DEPARTMENT OF STATE REVENUE

<u>IN REGARDS TO THE MATTER OF:</u>
FRATERNAL ORDER OF EAGLES #1717
DOCKET NO. 29-2002-0381

<u>PROPOSED ORDER</u>

The Criminal Investigation Division of the Indiana Department of Revenue conducted an investigation of the Fraternal Order of Eagles No. 1717 on April 19, 2002. As a result of the investigation, on July 17, 2002, the Petitioner's pull tab license was not renewed and the Petitioner was prohibited from conducting any charity gaming in Indiana for a period of three (3) years from July 1, 2002. The Petitioner protested in a timely manner.

<u>FINDINGS OF FACTS</u>

1) Petitioner protested the Department's proposed actions on August 8, 2002.
2) The Department acknowledged the Petitioner's appeal in a letter dated August 8, 2002.
3) The Department contacted the Petitioner a second time regarding setting a hearing on August 8, 2002.
4) The Department sent Petitioner a letter dated May 21, 2003 regarding the legislative changes that directly affected the procedures governing the administrative hearing.
5) The Department contacted the Petitioner a second time regarding setting a hearing on January 14, 2004.
6) Pursuant to IC 4-21.5-3-1 notice was given to the Petitioner on January 14, 2004, via certified mail return receipt requested, regarding a possible dismissal of its appeal.
7) The notice was delivered and signed for by Petitioner's representative on January 20, 2004.
8) Petitioner has repeatedly failed to respond to the Department's correspondence.

<u>STATEMENT OF LAW</u>

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.

<u>CONCLUSIONS OF LAW</u>

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.

<u>PROPOSED ORDER</u>

The Administrative Law Judge orders the following:
Petitioner's appeal is dismissed.
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.

<u>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</u>

SERVED ON THE PETITIONER.
Dated: ____________________

____
Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

04-990051LOF

LETTER OF FINDINGS NUMBER: 99-0051
Sales/Use Tax
For the Years 1995-1997

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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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

ISSUES

I. Sales Tax Assessment—Booth Rental

Authority: 45 IAC 2.2-4-8; 45 IAC 2.2-4-9

Taxpayer protests the Department's timely proposed assessment of tax on the taxpayer's rental of vendor booths.

II. Tax Administration—Penalty and Interest

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

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

STATEMENT OF FACTS

The taxpayer operates two flea markets. At the flea markets, the taxpayer rents booth space to vendors and operates food concessions. The flea markets are open to the public three (3) days a month. Vendors pay rent on booths supplied by the taxpayer. The taxpayer had two types of vendors: (1) occasional; and (2) long term (consecutive months). The taxpayer collected sales tax on occasional vendors, but only collected tax for the first month on vendors who returned monthly. Also, some category (2) vendors opted to pay their rental amounts annually. Neither side disputes whether category (1) vendors are taxable, but there is a dispute regarding (2).

I. Sales Tax Assessments—Booth Rental

DISCUSSION

The auditor argues that since the flea markets are only open three days a month, and that the buildings are locked when the flea markets are not open (and per the auditor, the vendors do not have access save for the three days each month), the taxpayer's rental of booths was taxable under 45 IAC 2.2-4-8, which states in pertinent part, "Every person engaged in the business of renting or furnishing for periods of less than thirty (30) days any accommodation including booths … is a retail merchant making retail transactions…." "Accommodation," for our purposes, is defined at 45 IAC 2.2-4-9(a)(7):

(a) For purposes of the state gross retail and use tax, an "accommodation" is any space, facility, structure, or combination thereof including booths, display spaces and banquet facilities, together with all associated personal or real property (including land), which is intended for occupancy by human beings for a period less than thirty (30) days including:

* * * *

(7) Booths or display spaces in a building, coliseum or hall.

The auditor's position is that vendors are only renting for three days, and not the full month. As for the vendors that pay annually, the auditor characterizes those payments as "simply three days rent paid several months in advance."

The taxpayer also relies on 45 IAC 2.2-4-8, but cites different language for a different result:

(b) In general, the gross receipts from renting or furnishing accommodations are taxable. An accommodation which is rented for a period of thirty (30) days or more is not subject to the gross retail tax.

The taxpayer provided the Department sample copies of contracts between the taxpayer and vendors. The contracts are signed monthly and contain the following relevant language:

I [Vendor] am a permanent dealer in the [flea market] of [City of X].

