process."

The computer and the software are necessary for the processing of the film, and thus are an essential and integral part of an integrated manufacturing process.

FINDING

The taxpayer's protest is sustained.

III. Sales/Use Tax: Pricing Station

DISCUSSION

The taxpayer describes the pricing station thusly:

The pricing station [a piece of equipment with a computer attached] receives a dealer envelope, the outermost package containing customers processed photographs, with a bar code printed on it. It scans the bar code and then uses information obtained by the computer to print the appropriate pricing information on the envelope. The computer obtains its information directly from the billing system. The pricing process occurs before the sorting process, which is where photographs are sorted and inserted into the appropriate dealer envelope.

The taxpayer goes on to make the conclusion that since the "photographs cannot be sold without the pricing information printed on the dealer envelope" that the station is therefore "an essential and integral part of an integrated manufacturing process."

At issue here is a piece of machinery, the pricing station, and its role (if any) in the production process. Indiana Code 6-2.5-5-3(b) states that machinery and equipment are exempt if used in the "direct production, manufacture, fabrication, assembly, … processing, refining, or finishing of other tangible personal property."

Indiana Code 6-2.5-5-6 is also relevant:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business. …

And 45 IAC 2.2-5-14 in pertinent part says, "[M]aterial must be physically incorporated into and become a component of the finished product."

The pricing station acts upon the *dealer* envelope, and not the prints/photographs. The photographs are the taxpayer's product, and the envelopes are not part of the production process. Since the pricing station does not act upon the product (i.e., prints/photographs), but acts upon the dealer envelopes (which are not part of production), and the price is not incorporated into the product, the pricing station is taxable.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220000379.LOF

LETTER OF FINDINGS: 00-0379
Indiana Corporate Income Tax
For the Years 1994, 1995, 1996, and 1997

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

ISSUES

I. Delaware Holding Company – Adjusted Gross Income Tax.

Authority: IC 6-3-2-2(l); IC 6-3-2-2(m); Gregory v. Helvering 293 U.S. 465 (1935); Bethlehem Steel Corp. v. Ind. Dept of State Revenue, 597 N.E.2d 1327 (Ind. Tax Ct. 1992); Horn v. Commissioner of Internal Revenue, 968 F.2d 1229 (D.C. Cir. 1992); Marshalk v. Green, 746 F.2d 927 (2d Cir. 1984); PepsiCo, Inc. v. Grapette Co, 416 F2d 825 (9th Cir. 1969); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); J. Gilson, Trademark Protection and Practice (2001); Del. Code Ann. tit. 30, § 1902(b)(8).

Taxpayer takes issue with the audit's decision to include a Delaware Holding Company and its trademark royalty income within taxpayer's Indiana consolidated income tax returns.

II. Unitary Relationship – Foreign Partnership.

Authority: Allied-Signal, Inc. v. Director, Div. Of Taxation, 504 U.S. 768 (1992); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983); ASARCO, Inc. v. Idaho State Tax Comm'n., 458 U.S. 307 (1982); Bell v. Clark, 670 N.E.2d 1290, 1293 (Ind. 1996); 45 IAC 3.1-1-153; 45 IAC 3.1-1-153(b); Black's Law Dictionary p. 1142 (7th ed. 1999)

Taxpayer argues that the Department erred when it determined that it had a "non-unitary" relationship with a "silent partner."

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of selling food and food-related specialty products to retail stores and industrial food processors. Taxpayer has a manufacturing facility in Indiana. Delaware holding company is taxpayer's wholly-owned subsidiary.

The Department of Revenue (Department) conducted an audit of taxpayer's business records and tax returns. During that audit, a number of adjustments were made which resulted in an assessment of additional corporate income tax. Taxpayer disagreed with certain of the adjustments and submitted a protest to that effect. The Department agreed with a number of the taxpayer's arguments. However, two issues remained unresolved. An administrative hearing was conducted during which taxpayer's representatives set forth their concerns, and this Letter of Findings results.

DISCUSSION

I. Delaware Holding Company – Adjusted Gross Income Tax.

During the audit review, the Department determined that taxpayer's Delaware holding company should be included in taxpayer's combined Indiana return. The effect of this decision was to increase taxpayer's allocable Indiana income.

Taxpayer's Delaware holding company received approximately $10,000 in interest income during 1994. In 1995, taxpayer's board of directors approved amendments to Delaware holding company's certificate of incorporation. These amendments facilitated the transfer of taxpayer's trademarks to Delaware holding company. Simultaneously, a licensing agreement was entered into between taxpayer and Delaware holding company. The agreement provided taxpayer the right to make continued use of its trademarks; in return, taxpayer paid royalties to Delaware holding company. According to the audit report, "This resulted in a royalty expense that the taxpayer would not normally incur reducing [taxpayer's] apportionable income and royalty income free of state tax for [Delaware holding company]." Delaware holding company's royalty income was not taxable because that state does not tax income attributable to intangibles. *See* Del. Code Ann. tit. 30, § 1902(b)(8).

Following the amendments to Delaware holding company's certificate of incorporation and execution of the royalty agreement, Delaware holding company's income increased. In 1995, Delaware holding company received approximately $38,000,000 in royalties. In 1996, Delaware holding company received approximately $58,000,000 in royalties. During 1995, taxpayer reported royalty expenses of approximately $35,000,000 and – in 1996 – reported royalty expenses of approximately $53,000,000.

The audit review concluded that – in calculating taxpayer's Indiana income – the Delaware holding company should be included in taxpayer's combined return thereby effectively ignoring Delaware holding company's separate existence and the taxpayer's royalty expenses.

Taxpayer disagrees maintaining that the Delaware holding company is a "viable corporation having as its valid business purpose the protection, maintenance, and management of valuable intangible assets." In effect, taxpayer argues that the Delaware holding company – because it has a legitimate and independent purpose and because it has no ties with the state of Indiana – should not have been included in taxpayer's combined Indiana return.

Taxpayer manufactures and sells various food products. Associated with those products taxpayer over the years has developed certain trademarks. In 1995, taxpayer transferred ownership of the trademarks to Delaware holding company. In 1996, taxpayer and Delaware holding company entered into a "Trademark Licensing Agreement" in which taxpayer obtained the "exclusive license to use the Licensed Marks in connection with the manufacture, distribution, promotion, advertising and sale of products in the United States." In exchange for the right to use the trademarks, taxpayer agreed to pay Delaware holding company five percent of the trademarked food product net sales.

Four days before Delaware holding company and taxpayer entered into the licensing agreement, the parties entered into an "Agreement" whereby taxpayer agreed to administer Delaware holding company's trademarks, enforce trademark protection, monitor the illegal use of the trademarks, and "[r]etain outside trademark counsel on [Delaware holding company's] behalf." In exchange, Delaware holding company agreed to pay taxpayer approximately $600,000 each year.

Summarizing, taxpayer transferred its trademarks to Delaware holding company; taxpayer licensed the trademarks back from Delaware holding company in exchange for ongoing royalty payments; taxpayer agreed to assume responsibility for the monitoring and protection of the trademarks in exchange for which Delaware holding company agreed to make monthly payments to taxpayer.

During 1996 and 1997 taxpayer paid Delaware holding company approximately $90,000,000 in royalty payments. However, based upon the information available, Delaware holding company did not retain the $90,000,000. Based upon a pre-existing 1991 "Loan Agreement," Delaware holding company – as a "wholly owned subsidiary of [taxpayer]" – agreed to make loans to taxpayer "from time to time" and for "any amount requested by [taxpayer]."

Although the details of any loans made pursuant to the "Loan Agreement" are unavailable, it is apparent that the royalty payments were not retained by Delaware holding company but were loaned to taxpayer. In addition – as previously noted – Delaware holding company paid taxpayer monthly "fees for services" because taxpayer had reassumed responsibility for protecting and monitoring the trademarks.

On the ground that the trademark arrangement was entered into "for the sole purpose of transferring allocable income from [taxpayer] to [Delaware holding] thru the creation of an expense that would not normally be incurred," the audit review imposed a unitary filing requirement under authority of IC 6-3-2-2(m) which provides as follows:

> In the case of two (2) or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interest, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those organizations, trades, or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

In addition, IC 6-3-2-2(l) vests both taxpayers and the Department with authority to allocate and apportion a taxpayer's income within and among the members of a unitary group of related entities.