YES NO [The Vendor is to circle the appropriate answer]

The taxpayer states "permanent" means that the vendor will have the same, discrete, booth space for a continual period (unlike the non-permanent, occasional vendors).

The taxpayer notes:

While open to the public only three days each month, Vendors rent the space for the entire month, or longer period. Vendors may store merchandise in the space on a permanent basis so long as the rent is paid. Moreover, many Vendors leave their fixtures, booths, tables, advertising materials, and banners in the rented space from month to month.

Also, at hearing, the taxpayer disputed whether or not vendors had access to their booths. The taxpayer stated that if, for example, a vendor wanted access to their booth space when the flea market is closed, that the vendor has a contact person, who also does custodial work for the flea market, that can let them inside.

Also of import is the example provided by 45 IAC 2.2-4-9:

> If a person moves into a room for an indefinite period, but pays weekly, sales tax must be collected until a person has rented the room for longer than 30 consecutive days.

To recapitulate: the contracts between the taxpayer and its vendors are monthly (the contract does not say for "three days a month"); taxpayer states that the vendors can and do leave various items (listed earlier) in their specific booth for periods that exceed thirty days; vendors have access to the booths by going through the contact person who can let them inside the flea market when it is closed (also, the taxpayer states that the flea markets are open to all of the vendors the day before the three days the flea market is open to the general public); and the rental booth is for a specific, discrete, location in one the flea markets. Based upon these facts, the Department finds for the taxpayer.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Penalty and Interest

DISCUSSION

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

Subsection (d) of IC 6-8.1-10-2.1 allows the penalty to be waived upon a showing that the failure to pay the deficiency was "due to reasonable cause and not due to willful neglect." To establish this the "taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...." 45 IAC 15-11-2(c).

Beyond the issue discussed above in part **I**, which the taxpayer has prevailed on and therefore cannot be a basis for negligence, the taxpayer also was assessed for food sales made at its concessions at the flea markets. Under Indiana law food sold at the concessions is taxable, and the taxpayer explains that the "error resulted from Taxpayers' understanding that the only tax imposed on food and beverage sales was the county tax." Since 45 IAC 2.2-5-43 clearly indicates that so-called "food for immediate consumption" is taxable, the taxpayer was negligent in this respect.

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

FINDING

The taxpayer's protest of the penalty and interest is denied.

DEPARTMENT OF STATE REVENUE

02990057.LOF

LETTER OF FINDINGS: 99-0057
Indiana Adjusted Gross Income Tax
For Tax Years 1995 through 1997

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

ISSUES

I. Adjusted Gross Income Tax: Partnership Distributions

Authority: IRC §63; IC 6-3-2-1

Taxpayer protests the Department's characterization of income received from an Indiana partnership.

II. Tax Administration: Negligence Penalty

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

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer provides financial products and services to individual and institutional investors. Additionally, Taxpayer offers investment and banking services to corporate, governmental, and municipal clients.

In 1985, Taxpayer formed an Indiana partnership ("Partnership"). The stated purpose behind formation of the Partnership was to purchase, rehabilitate, and market residential buildings in downtown Indianapolis. Taxpayer's *planned* participation in the Partnership consisted, primarily, of bond underwriting and equity syndication. Taxpayer, as the initial equity investor ($6.5 million capital investment), intended to offer limited interests in the Partnership to its retail customers. (The general partner was an unrelated third party.) Taxpayer also intended to reserve, for itself, a limited interest in the Partnership.

Taxpayer's partnership plans proved untenable. Federal tax law changed. The residential real estate market weakened. The general partner, a local builder, declared bankruptcy. Limited partnership interests could not be sold. Consequently, Taxpayer chose to retain its ninety-nine percent (99%) limited partnership interest. A new general partner, an affiliated corporation, acquired the remaining one-percent (1%) partnership interest. Additional limited partners were never found.

Despite the absence of outside investors, the Partnership, over the next eleven (11) years, operated as intended; the Partnership rehabilitated residential properties. The Partnership operations, though, were not profitable. Taxpayer continued to fund the Partnership's residential real estate activities. Taxpayer "advanced" the Partnership $31 million. For federal income tax purposes, Taxpayer characterized the $31 million "advancements" as capital contributions (i.e., equity). Taxpayer explains:

> For federal tax purposes…the advances did not possess sufficient characteristics of debt and were therefore treated as equity. Annual losses were recognized [by Taxpayer] for federal tax purposes because the additional equity contributions gave the company sufficient tax basis to claim such losses.