> If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable;
>
> (1) separate accounting;
>
> (2) the exclusion of any one (1) or more of the factors;
>
> (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; or
>
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

It is apparent from the language contained with IC 6-3-2-2(l) that the standard apportionment filing method is the preferred method of representing a taxpayer's income derived from Indiana sources. The alternate methods of allocation and apportionment – including the unitary reporting method of which taxpayer complains – are only employed when the standard apportionment formula does not fairly reflect the taxpayer's Indiana income.

The audit was clearly justified in determining that permitting the taxpayer to classify the royalty payments as business expenses artificially distorted taxpayer's Indiana income. The plain language of IC 6-3-2-2(l) states that "[i]f the allocation and apportionment provisions of this article do not fairly represent that taxpayer's income derived from sources within the state of Indiana... the department may require, in respect *to all or any part of the taxpayer's business activity*... the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income." (*Emphasis added*). Other than the hoped-for favorable tax consequences, the transfer of the trademarks to Delaware holding company and the subsequent licensing agreement appear to have no discernible business purpose. There is nothing to indicate that taxpayer's business operation was in any way affected by the transfer of the trademarks. There is nothing to indicate that the Delaware holding company exercised any independent ownership of the trademarks. There is nothing to indicate the Delaware holding company had any experience in or was qualified to develop, manage, or exploit intellectual property such as these trademarks. There is nothing to indicate that Delaware holding did anything to manage these trademarks, work to enhance the value of the trademarks, or protect the trademarks. Indeed by the terms of the parties' ancillary 1996 agreement, taxpayer had reassumed the responsibility for administering and protecting the trademark properties.

In addition, the audit – in determining taxpayer's taxable income – would have been justified in simply ignoring the $90,000,000 royalties payments on the ground that the payments stemmed from a "sham transaction."

The "sham transaction" doctrine is well established both in state and federal tax jurisprudence dating back to Gregory v. Helvering 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert denied,* 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 F.2d 1229, 1236-37 (D.C. Cir. 1992). In determining whether a business transaction was an economic sham, two factors can be considered; "(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" Id. at 1337.

Taxpayer maintains that the royalty/trademark/license/loan agreement[s] all had an "economic substance," that Delaware holding company "incurs operating costs, contracts in its own name, and holds and manages intangible assets." Further, taxpayer maintains that the royalty payments amounts - $90,000,000 in two years – are "based on arms length and commercial rates and terms." The Department has no reason to doubt taxpayer's veracity or its good faith; however, it is evident that the royalty payments were made for no other discernible "motive but to escape taxation." Commissioner 176 F.2d at 572. There is no evidence that these various transactions entered into by taxpayer and Delaware holding company added anything of value to the trademarks, increased taxpayer's profits, or had any other business purpose outside of obtaining tax benefits. The Department would have been justified in ignoring the trademark transfers and subsequent royalty payments because they were based on a "sham transaction."

Further, the notion that the trademarks in questions – essentially, a collection of approximately 120 brand names attached to various foods items – have any transferable value once severed from the food items, is unsupported in law, practice, or simple business reality. Taxpayer's assumption that it can sever the trademarks from their associated products and then transfer those marks is flawed because a trademark "is merely a symbol of goodwill; it has no independent significance apart from the goodwill it symbolizes." Marshalk v. Green, 746 F.2d 927, 929 (2d Cir. 1984). "There are no rights in a trademark apart from the business with which the mark has been associated; they are inseparable." Id. The trademarks themselves have no independent value because the trademarks are simply advertising tools symbolizing customer good will and the customer's willingness to purchase – and repurchase – the taxpayer's products. J. Gilson, Trademark Protection and Practice 1.03[6][a] (2001). The fact that the independent evaluation placed a "value" on the trademarks, is insufficient to establish that the transfer of the trademarks to the Delaware holding company was anything more than an exercise in empty legal formalism.

The audit was justified in including the Delaware holding company in taxpayer's combined Indiana return in order to more fairly reflect taxpayer's Indiana income. The audit would have been equally justified in ignoring the tax effects of the royalty payment and interest deductions because the royalty payments, license agreement, loan agreement were all part of a "sham transaction." In addition the audit would have been justified in ignoring the tax consequences of the royalty and interest payments because the initial transfer of the trademarks and the consequent royalty payments was entirely illusory. The transfer of the trademarks to the Delaware holding company was illusory because the trademarks have no value distinct from the taxpayer's goodwill. The royalty payments were illusory because the taxpayer was paying for something which had no existence independent from the taxpayer's own commercial activity. PepsiCo, Inc. v. Grapette Co, 416 F2d 825, 288 (9th Cir. 1969). The transfer of the trademarks to the Delaware holding company was illusory because the holding company was incapable of managing or exploiting the intellectual property irrespective of the subsidiaries' business activities. The royalty payments were illusory because the holding companies simply "loaned" the money back to the taxpayer.

With all due respect to taxpayer best intentions, the entire arrangement – the "Trademark License Agreement," the "Loan Agreement," the trademark protection "Agreement," the substantial royalty payments – constitute nothing more than an elaborate form of corporate three-card monte. Taxpayer is, of course, entitled to structure its business affairs in any manner it deems appropriate and to vigorously pursue any tax advantage attendant upon the management of those affairs. However, in determining the nature of a business transaction and the resultant tax consequences, the Department is required to look at "the substance rather than the form of the transaction." Bethlehem Steel Corp. v. Ind. Dept. of State Revenue, 597 N.E.2d 1327, 1331 (Ind. Tax Ct. 1992).

FINDING

Taxpayer's protest is respectfully denied.

II. Unitary Relationship – Foreign Partnership.

Taxpayer has a partnership arrangement with a foreign company. The foreign company has no Indiana presence. According to taxpayer, it is a "limited partner" in the foreign company. Taxpayer states that the foreign company is dormant and has conducted no business for a number of years. However, because the partners wish to keep this foreign company in good standing, the foreign company incurs routine ongoing administrative expenses. Taxpayer contributes cash to pay for these costs. According to the terms of the partnership agreement, taxpayer is entitled to 100 percent of the foreign company's losses up to the amount of contributed capital.

The audit found that the foreign company was a "limited partnership" and also describes the foreign company as a "silent partnership." Therefore, the audit concluded that taxpayer and foreign company did not have a unitary relationship and that the partnership losses – the money paid to pay the administrative expenses necessary to maintain the foreign company's existence – should be deducted from schedule B of the taxpayer's Indiana return and be treated as non-business income or loss.

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

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

The foreign company is a "limited partnership," and the taxpayer is a "limited partner." A limited partnership is one in which some of the partners control the business and are personally responsible for the partnership's debits. Black's Law Dictionary p. 1142 (7th ed. 1999). The other participants – such as taxpayer – are limited partners who "contribute capital and share profits but who cannot manage the business and are liable only for the amount of their contribution." Id. Such an arrangement enables the limited partners "to invest their money in a business without taking an active part in managing the business, and without risking more than the sum originally contributed...." Id. at p. 1143. *See also* Bell v. Clark, 670 N.E.2d 1290, 1293 (Ind. 1996).

Because taxpayer is a limited partner in the foreign business, by definition it exercises no day-to-day operational control. Operational control is an essential element in establishing a unitary relationship. Container Corp. of America 463 U.S. at 165-66. Therefore, because the taxpayer does not have a unitary relationship with the foreign company, the audit review correctly determined that the losses were "non-business income" and should be eliminated from the taxpayer's Indiana return.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420010088.LOF

LETTER OF FINDINGS NUMBER: 01-0088
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- Manufacturing Exemption

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-3-2 (a), IC 6-2.5-5-3, 45 IAC 2.2-5-10 (c), 45 IAC 2.2-5-8 (k), *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), *Indiana Department of Natural Resources v. United Minerals, Inc.*, 686 N.E.2d 851, 857, (Ind. Ct., App. 1st Dist. 1997), *Accord, Hartford Acc. & Indem. Company v. Dana Corporation*, 690 N.E.2d 285, (Ind. Ct. App. 2d Dist. 1997).

The taxpayer protests the imposition of use tax on certain equipment.

II. Sales and Use Tax-Public Transportation Exemption

Authority: IC 6-2.5-3-2, IC 6-2.5-5-27, National Serv-All, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), Indiana Waste Systems of Indiana, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), Panhandle Eastern Pipeline Company and Trunkline Gas Company v. Indiana Department of State Revenue, 741 N.E.2d 816 (Ind. Tax 2001).

The taxpayer protests the assessment of tax on certain trucks, a trailer, and parts.

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 negligence penalty.

STATEMENT OF FACTS

The taxpayer is a manufacturer of ready-mix concrete for sale to retail customers. It manufactures concrete in its batch plant, and then delivers it to customers in trucks specially designed for the mixing and delivery of concrete. 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 the assessment of tax on the Bob Cat Dozer, Kawasaki Loader, hydraulic excavator, several trucks, a trailer, related parts and the penalty. A hearing was held.

I. Sales and Use Tax- Manufacturing Exemption

DISCUSSION

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

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana when the sales tax was not paid. A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. 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." 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 the property in production. The manufacturing process starts when there is a change "... in a form, composition, or character different from that in which it was acquired." Pursuant to 45 IAC 2.2-5-8 (k), the use of the machinery and the time of its use then determines whether or not it qualifies for exemption.

In the taxpayer's operation, the raw materials, including cement, sand, aggregate and gravel, water and other chemicals, are delivered by vendors to the taxpayer's site by various means. Aggregate, sand, and gravel are all stored in piles near the batch plant.

The Kawasaki loader and hydraulic excavator pick up the aggregate, sand, and gravel off the ground and "charge" or load the bin of the cement batch plant. These pieces of equipment are necessary for loading the initial bin of the plant since the materials are stored approximately ten to fifteen feet above ground level. Often, some of the material being added to the bins spills on the ground around the batch plant. The taxpayer then uses the smaller Bob Cat Dozer to pick up the spilled material and return it to the batch plant bin. Once the initial bin of the batch plant has been charged, the materials are transported upwards from that bin onto a conveyor belt and transported to a second bin, which measures the correct quantities of each material for a particular batch of concrete. The proportions for each component material change with weather conditions, temperature, and the desired properties of the finished concrete.

The taxpayer protests the department's assessment of use tax on the Kawasaki Loader, the Bob Cat Dozer, and hydraulic excavator. The taxpayer contends that the charging of the bins by the use of the loaders, excavator, and dozer constitutes the first operation in a series of operations that collectively comprise the integrated production process for the manufacture of its product, concrete. The taxpayer argues that the charging process is an integral part of the production process, and that the equipment used in that process should be exempt from the use tax as machinery directly used in the direct production. The taxpayer bases its argument on the Indiana Tax Court's holding in an unpublished decision concerning a similar industry. That case is not valid authority for the proposition that the taxpayer's equipment is exempt from the use tax. The case cited by the taxpayer is a trial court judgment from which no appeal was taken. Although the Indiana Supreme Court has not ruled on the question, a majority of the panels of the Indiana Court of Appeals have held that a cited unpublished judgment has no effect as precedent. "[A] conclusion of law by a circuit court in a case from which no appeal has been taken is not binding precedent..." *Indiana Department of Natural Resources v. United Minerals, Inc.,* 686 N.E.2d 851, 857, (Ind. Ct., App. 1st Dist. 1997). *Accord, Hartford Acc. & Indem. Company v. Dana Corporation.,* 690 N.E.2d 285, (Ind. Ct. App. 2d Dist. 1997).

The taxpayer's production process begins when the computer measures and blends the taxpayer's various ingredients for the formulation of cement. Any equipment used prior to this time in the production process is pre-production equipment. Since the Kawasaki Loader, Bob Cat Dozer, and hydraulic excavator are used prior to the computer measurement and blending of the ingredients, these items are pre-production equipment and do not qualify for exemption from the sales and use tax.

FINDING

The taxpayer's protest is denied.

II. Sales and Use Tax-Public Transportation Exemption

DISCUSSION

Pursuant to IC 6-2.5-3-2 (a), the department assessed use tax on the taxpayer's purchase and use of several trucks, a trailer, and replacement parts. These items are used to haul aggregate for the taxpayer and others. The taxpayer protests this assessment contending that the items qualify for the public transportation exemption pursuant to the following provisions of IC 6-2.5-5-27:

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

The Indiana Tax Court has addressed the issue of public transportation in several cases. The first two cases involved contract hauling of garbage. In National Serv-All, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994), the Court stated that although National Serv-All "engaged in 'public transportation' when it hauled Contract garbage," nonetheless National Serv-All did not prove "that its hauling of Contract garbage was the *predominant share* of its use of the items at issue." Id. At 959. (Emphasis in the original). The Court concluded: "Although National engaged in the public transportation of property within the meaning of IC 6-2.5-5-27 when it hauled Contract garbage, it did not prove it predominantly engaged in public transportation." Id. at 960.

The Court faced a similar issue concerning the applicability of the public transportation exemption to the contract hauling of garbage in Indiana Waste Systems of Indiana, Inc. v. Indiana Department of State Revenue, 644 N.E. 2d 960 (Ind. Tax 1994). In that case the Court held as follows:

> Waste Management's maximum annual revenue from public transportation was 17.7 percent of its total revenue, and therefore, the remaining 80 percent of its revenue came from non-public transportation. The predominant use of Waste Management's trucks and other items, therefore, is not exempt...

Id. at 962.

The third case dealing with this issue in Panhandle Eastern Pipeline Company and Trunkline Gas Company v. Indiana Department of State Revenue, 741 N.E.2d 816 (Ind. Tax 2001). The petitioners were pipeline companies that transported natural gas belonging to third parties and natural gas belonging to the petitioners. In each case, the predominate use of the pipelines was to transport natural gas belonging to others. The Court, after noting the relevance of its two previous cases on public transportation, stated the following.

> If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption.

Id. at 819.

The Indiana Tax Court has set out a two-pronged test to determine if a particular business qualifies for the public transportation exemption from sales and use tax. First the taxpayer must be predominately engaged in public transportation of the property of another. Secondly, the taxpayer's property must be predominately used for providing public transportation.

The first prong looks at the taxpayer itself. A determination must be made whether or not the taxpayer is engaged in public transportation. The second prong looks at the individual units to determine how they are used. Both prongs must be satisfied for the taxpayer to qualify for the public transportation exemption.

In this situation, the taxpayer is primarily engaged in the production of concrete. It is not predominately engaged in public transportation. Therefore, having failed the first prong of the test, the taxpayer does not qualify for the public transportation exemption from the sales and use tax for any of the years of the audit.

FINDING

The taxpayer's protest is denied.

III. Tax Administration-Negligence Penalty

DISCUSSION

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

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

The taxpayer did not self assess or remit any use tax during the audit period. This disregard of the taxpayer's statutory duty constitutes negligence. The penalty was properly imposed.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20020058.LOF

LETTER OF FINDINGS NUMBER: 02-0058
TAX ADMINISTRATION
For Years 1997 and 1998

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

ISSUES

I. Tax administration – Credit for Prior Tax Paid

Authority: 45 IAC 2.2-3-16; 45 IAC 2.2-3-12

Taxpayer protests the imposition of Indiana use tax on transactions for which Kentucky sales tax had previously been paid by a third party contractor.

STATEMENT OF FACTS

Taxpayer is a Kentucky corporation that owns and operates several restaurants in Kentucky and that opened a restaurant in Indiana in 1998. The restaurant was built by a Kentucky-based contractor. Said contractor purchased the materials used in the construction of the restaurant in Kentucky, paid Kentucky sales tax on the materials, and brought them into Indiana for the construction project.

The contractor, through a time and materials contract signed by taxpayer, did not bill taxpayer directly for the sales tax it paid in Kentucky. Rather the contractor incorporated the Kentucky sales tax into the materials charges and charged taxpayer accordingly.