In 1996, Taxpayer liquidated the Partnership. According to Taxpayer, the liquidation proceeds were sufficient to return Taxpayer's initial capital investment of $6.5 million. The liquidation proceeds, however, were insufficient to "cover" any of Taxpayer's $31 million "advancements." The proper characterization of these liquidation proceeds is at issue.

Taxpayer *initially* characterized the $31 million liquidation proceeds as income. Taxpayer explains:

> [Taxpayer's] department that prepared the [Partnership's] returns used the financial statement information that included the COD income [received by Taxpayer from the Partnership] as the basis for amounts reported on the [federal] return. This department was unaware that the appropriate federal tax treatment of the transaction was different from the treatment on the financial statement and included COD income of approximately $31 million on the partnership return as additional rental income.

Furthermore (again, according to Taxpayer):

> The [Partnership's] federal partnership return, Schedule K-1, erroneously reported partnership income of $26,423,497 that included $31 million of COD income. … Building on the mistake on the K-1, Taxpayer's tax compliance group deducted $26,423,497 as foreign source income before apportionment on Taxpayer's Indiana Corporate Income Tax Return….

Upon review, Audit disallowed Taxpayer's $26,423,497 foreign source income deduction. Audit re-characterized the $26,423,497 as non-unitary partnership income. Accordingly, Audit allocated the entire amount to Indiana. These adjustments "resulted in a significant increase to [Taxpayer's] Indiana adjusted gross income." Specifically, Audit proposed an additional $1,966,645 of assessments. Taxpayer protests these additional assessments.

DISCUSSION

I. Adjusted Gross Income Tax: Partnership Distributions

This assessment is based on Audit's disallowance of the foreign source income deduction and subsequent re-characterization of the reported income as non-unitary partnership income. Audit explains:

> During the audit period, the [T]axpayer [received]…distributions from…an Indiana partnership [Partnership]. The distributions were reported on line 31 of Schedule B as other adjustments before apportionment. The [T]axpayer failed to add back non-unitary partnership distributions attributed to Indiana on line 37.

Taxpayer does not directly contest either Audit's disallowance of the foreign source income deduction, or Audit's subsequent re-characterization of the income as non-unitary partnership income. Rather, taxpayer contends the amounts in question were not "income."

Taxpayer explains:

> [Taxpayer] treated certain book accounting entries related to contributions of capital improperly as partnership rental income. For federal income tax purposes, the book accounting entries erroneous characterization does not cause federal taxable income. In the case of a partner and its partnership, the Internal Revenue Code classifies the amount in question as contributions of capital. Return of capital does not result in IRC §63 taxable income to the recipient.

The threshold question, then, is whether the amounts reported as income by Taxpayer (and subsequently re-characterized as non-unitary partnership income by Audit—i.e., the liquidation proceeds), were, in fact, income. If the reported amounts were income, then the Department must determine whether this income should have been apportioned as unitary partnership income, or allocated to Indiana as non-unitary partnership income.

The Liquidation Proceeds

Despite Taxpayer's initial characterization of the liquidation proceeds as "partnership rental income," the underlying transactions belie such a portrayal. The Partnership, while in operation, never realized $31 million in rental income. Consequently, the liquidation proceeds could not, when in the hands of Taxpayer (a corporate partner), be characterized as rental income.

Similarly, Taxpayer's "advancements" did not represent loans to the partnership. The Partnership, upon liquidation did not realize $31 million of income from the cancellation of debt. Consequently, the liquidation proceeds could not, when in the hands of Taxpayer (a corporate partner), be characterized as cancellation of debt income.

The $31 million of "advancements" transferred to the Partnership by Taxpayer are best characterized as contributions of capital. Amounts characterized as "return of capital" do not represent "income." See IRC §63 and IC 6-3-2-1. While the amounts denominated as "liquidation proceeds" were sufficient to guarantee a return on Taxpayer's initial capital contribution, these proceeds failed to cover (or return) Taxpayer's subsequent capital contributions. Taxpayer, that is, failed to realize income when it received the liquidation proceeds. And absent realization, Taxpayer has nothing to recognize.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration: Negligence Penalty

The Department may impose, in certain situations, a ten percent (10%) negligence penalty. IC 6-8-10-2.1 and 45 IAC 15-11-2. Taxpayer's failure to timely file income tax returns, generally, will result in penalty assessment. IC 6-8.1-10-2.1(a)(1). The Department, however, may waive the penalty if Taxpayer can establish that its failure to file "was due to reasonable cause and not due to negligence." 45 IAC 15-11-2(c). A Taxpayer may demonstrate reasonable cause by showing "that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed…." *Id*. Since Taxpayer has prevailed on the only issue upon which this penalty was assessed, the penalty must be waived.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220010127; 0220010128.LOF

LETTER OF FINDINGS: 01-0127; 01-0128
Indiana Corporate Income Tax
For the Years 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. Applicability of the Throw-Back Rule – Adjusted Gross Income Tax.