DISCUSSION

I. Tax administration – Credit for Prior Tax Paid

Taxpayer believes that, because the contractor that built its restaurant had previously paid sales tax to the state of Kentucky, it should be credited for such against its own use tax liability through 45 IAC 2.2-3-16, which states:

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

The auditor believes that this credit should not be given when the tax paid to another state is made in error. While this reasoning is sound, such a conclusion need not be reached because the sales tax paid to Kentucky by the contractor is irrelevant to the liability of the taxpayer.

Taxpayer invites the Department to examine the tax laws of Kentucky to determine whether or not the contractor properly paid the Kentucky sales tax. The Department respectfully refuses this request as the contractor's payment of Kentucky sales tax is not at issue in the present case. What are at issue are the taxpayer's transactions with the contractor that took place in Indiana.

When the contractor sold the items in question to taxpayer, it did so in Indiana and without charging the taxpayer Indiana sales tax. Because the taxpayer did not pay sales tax to the contractor, it became liable for use tax under 45 IAC 2.2-3-12, which provides:

(a) Tangible personal property purchased to become a part of an improvement to real estate under a contract with an organization entitled to exemption is eligible for exemption when purchased by the contractor.

(b) In order to be exempt on such purchases, the contractor must be registered as a retail merchant, must obtain an exemption certificate from the exempt organization, and must issue an exemption certificate to his supplier.

(c) 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.

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

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

Taxpayer may not step into the shoes of its contractor and make use of its credits, be they meritorious or not.

FINDINGS

The taxpayer is respectfully denied.

DEPARTMENT OF STATE REVENUE

0120020528.LOF

LETTER OF FINDINGS: 02-0528
Indiana Individual Income Tax
For the 1999 Tax Year

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. Distributions from S Corporation to Shareholder – Individual Adjusted Gross Income.

Authority: IC 6-3-1-3.5; 45 IAC 3.1-1-1; Harris v. United States, 902 F.2d 439 (5th Cir. 1990); Estate of Leavitt v. Commissioner, 875 F.2d 420 (4th Cir. 1989); I.R.C. § 1368(b).

Taxpayer disagrees with the audit's conclusion that taxpayer – as sole shareholder –received distributions in excess of the taxpayer's basis in the S Corporation and in excess of the taxpayer's salary. Instead, taxpayer argues that the excess distributions were in fact a shareholder loan and that the excess distributions were not, in fact, taxable income.

STATEMENT OF FACTS

Taxpayer works as a healthcare provider. Taxpayer's practice is organized as an "S Corporation." To finance the business, taxpayer signed a promissory note with a bank in 1998.

The Department of Revenue (Department) conducted an audit review of taxpayer and the S Corporation. At that time, the audit review came to a preliminary conclusion that the taxpayer had received distributions from the S Corporation in excess of her stock basis in the corporation and in excess of her salary. In arriving at that conclusion, the audit concluded that although it was taxpayer who signed for the bank loan, "this appeared to be a substance-over-form type issue where the corporation was taking responsibility for the debt used to buy the [corporation's] assets."

The taxpayer disagreed with the audit's preliminary conclusions arguing that the purported excess distributions were misclassified on the S Corporation's 1999 Form 1120S. Taxpayer argued that the purported distributions were – in reality – payments for the bank loan. Taxpayer maintained that the payments were, as a matter of convenience, made to the taxpayer but that the taxpayer turned around and directed the payments to the bank.

The audit concluded that taxpayer's explanation would be acceptable if it could be demonstrated that taxpayer forwarded the amounts to the bank as payments on the original 1998 bank loan. Thereafter, the audit was informed that the amounts were not forwarded to the bank but that amounts – originally classified by the S Corporation as "excess distributions" – were actually loans to the taxpayer. Despite the turnaround in position, the audit determined that this would be a "workable solution." Taxpayer offered to provide amended returns reflecting that "workable solution."

However, when the amended returns were submitted, the returns did not include a shareholder (taxpayer) loan receivable on the S Corporation's books. Instead the amended returns included a reduction in the bank note payable by the corporation and an equal reduction in shareholder distributions. In effect, taxpayer argues that the note payable was, in actuality, a note payable to the taxpayer; therefore, a netting of the receivable and payable took place.

The audit rejected taxpayer's characterization of the arrangement between taxpayer, S Corporation, and the originating bank concluding that "[y]ou cannot distribute debt."

Taxpayer challenged the audit report's conclusion and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer's representative further explained the reasons for the protest. This Letter of Findings follows.

DISCUSSION

I. Distributions from S Corporation to Shareholder – Individual Adjusted Gross.

When taxpayer began her health care practice, she did so in the form of an "S Corporation." Taxpayer was the sole shareholder of the S Corporation. To fund the startup costs, taxpayer arranged for a bank loan. This amount was invested in the S Corporation and formed the "basis" of the taxpayer's interest in the S Corporation.

The Indiana tax rules piggyback on the federal income tax regulations. IC 6-3-1-3.5 states as follows: "When used in IC 6-3, the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code)...." *See also* 45 IAC 3.1-1-1.

Therefore, the federal rules are used to determine whether the "distributions" were received as taxable income by taxpayer.

Most distributions from an S Corporation are tax free to the shareholder or shareholders. Tax is imposed on the shareholder's "distributive share" of the S Corporation's income. However, any such distributions reduce the basis of the taxpayer's corporate stock. If the distribution amounts ever exceed the amount of "basis" – the amount originally invested – the amount received is treated as a capital gain. I.R.C. § 1368(b).

Originally the payments at issue were classified as distributions on the taxpayer's return and in the taxpayer's general ledger. However, taxpayer filed amended returns reclassifying the amounts and now argues that the payments were – in reality – tax free loan repayments directed toward reducing the amount owed to the bank. Additionally, taxpayer argues that the payments were distributions of the S Corporation's debt and that these "debt distributions" were also tax exempt.

The Department is unable to agree that an S Corporation can distribute its debt in the form of tax-free payments made to the sole shareholder. In addition, the Department is unable find an indication that any of the payments made to the taxpayer (as sole shareholder) were actually intended as loan payments and that – having received the payments – taxpayer turned around and paid the money to the bank. Instead, there is nothing to refute the audit review's conclusion that the S Corporation "appears to make all loan payments and the loan has been treated as a corporate loan even though the original loan was executed in the [taxpayer's] name individually." What taxpayer appears to be suggesting is that taxpayer increased its basis in the S Corporation by making the loan payments via the taxpayer. However, the courts have held that a "shareholders' guarantees of loans to their Subchapter S corporation could not increase their bases in their stock in the corporation unless the stockholders made an economic outlay by satisfying at least a portion of the guaranteed debt." Harris v. United States, 902 F.2d 439, 442 (5th Cir. 1990). Unless the loan guarantee "cost" the shareholder something – i.e. constituted an economic outlay on the part of the shareholder personally – the shareholder's basis in the S Corporation remained unaffected. *See* Estate of Leavitt v. Commissioner, 875 F.2d 420, 422 & n.9 (4th Cir. 1989).

Following the filing of the initial returns in which payments were characterized as distributions in excess of basis, taxpayer has recharacterized and re-recharacterized the payments. The Department is unable to conclude that any of the subsequent clarifications and explanations is entirely satisfactory. At the end of the day, taxpayer's original reported explanation of the payments as distributions in excess of basis appears to comport most closely with the arrangement between taxpayer, the S Corporation, and the originating bank.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0320020571.LOF

LETTER OF FINDINGS: 02-0571
Withholding Taxes
For the Year 2000

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

ISSUE

I. Withholding Tax Levies Against Taxpayer as Responsible Corporate Officer.

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

Taxpayer protests the assessment of tax levies based upon the presumption that taxpayer, as corporate vice president, functioned as a responsible officer for a now bankrupt computer software corporation. Taxpayer maintains that during the year in which he held the office of vice president, he was not responsible for decisions regarding payment of bills, payroll, or any other financial matters and should not now be held responsible for the unpaid withholding taxes.

STATEMENT OF FACTS

In 1999, a now-defunct computer software company was formed in Indiana. One thousand shares of common stock were issued. The president of the company and his family owned the majority of the shares. The secretary/treasurer owned 30 percent of the shares. Taxpayer owned the remaining 13 percent of the shares. The president and secretary/treasurer were full-time employees of the company. Taxpayer indicates that the company failed, ceased operations, and entered into bankruptcy approximately eight months after it was formed.

In 2002, the Department of Revenue (Department) sent taxpayer notices of unpaid withholding taxes apparently on the ground that taxpayer was a responsible officer of the company. Taxpayer submitted a protest, and an administrative hearing was conducted during which taxpayer explained the basis for his protest. This Letter of Findings results.

DISCUSSION

I. Withholding Tax Levies Against Taxpayer as Responsible Corporate Officer.

Withholding taxes may be assessed against a responsible officer under the provisions of IC 6-3-4-8(g) which state that "[i]n the case of a corporate or partnership employer, every officer, employee, or member of such employee, 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."

Taxpayer raises the issue of whether, under IC 6-3-4-8(g), taxpayer was a responsible corporate officer who had the authority to see that the withholding taxes were paid.

Pursuant to Indiana Dept. of Revenue v. Safayan, 654 N.E.2d 270, 273 (Ind. 1995), three factors are relevant in determining if taxpayer had that authority. The court looks to the person's position within the power structure of the corporation. Where that person is a high ranking corporate officer within the 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.

Under IC 6-8.1-5-1(b), the "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Therefore, taxpayer has the burden on demonstrating that as a high-ranking officer of the defunct software company, he is not now responsible for the company's unpaid withholding taxes.

The available documentation indicates that taxpayer advanced money in the form of start-up loans to the company. That same information indicates taxpayer eventually purchased 13 percent of the company's common stock. At some time early in the company's brief history, taxpayer was designated – at the behest of the company's other officers – as "vice president of operations." Shortly thereafter, taxpayer agreed to counter-sign for a substantial bank loan for which – following the company's demise – taxpayer found himself personally and solely liable.

This appears to be the extent of taxpayer's involvement with the company. Taxpayer apparently had no knowledge of the manner in which the company's assets were dissipated. There is evidence to indicate that the company's two operating officers and full-time employees – the president and the secretary/treasurer – unilaterally authorized loans, salaries, and unidentified payments in their favor. These salaries, loans, and payments largely depleted the company's financial resources and were made without the consent or knowledge of the taxpayer. There is information to indicate that the two operating officers hired employees, agreed to pay the employees liberal salaries, and – on at least one occasion – awarded a large severance payment. This is no indication taxpayer ever received any benefit – financial or otherwise – from the company.

From the day-to-day financial records, it is possible to arrive at a conclusion that the company's assets were mismanaged from the date of the company's inception; the company never made a single sale of its software product; the two operating officers used company assets for their personal benefit; and the taxpayer did not agree to or have knowledge of the decisions which – on their face – rapidly brought about the failure of the company.

Despite taxpayer's corporate officer status, the available information indicates that taxpayer had no knowledge of and was uninvolved in the company's day-to-day financial arrears. Taxpayer did not have access to or sign company checks. There is nothing which indicates taxpayer authorized any company disbursements. There is no indication tax- payer had access to the company's day-to-day financial records during his involvement with the company. Indeed, the information indicates that taxpayer was able to obtain the company's financial records only after the company failed and only after agreeing to take individual responsibility for paying the company accountant's unpaid fees.

Taxpayer has supplied an affidavit describing the extent of his involvement with the company. Taxpayer has also supplied an affidavit prepared by the company's independent accountant. The accountant's affidavit indicates that taxpayer "was only an investor in the [company] and did not participate in [the] company's business decisions." The accountant states that taxpayer was only given the "vice president" title "because the bank required that as a guarantor of the bank loan [taxpayer] had to hold a title of a corporate officer." The affidavit stipulates that the president and secretary/treasurer made "substantially all business decisions...."

Under IC 6-3-4-8(g), taxpayer was not a responsible officer and is not personally responsible for the company's unpaid withholding taxes. Although taxpayer was a high ranking company officer, there is nothing to indicate taxpayer had any knowledge of, or exercised any control over, the company's finances. Taxpayer did not have access to or control the company's bank account, did not sign or authorize company checks, and had no say-so in determining when and what order to pay the company's creditors.

Under the standard set out by the Supreme Court in Safayan and under IC 6-8.1-5-1(g), taxpayer has met his burden of proving that the proposed assessment of withholding taxes is wrong. The withholding tax assessments levied against taxpayer should be abated in their entirety.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

#04-20020600.LOF

LETTER OF FINDINGS NUMBER: 02-0600
SALES 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 Tax—Imposed on materials used on construction jobs

Authority: 45 IAC 2.2-3-12(c)

Taxpayer protests the imposition of sales tax on materials used on construction jobs but not incorporated into the final product.

STATEMENT OF FACTS

Taxpayer acts as a fabricator of tangible personal property with or without related installation. Taxpayer also performs jobs for improvement to realty and has performed some smaller repair jobs. Taxpayer considers itself to be a contractor. A large portion of taxpayer's work has been exempt due to customer use in direct production. A majority of taxpayer's jobs are done through lump-sum contracts.

DISCUSSION

I. Sales Tax—Imposed on materials used on construction jobs

The transactions in question all revolve around the renting of tangible personal property for use on the construction site. This property includes booms, pick boards, and scaffolding, none of which were consumed or incorporated into the final product during the construction process. Taxpayer claims that because its customers issue exemption certificates, those certificates should cover taxpayer's rental of equipment used to finish its jobs.

However, 45 IAC 2.2-3-12(c) provides an exception to the general applicability of exemption certificates. It reads, in relevant part:

> Utilities, machinery, tools, … 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. (*Emphasis added*).

The booms, pick boards, and scaffolds in question did not become a part of the improvement to the real estate upon which construction was taking place, and taxpayer has not advanced the argument that they were. Therefore, taxpayer has failed to provide a basis for taking the transactions out of the governing regulation, and the transactions are therefore subject to applicable sales tax.

FINDINGS

The taxpayer is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420030072.LOF

LETTER OF FINDINGS NUMBER: 03-0072
Sales and Use Tax
For the Years 1999-2001

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- Ten Percent (10%) Negligence Penalty

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

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

STATEMENT OF FACTS

The taxpayer is a not-for-profit corporation operating a golf course. 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 a portion of the assessment and the penalty. After the hearing was scheduled, the taxpayer withdrew its protest to the tax assessment. The taxpayer requested that the determination on the applicability of the penalty be made on the basis of the contents of the file.

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

DISCUSSION

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

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

The taxpayer failed to collect and remit sales tax on soft drinks, snacks, and sandwiches based on its incorrect interpretation of the effects of not-for-profit status. The department makes easily available the rules and regulations concerning the collection and remittance of sales tax on food for immediate consumption. The taxpayer failed to read and follow the instructions related to the collection and remittance of sales tax by not-for-profit corporations on sales of food for immediate consumption. This breach of the taxpayer's duty constitutes negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030087P.LOF

LETTER OF FINDINGS NUMBER: 03-0087P

Sales and Use Taxes

Calendar Year 2001 and Months January through June, 2002

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

ISSUES

I. Tax Administration – Penalty

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

The taxpayer protests the penalties assessed for failure to file sales tax returns in a timely manner.

II. Tax Administration – Interest

Authority: IC 6-8.1-10-1

The taxpayer protests the assessment of interest.

STATEMENT OF FACTS

The taxpayer is a corporation engaged in the sale of real estate. The taxpayer filed its sales tax returns after their respective due dates for each month of 2001 and the first six months of 2002. Accordingly, the Department assessed a penalty and interest on each of these returns for the taxpayer's failure to timely remit Indiana sales tax. In its letter of protest, the taxpayer requested that the penalties and interest be abated due to reasonable cause.

I. Tax Administration – Penalty

The taxpayer protests the imposition of penalty based upon the following:

- The taxpayer's former executive team violated its fiduciary duties by failing to file tax returns in a timely manner.
- The taxpayer's funds have been depleted, and payment of the penalties would impede the taxpayer's ability to continue its business activities.