Authority: 15 U.S.C.S. § 381; IC 6-3-2-2; IC 6-3-2-2(e); IC 6-3-2-2(n); IC 6-3-2-2(n)(1); Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992); 45 IAC 3.1-1-53(5); 45 IAC 3.1-1-64.

Taxpayer argues that the Department of Revenue (Department) erred when it determined that the income received from sales of auto parts to its Illinois customer was subject to Indiana adjusted gross income tax.

II. Management Fees and Royalty Payments as Indiana Source Income – Adjusted Gross Income Tax.

Authority: IC 6-3-2-1; IC 6-3-2-2(a); 45 IAC 3.1-1-38; 45 IAC 3.1-1-38(4); 45 IAC 3.1-1-55.

Taxpayer argues that as the out-of-state parent company, money it received in the form of management fees and royalties from its Indiana manufacturing division was not subject to the state's adjusted gross income tax.

STATEMENT OF FACTS

Taxpayers are in the business of manufacturing and selling original equipment auto parts. There are two separate but related entities involved in this protest. The first entity is the out-of-state parent company; the second entity is the manufacturing division which operates a manufacturing facility in Indiana.

The Department of Revenue conducted an audit review of taxpayers' 1996 and 1997 business records and tax returns concluding that both taxpayers owed additional Indiana corporate income tax. Taxpayer manufacturing division (located in Indiana) argues that money received from the sale of its auto parts to an Illinois auto manufacturer should not have been "thrown back" to Indiana. Taxpayer parent company (located in Michigan) argues that money received from taxpayer manufacturing division in the form of management fees and royalties was not subject to Indiana's corporate income tax.

Taxpayers both challenged the audit's conclusions and the assessment of additional income tax. They submitted a protest to that effect, an administrative hearing was conducted during which taxpayers explained the basis for their protest, and this Letter of Findings results.

DISCUSSION

I. Applicability of the Throw-Back Rule – Adjusted Gross Income Tax.

Taxpayer manufacturing division argues that the Department erred when it "threw back" the Illinois sales to Indiana. Taxpayer argues that the decision was inappropriate because it was subject to income tax in Illinois.

The audit determined that, for purposes of calculating taxpayer's Indiana tax liability, sales of auto parts to Illinois should be thrown back to Indiana because the sales were made within a state where taxpayer (the Indiana manufacturing division) was not subject to the state's income tax. The audit arrived at this conclusion because taxpayer did not have an Illinois situs, Illinois property, Illinois payroll, or an Illinois nexus. The audit found that taxpayer's only Illinois in-state activity was "sporadic."

The audit found authority for its decision to throw back the Illinois sales in 45 IAC 3.1-1-53(5) which states that "[i]f the taxpayer is not taxable in the state of the purchaser, the sale is attributed to [Indiana] if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state." These sales are called "throw-back" sales. Id.

The underlying rule is found at IC 6-3-2-2. IC 6-3-2-2(e) provides that "[s]ales of tangible personal property are in this state if... (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and... (B) the taxpayer is not taxable in the state of the purchaser." IC 6-3-2-2(n) provides that "[f]or purposes of allocation and apportionment of income... a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact the state does or does not." Accordingly, in order to properly allocate income to a foreign state, taxpayer must show that one of the taxes listed in IC 6-3-2-2(n)(1) has been levied against him or that the state has the jurisdiction to impose a net income tax regardless of "whether, in fact, the state does or does not." Id.

Therefore, in order to avoid having the Illinois sales receipts thrown back to Indiana, the taxpayer must show its Illinois activities are such that it was brought within the orbit of the Illinois tax scheme. In support of the proposition that the sales should be thrown back to Indiana, the audit report noted that taxpayer did not pay Illinois income tax during 1996 and 1997 and that it had not filed Illinois returns during that period. In addition, the audit reported that taxpayer did not maintain an Illinois business location, did not have property within Illinois, and did not have payroll attributable to Illinois.