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

> "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the

listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The taxpayer submitted documentation to substantiate its claim that past members of its management team were negligent. However, according to the taxpayer's letter of protest, this prior management team has been replaced by one which is, "…committed to being in full compliance with all rules and regulations relating to sales and use tax…" Indeed, the Department notes that the taxpayer's filing record since July 2002 has greatly improved. As commendable as that is, however, in determining negligence, the Department must evaluate the taxpayer's filing behavior during the period under review: January 2001 through June 2002. Clearly, the taxpayer was negligent throughout this period of time.

Regarding the taxpayer's assertion that payment of the penalties will exacerbate its present financial hardship, the Department has no authority to waive penalties on this basis.

FINDING

The taxpayer's protest is denied.

II. Tax Administration – Interest

The Department does not have the authority to waive interest.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0320030101P.LOF

LETTER OF FINDINGS NUMBER: 03-0101P
Withholding Tax
Calendar Year 2001 and the Months of January Through May 2002 and July 2002

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

ISSUES

I. Tax Administration – Penalty

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

The taxpayer protests the penalties assessed for failure to file an annual reconciliation and monthly returns in a timely manner.

STATEMENT OF FACTS

The taxpayer is a corporation that operates a not-for-profit school. The taxpayer filed the following documents after their respective due dates:

- Annual withholding reconciliation (WH-3) for 2001
- Indiana Employer's Withholding Tax Returns (WH-1s) for these months of 2002: January through May and July

Accordingly, the Department assessed a penalty on each of these documents. In its letter of protest, the taxpayer requested that the penalties be abated due to reasonable cause.

I. Tax Administration – Penalty

In its letter of protest, the taxpayer requests that the penalties be waived because it experienced a change in personnel. In January 2002, the taxpayer's accountant resigned from her position. The director of the school assumed the accounting function.

At about the same time, an independent accountant commenced an audit of the school. The independent accountant retained custody of the taxpayer's financial records until July 2002. Without these records, the director did not have the information required to file returns and remit taxes. The present treasurer of the taxpayer assumed that position in September 2002.

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

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

The Department notes that the taxpayer's filing record since September 2002 has improved. As commendable as that is, however, in determining negligence, the Department must evaluate the taxpayer's filing behavior during the period under review.

The Department acknowledges the confusion created by the loss of vital personnel and the performance of an audit by an independent accountant. However, the possibility of such events should have been anticipated by the taxpayer; procedures should have been in place to assure that tax obligations were timely met.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20030281P.LOF

LETTER OF FINDINGS NUMBER: 03-0281P
Sales and Use Tax
For Tax Years 1998 through 2000

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

ISSUE

I. Tax Administration—Negligence Penalty

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

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

STATEMENT OF FACTS

As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments, ten percent (10%) negligence penalty and interest. Taxpayer protests the imposition of penalty. Further facts will be provided as necessary.

I. Tax Administration—Negligence Penalty

DISCUSSION

The Department issued proposed assessments, a ten percent (10%) negligence penalty and interest for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC 6-8.1-10-2.1(a), which states in relevant part:

If a person:

…

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

…

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which 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 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.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). Taxpayer offered no explanation and did not affirmatively establish that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20030282P.LOF

LETTER OF FINDINGS NUMBER: 03-0282P
Income Tax
For Tax Years 1998 through 2000

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

ISSUE

I. Tax Administration—Negligence Penalty

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

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

STATEMENT OF FACTS

As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments, ten percent (10%) negligence penalty and interest. Taxpayer protests the imposition of penalty. Further facts will be provided as necessary.

I. Tax Administration—Negligence Penalty

DISCUSSION

The Department issued proposed assessments, a ten percent (10%) negligence penalty and interest for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC 6-8.1-10-2.1(a), which states in relevant part:

> If a person:
> …
> (3) incurs, upon examination by the department, a deficiency that is due to negligence;
> …
> the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which 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 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.

45 IAC 15-11-2(c) provides in pertinent part:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). Taxpayer offered no explanation and did not affirmatively establish that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20030349P.LOF

LETTER OF FINDINGS NUMBER: 03-0349P
Failure to File Penalty
For Years 1999, 2000, and 2001

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

ISSUE

I. Tax Administration - Twenty Percent (20%) Failure to File Penalty

Authority: § 6-8.1-10-3; 45 IAC 2.2-3-9; IC 6-2.5-3-5.

The taxpayer protests the imposition of the twenty percent (20%) failure to file penalty.

STATEMENT OF FACTS

Taxpayer, an S corporation, is an Illinois contractor that makes improvements to real property. Taxpayer sells and installs windows, siding, doors, and sunrooms. Taxpayer subcontracts all construction labor. Taxpayer has no property in Indiana, but does business with Indiana customers.

I. Tax Administration - Twenty Percent (20%) Failure to File Penalty

DISCUSSION

The taxpayer protests the imposition of the twenty percent (20%) failure to file penalty pursuant to IC § 6-8.1-10-3. Said statue reads:

(a) If a person fails to file a return on or before the due date, the department shall send him a notice, by United States mail, stating that he has thirty (30) days from the date the notice is mailed to file the return. If the person does not file the return within the thirty (30) day period, the department may prepare a return for him, based on the best information available to the department. The department prepared return is prima facie correct.

(b) If the department prepares a person's return under this section, the person is subject to a penalty of twenty percent (20%) of the unpaid tax. In the absence of fraud, the penalty imposed under this section is in place of and not in addition to the penalties imposed under any other section.

Taxpayer claims it believes, under the tax statutes of Illinois, that it was properly paying sales tax on items it was purchasing for materials incorporated into real property in Indiana. The auditor assessed Indiana use tax on those materials pursuant to 45 IAC 2.2-3-9. Taxpayer believes that if it correctly paid the sales tax to Illinois, it would be entitled to an offsetting credit to the use tax assessed against it by Indiana pursuant to IC 6-2.5-3-5.

The Department declines taxpayer's invitation to determine whether or not Illinois sales tax was correctly paid. The Department normally makes no rulings with regard to the laws of other states, nor does it interpret the application of those laws. And while an analysis that would tend to show that taxpayer was correct in its payment of Illinois sales tax might alter the assessment for underpayment, taxpayer has not filed an Indiana tax return through which it could claim the credit granted by IC 6-2.5-3-5. Therefore, the Department also need not determine whether or not credit would have been granted pursuant to that statute.

As such, taxpayer's failure to file an Indiana return leaves it without a basis for protesting the penalties assessed against it.

FINDING

The taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20030359P.LOF

LETTER OF FINDINGS NUMBER: 03-0359P
Sales and Use Tax
For Tax Years 2000 through 2002

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

ISSUE

I. Tax Administration—Negligence Penalty and Interest

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

Taxpayer protests a ten percent (10%) negligence penalty and interest.

STATEMENT OF FACTS

As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments, ten percent (10%) negligence penalty and interest. Taxpayer protests the imposition of penalty and interest. Further facts will be provided as necessary.

I. Tax Administration—Negligence Penalty and Interest

DISCUSSION

The Department issued proposed assessments, a ten percent (10%) negligence penalty and interest for the tax years in question. Taxpayer protests the imposition of penalty and interest. The Department refers to IC 6-8.1-10-2.1(a), which states in relevant part:

If a person:

…
(3) incurs, upon examination by the department, a deficiency that is due to negligence;
…
the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which 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 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.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). Taxpayer offered no explanation and did not affirmatively establish that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

Also taxpayer protests imposition of interest. The Department refers to IC 6-8.1-10-1(e), which states:

Except as provided by IC 6-8.1-5-2(e)(2), the department may not waive the interest imposed under this section.

Taxpayer has not provided any documentation in support of its protest of the imposition of interest and the Department may not waive interest under IC 6-8.1-10-1(e).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120030378.LOF

LETTER OF FINDINGS: 03-0378
Indiana Individual Income Tax
For 1999 Tax Year

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. Gambling Losses – Individual Adjusted Gross Income Tax.