The fact that taxpayer did not pay Illinois income tax during this period and – in fact – did not even file Illinois returns is useful in resolving the throw-back issue, but it is not determinative. Instead, whether or not Indiana can throw back these sales hinges on whether or not "taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States." 45 IAC 3.1-1-64.

15 U.S.C.S. § 381 (Public Law 86-272) controls those occasions in which a state – such as Illinois – can impose a tax on the net income, derived from sources within that state, received by foreign (out-of-state) taxpayers. 15 U.S.C.S. § 381 sets a minimum standard for the imposition of a state income based on the solicitation of interstate sales. Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447, 2453 (1992). 15 U.S.C.S. § 381 prohibits Illinois from imposing its net income tax on taxpayer if taxpayer's only business activity within that state is the solicitation of sales. Illinois may impose its net income tax on income received from an out-of-state entity's business activities unless those business activities exceed the mere solicitation of sales. Conversely, the effect of Indiana's throw-back rule is to revert this sales income back to Indiana in those situations where 15 U.S.C.S. § 381 deprives the purchaser's own state of the authority to impose a net income tax. 45 IAC 3.1-1-64. In effect, 15 U.S.C.S. § 381 allows Indiana to tax out-of-state business activities, without violating the Commerce Clause and without subjecting taxpayer to double taxation, because Indiana's right to tax those out-of-state activities is derivative of the foreign state's own taxing authority. In every sales transaction, at least one state has the power to tax income derived from the sale of tangible personal property; if the state wherein the sale occurred is forbidden to do so by 15 U.S.C.S. § 381, then that income is "thrown back" to the originating state.

The Department is unable to agree with taxpayer's conclusion that its Illinois activities subjected it to the Illinois net income tax during 1996 and 1997. During that period, taxpayer's only Illinois activity – aside from soliciting sales of its auto parts – consisted of sending one or two employees "on a sporadic basis" to inspect nonconforming auto parts at the Illinois customer's location. This would appear to be the extent of taxpayer's non-solicitation Illinois activity; if Illinois customer complained that one of taxpayer's auto parts did not conform to the customer's original specification, taxpayer would send one (or two) of its Indiana employees to examine that part. Even if it is possible to separate these inspections from the solicitation of the original sale, these investigative activities plainly fall within the de minimis exception described by the Court in Wrigley. As explained by the Court, "[A] company does not necessarily forfeit its tax immunity under § 381 by performing *some* in-state business activities go beyond 'solicitation of orders.'" Wrigley 112 S.Ct. at 2457. (*Emphasis in original*). Taxpayer's sporadic inspection of non-conforming parts "is sufficiently *de minimis* to avoid loss of the tax immunity conferred by § 381." Id. at 2458. The inspection of the auto parts did not void the immunity from Illinois income taxes conferred under 15 U.S.C.S. § 381 and Illinois may not tax these particular receipts. Accordingly, the audit was correct in concluding that the income received from the Illinois sales should have been thrown back to Indiana.

FINDING

Taxpayer's protest is respectfully denied.

II. Management Fees and Royalty Payments as Indiana Source Income – Adjusted Gross Income Tax.

Taxpayer parent company (Michigan) and taxpayer manufacturing division (Indiana) had an arrangement by which taxpayer manufacturing division paid money to taxpayer parent company. Taxpayer parent company provided taxpayer manufacturing division with "patented proprietary technology," "ancillary technical services," the right to use taxpayer parent company's trade name, and the right to use proprietary "just in time computer technology." In return, taxpayer manufacturing division agreed to manufacture auto parts which met taxpayer parent company's standards for quality of materials, procedures, and manufacturing methods. Taxpayer manufacturing division agreed to pay taxpayer parent company a five percent royalty fee based on the invoice price of the auto parts.

Taxpayer parent company also provided management services to taxpayer manufacturing division. Taxpayer parent company's personnel visited the Indiana facility, provided engineering services, research and development services, and provided various management functions. In return, taxpayer manufacturing division paid taxpayer parent company a "management fee."

The audit review concluded that taxpayer parent company should have been paying Indiana adjusted gross and supplemental net income tax on the royalties and management fees. Taxpayer – in the most general of terms – disagrees.