Authority: Ind. Const. art. 10, § 8; IC 6-2.1-1-2(a); IC 6-2.1-2-2; IC 6-3-1-1 et seq.; IC 6-3-1-3.5; 45 IAC 3.1-1-1; I.R.C. § 61; I.R.C. § 62; I.R.C. § 165; I.R.C. § 165(d); 2002 U.S. Master Tax Guide (CCH 2002); Black's Law Dictionary (7th ed. 1999).

Taxpayer challenges an assessment of additional adjusted gross income tax on the ground that the additional taxes are based upon gambling earnings and that taxpayer should be permitted to offset the gambling losses against these particular earnings.

STATEMENT OF FACTS

Taxpayer received a notice of "Proposed Assessment" indicating that taxpayer owed an amount of additional Indiana income tax for 1999. This proposed assessment was apparently issued after the Internal Revenue Service notified the Department of Revenue (Department) that taxpayer had previously been billed for additional federal income tax based upon unreported 1999 income. Taxpayer challenged the assessment of the additional Indiana taxes, a hearing was conducted during which taxpayer's representatives explained the basis for the protest, and this Letter of Findings results.

DISCUSSION

I. Gambling Losses – Individual Adjusted Gross Income Tax.

Taxpayer argues that in reporting his gambling earnings, he is entitled to offset his gambling losses against his gambling earnings. According to taxpayer, if he won $5,000 gambling but lost $4,000, taxpayer should only be required to pay taxes on $1,000 in winnings. However, taxpayer contends that he should be permitted to offset gambling losses only to the extent that his gambling earnings exceed the losses. Thus, if taxpayer won $2,000 but lost $3,000, he would be entitled to offset the entire $2,000 in earnings; taxpayer pays taxes on $0 in gambling income.

Taxpayer's argument is based on the contention that, "The Gross Income Tax imposed by the State of Indiana is unconstitutional under Article 10, Section 8 of the Indiana Constitution." That constitutional provision permits the Indiana General Assembly to "levy and collect a tax upon income from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art. 10, § 8. Specifically, taxpayer challenges IC 6-2.1-1-2(a) which states that, "Except as expressly provided in this article, 'gross income' means all the gross receipts a taxpayer receives...." Taxpayer takes this to mean that gambling winnings are not "income" to the extent that the winnings are offset by gambling losses. As taxpayer summarizes, "The Indiana Gross Income tax, to the extent that it taxes beyond income is unconstitutional under the Indiana Constitution and contrary to Indiana case law, and therefore [taxpayer] should be allowed to deduct his losses to the extent of his winnings."

Taxpayer believes that the proposed assessment is incorrect because the state legislature exceeded its constitutional mandate in imposing a gross income tax on "gross receipts," that the Indiana Constitution allows only a tax on "income," and that gambling losses are inherently not part of a taxpayer's "income." (e.g. $800 in gambling earnings + $200 in gambling losses = $600 in taxable income.)

Metaphorically speaking, taxpayer is barking up the wrong tree. It is not necessary to determine if gambling losses should be excluded from "gross receipts" because taxpayer was not assessed gross income tax. Indiana's gross income tax is imposed exclusively on corporate entities which are either residents or domiciliarys of Indiana or on non-resident business entities which nonetheless derive income from doing business within the state. IC 6-2.1-2-2. The proposed assessment was issued pursuant to the provisions of the individual adjusted gross income tax provisions set out in IC 6-3-1-1 et seq.

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

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

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

I.R.C. § 62 states that, "For purposes of this subtitle, the term 'adjusted gross income' means, in the case of an individual, gross income minus the following deductions...." The deductions specified under I.R.C. § 62 contain no provision permitting an individual to deduct gambling losses from his gross income. However, the federal law does permit the deduction of gambling losses to the extent of the taxpayer's gains from similar transactions. I.R.C. § 165(d). "Nonbusiness gambling losses are deductible only as deductions itemized on schedule A of Form 1040." 2002 U.S. Master Tax Guide para. 788, p. 248 (CCH 2002). Thereafter, the total amount of itemized deductions from Schedule A is then subtracted from the amount of federal adjusted gross income yielding federal "taxable income."

Nevertheless, I.R.C. § 165 does not get taxpayer where he wants to go. Although Indiana's income tax piggybacks on the federal tax, it piggybacks on federal "adjusted gross income" and not on "taxable income." The deduction permitted by I.R.C. § 165(d) is a "below the line adjustment" – taken after determining adjusted gross income – and is irrelevant in determining the amount of Indiana income tax.

"Gross income" is "[t]otal income from all sources before deductions, exemptions, or other tax reductions." Black's Law Dictionary p. 766 (7th ed. 1999). I.R.C. § 61 defines "gross income" as "all income from whatever source derived" Gambling winnings are merely one portion of any taxpayer's "income from all sources." The specific deductions listed under I.R.C. § 62 are then subtracted from the amount of "gross income" to yield a number called "adjusted gross income." It is that particular number which is the jumping off point for determining Indiana adjusted gross income. Under IC 6-3-1-3.5, Indiana permits a number of additional, state-specific modifications but, as in I.R.C. § 62, there is nothing in IC 6-3-1-3.5 which permits an Indiana taxpayer to deduct an amount for gambling losses.

Under Ind. Const. art. 10, § 8, the state legislature has seen fit to adopt a taxing scheme which taxes gambling earnings as one part of a taxpayer's adjusted gross income. It has also decided that there is no deduction, exemption, or exclusion for associated gambling losses. Therefore, the Department does not accept taxpayer's assertion that the state's income tax scheme is unconstitutional. For whatever reasons, the state legislature has determined that Indiana residents may not deduct gambling losses from that citizen's adjusted gross income. There is nothing to indicate that the legislature exceeded its constitutional authority in making that determination. The Department must decline the opportunity to unilaterally carve out an adjusted gross income modification where none exists.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0120030416P.LOF

LETTER OF FINDINGS NUMBER: 03-0416P
Income Tax
For the 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 underpayment penalty for estimated tax.

II. Tax Administration – Interest

Authority: IC 6-8.1-10-1

The taxpayer protests the interest assessment.

STATEMENT OF FACTS

The underpayment penalty along with interest was assessed on the filing of the annual income tax return for the calendar year 2001.

The taxpayer is an individual residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the underpayment penalty be waived or reduced as the penalty is excessive in relation to what the taxpayer usually pays in taxes. The penalty is $1,031.70 and the taxpayer has paid an average in taxes over the last several years of about $1,000.

The Department points out the taxpayer underpaid the estimated taxes as a result of misreading the income tax instructions.

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.

II. Tax Administration – Interest

Interest may not be waived according to IC 6-8.1-10-1.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20030427P.LOF

LETTER OF FINDINGS NUMBER: 03-0427P
Sales and Use Tax
For Tax Years 2000 through 2002

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

ISSUE

I. Tax Administration—Negligence Penalty and Interest

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

Taxpayer protests a ten percent (10%) negligence penalty and interest.

STATEMENT OF FACTS

As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments, ten percent (10%) negligence penalty and interest. Taxpayer protests the imposition of penalty and interest. Further facts will be provided as necessary.

I. Tax Administration—Negligence Penalty and Interest

DISCUSSION

The Department issued proposed assessments, a ten percent (10%) negligence penalty and interest for the tax years in question. Taxpayer protests the imposition of penalty and interest. The Department refers to IC 6-8.1-10-2.1(a), which states in relevant part:

If a person:

…

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

…

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which 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 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.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). Taxpayer offered no explanation and did not affirmatively establish that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

Also taxpayer protests imposition of interest. The Department refers to IC 6-8.1-10-1(e), which states:

Except as provided by IC 6-8.1-5-2(e)(2), the department may not waive the interest imposed under this section.

Taxpayer has not provided any documentation in support of its protest of the imposition of interest and the Department may not waive interest under IC 6-8.1-10-1(e).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

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SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 98-0737; 98-0736; 01-980734

Gross Retail Sales and Income Taxes

Calendar Years 1994, 1995, and 1996

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

ISSUE

I. Sales Tax – Assessment: – Best Information Available (BIA)

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2: IC 6-2.5-3-6(b),(c); IC 6-2.5-4-1(b); IC 6-2.5-6 et seq., IC 6-8.1-5-1(a); IC 6-8.1-5-1(b); IC 6-8.1-5-4(a); 45 IAC 2.2-2-2.

Taxpayer protests the auditor's BIA method of calculating gross retail income and the auditor's BIA determination of the rate of markup used in calculating taxable sales.

STATEMENT OF FACTS

Taxpayers are husband and wife who owned and operated one each of two licensed package liquor stores. Various records related to the business were lost, and at the time of the audit the auditor completed a "best information available" audit.

The auditor focused on vendor records for product supplied to the taxpayers, then extrapolated an estimate of taxpayers' retail sales based on taxpayers records that were available, published ratios from the ***Almanac of Business and Industrial Financial Ratios*** authored by Leo Troy, Ph.D., 1997 Edition, Prentice Hall, and income tax returns with supporting schedules, (1994 IT-40 only, no Federal information, 1995, and 1996).

The auditor calculated an error factor based upon records from one of the taxpayers' liquor distributors and the taxpayers' records for 1995 and 1996. No records were made available for 1994; therefore, an average of 1995 and 1996 was utilized. (Basis and reasons for the calculation is contained on page 5-6 of the audit report) Taxpayers' records did not coincide with the "reporting distributor's" amounts. Auditor states that the taxpayers insisted that all purchases were made solely at one location, however, the distributor's records indicate otherwise.

It was necessary for audit to extrapolate the information provided by year to determine net income by year and to account for months in which no information was available.

Because the taxpayers had a limited number of purchase invoices available for review, the audit proposed an adjustment to cost of goods sold based on items purchased during the audit period by utilizing a vendor's information and calculating the error factor for those purchases with taxpayers' records for that vendor.

The records would indicate that the auditor employed, in a conscientious and professional manner, the best available records and source materials to produce the BIA assessments. Taxpayers were invited to contribute additional substantive information or to rebut the audit's conclusions with concrete information. Taxpayers' CPA, instead states, that as the concrete information was unavailable, he has reconstructed taxpayers' records based on taxpayers' bank records.

I. Sales Tax – Best Information Available

DISCUSSION

Taxpayers protest the assessment and state their records were incomplete because they experienced a basement flood in 1995, which destroyed some of the records. At hearing, Taxpayers' CPA provided additional facts, observations, and conclusions he reached to support the reconstruction of taxpayer's 1994 through 1996 records and provided the hearing officer with supporting summaries and what documentation was available.

Taxpayers admit that they may owe additional taxes. However, taxpayers protest the means by which audit determined the amount of income tax owed. Taxpayers disagree with audit's determination of the base amount of its gross retail income and error factors. Taxpayers contend that the mark-up in an economically depressed area never generated the quantity of sales estimated by the auditor. Further, taxpayers contend that the calculated error factor determined by audit is a wholly unrealistic estimate of the actual sales of their business. Taxpayers' representative contends that the audit rate of 22.5% conflicts with the published ratios from the ***Almanac of Business and Industrial Financial Ratios*** rate of 4.5%.

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. Audit's BIA determinations were made necessary by taxpayers' failure to maintain or provide pertinent information, records, or invoices.

Under IC 6-8.1-5-4(a),"Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." The records referred to "include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and cancelled checks."

The audit was conducted in the absence of complete records of taxpayers' sales, purchases and expense records. The business records supplied to the auditor were not complete.

In attempting to rebut the assessment, taxpayers stated that audit's determination and methods were "grossly misrepresentat [ive]" inaccurate and based upon standards that were inapplicable to this taxpayer. Taxpayers' CPA stated that his own investigation found that the markup was highly overstated. Taxpayers provided plausible inferential information as to why a lower assessment could be appropriate, but have failed to provide sufficient evidence of error by the Department to warrant a reversal of the Department's original assessment.

By failing to present any concrete evidence of taxpayers' financial activity, the taxpayers have failed to meet their burden of proof, imposed under IC 6-8.1-5-1 (b), to rebut the presumptive validity afforded the Department's proposed sales tax assessments.

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."

FINDING

Taxpayers' protest is respectfully denied.

DEPARTMENT OF STATE REVENUE
REVENUE RULING #2003-01 URT
November 24, 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 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

Utility Receipts Tax – Application of Utility Receipts Tax to Interstate and International Land-Line Telecommunications Services

Authority: IC 6-2.3-1-4, IC 6-2.3-1-13&14, IC 6-2.3-4-2, The United States Constitution, Central Greyhound Lines, Inc. v. Mealey, Oklahoma Tax Commission v. Jefferson Lines, Inc.

The taxpayer requests the Department to rule on the application of utility receipts tax to interstate and international land-line telecommunication services. The term "land-line telecommunication services", as used herein, refers to telecommunications by wire, cable, fiber optics or similar facilities. The taxpayer does not seek a ruling with respect to cellular or wireless services.

STATEMENT OF FACTS

The term "taxpayer", as used herein, refers to a corporation and its related entities, including without limitation an Indiana general partnership. The taxpayer provides, among other goods and services, interstate and international land-line telecommunication services.

DISCUSSION

IC 6-2.3-1-4 imposes utility receipts tax, hereinafter "URT", on the "the retail sale of utility services..." "Utility service" includes the furnishing of "telecommunications services", which are defined as the "transmission of messages or information by or using wire, cable, fiber optics, laser, microwave, radio, satellite, or similar facilities." IC 6-2.3-1-13,-14.

IC 6-2.3-4-2 states:

> Gross receipts derived from business conducted in commerce between Indiana and either another state or territory or a foreign country are exempt from utility receipts tax to the extent the state is prohibited from taxing the gross receipts by the Constitution of the United States.

The taxpayer believes that because of the nature of the URT and the absence of an apportionment provision in the URT, the imposition of URT on receipts from land-line interstate or international telecommunication services is prohibited under the Commerce Clause of the United States Constitution (U.S. Const., Art. 1, & 8) and therefore such services are exempt from tax under IC 6-2.3-4-2.

The URT is imposed on gross receipts from a utility's activities, not on the consumer of utility services. It is not imposed on consumption, but a tax on the business of furnishing utility services.

In support of the belief that the imposition of URT on receipts from land-line interstate and international telecommunication services is prohibited under the Commerce Clause of the United States Constitution the taxpayer offers certain court decisions. In 1948, the United States Supreme Court in Central Greyhound Lines, Inc. v. Mealey, 334 U.S. 653, 68 S. Ct. 1260 (1948), struck down New York's gross receipts tax on utility services as applied to receipts from interstate bus service. The State of New York sought to tax the total unapportioned receipts from New York sales of interstate transportation services, even though almost half of the mileage was in New Jersey and Pennsylvania. The Supreme Court held that, by its very nature, "an unapportioned gross receipts tax makes interstate transportation bear more than a fair share of the cost of the local government whose protection it enjoys."

The taxpayer summarizes that the New York utility receipts tax violated the Commerce Clause because it tried to tax more than the portion of the revenues of the interstate activities which reasonably reflected the in-state (New York) components of the activity being taxed.

The taxpayer, also, offers Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 115 S.Ct 1331 (1995), that reaffirmed the holding in Central Greyhound. The United States Supreme Court noted that in the case of gross receipts taxes on the seller – as opposed to a sales tax on the consumer – an unapportioned tax on interstate services remains unconstitutional.

The taxpayer states that Jefferson Lines and Central Greyhound dictate that once a tax has been identified as a gross receipts tax on an interstate business activity, the tax base must be apportioned to reflect interstate activities.

Upon review of the information submitted by the taxpayer, the Department concurs with the taxpayer's belief that the imposition of URT on receipts from interstate and international land-line telecommunication services originating or terminating in Indiana is prohibited by the Commerce Clause of the United States Constitution and, hence, under IC 6-2.3-4-2 receipts from such interstate and international telecommunication services are exempt from URT.

RULING

The Department rules that the taxpayer and its related entities, including without limitation the Indiana general partnership, are not liable for Indiana utility receipts tax on their receipts from furnishing interstate or international land-line telecommunication services.

CAVEAT

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