IC 6-3-2-1 imposes a tax on the adjusted gross income derived from "sources within Indiana." IC 6-3-2-2(a) provides that adjusted gross income derived from sources within Indiana includes "income from doing business in this state." IC 6-3-2-2(a). 45 IAC 3.1-1-38, in interpreting IC 6-3-2-2(a), provides that for apportionment purposes a taxpayer is "doing business" in Indiana if it operates a business enterprise or activity in Indiana including "[r]endering services to customers in the state." 45 IAC 3.1-1-38(4).

Taxpayer parent company entered into an agreement by which it provided management and other services to taxpayer manufacturing division. Taxpayer sent its employees into the state to provide these services. Therefore, the management fees taxpayer manufacturing division paid to taxpayer parent company constitute "income from doing business in this state." IC 6-3-2-2(a). Taxpayer parent company was providing services to its manufacturing division, and the resultant income is subject to the state's adjusted gross income tax.

In addition, taxpayer parent company received royalty payments from taxpayer manufacturing division. These royalty payments resulted when taxpayer parent company licensed its trademark rights to taxpayer manufacturing division; in return for the right to use the trademarks, taxpayer manufacturing division paid five percent of the sales of its branded auto parts to taxpayer parent company.

In order for Indiana to tax the money received from an intangible – such as taxpayer parent company's trademarks – the intangible must have acquired a "business situs" within the state. 45 IAC 3.1-1-55 states that "[t]he situs of intangible personal property is the commercial domicile of the taxpayer... unless the property has acquired a 'business situs' elsewhere. 'Business situs' is the place at which the intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property."

Taxpayer parent company's commercial domicile is in Michigan. However, it is clear from the arrangement between taxpayer parent company and taxpayer manufacturing division, that the intellectual property has acquired a "business situs" within Indiana. Taxpayer parent company has licensed to taxpayer manufacturing division to make use of the trademarks within Indiana in conjunction with the manufacture and sale of taxpayer manufacturing division's auto parts. The "substantial use or value" which attaches to these particular trademark rights is inherent in the ability to transfer the trademarks for use at the Indiana manufacturing facility. The royalty payments here at issue are merely the economic benefits which flow from the fact that taxpayer manufacturing division exploits the trademarks' value within Indiana. Under 45 IAC 3.1-1-55, the trademarks have acquired an Indiana business situs; under IC 6-3-2-2(a), the royalty payments are subject to Indiana's adjusted gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

6520010224.LOF

LETTER OF FINDINGS NUMBER: 01-0224
Motor Carrier
For Tax Period 1998-2000

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

ISSUES

I. Motor Carrier–Overweight Vehicle Permits

Authority: Black Beauty Trucking, Inc. v. Indiana Department of State Revenue, 527 N.E.2d 1163, 1165 (Ind. Tax 1988); IC 6-8.1-1-1; IC 6-8.1-4-4; IC 8.1-5-1; IC 6-8.1-5-4; IC 9-13-2-121; IC 9-20-1-1; IC 9-20-1-2; IC 9-20-4-1; IC 9-20-4-3; IC 9-20-6-1

Taxpayer protests imposition of fees for overweight vehicle permits.

II. Tax Administration–Negligence Penalty and Interest

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

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

STATEMENT OF FACTS

Taxpayer ships steel for steel industry customers. The Indiana Department of Revenue ("Department") determined that taxpayer had not purchased a sufficient number of overweight trip permits for overweight loads it shipped for its customers. The Department issued proposed assessments for the permit fees, a ten percent negligence penalty and interest. Taxpayer protests the imposition of fees, penalty and interest. Further facts will be provided as necessary.

I. Motor Carrier–Overweight Vehicle Permits

DISCUSSION

Taxpayer protests the imposition of fees for oversized and overweight permits for trucks carrying overweight loads. The Department reviewed taxpayer's records and taxpayer's customer's records and determined that taxpayer should have purchased overweight trucking permits for some loads it was carrying for its customer. The Department issued proposed assessments for the permit fees as well as penalties and interest. Taxpayer protests that the assessments are not valid.

Taxpayer's first point of protest is that the Department is not authorized to audit and assess it for overweight permit fees, penalties and interest, and that no statute or regulation affords feepayers notice of what records they should maintain for an audit with which they will be able to defend themselves in the event of an assessment. Taxpayer believes that the Department based its audit and assessment powers on IC 6-8.1-1-1, but that IC 6-8.1-1-1 only contains vague references to the fees and penalties assessed for overweight vehicles. IC 6-8.1-1-1 states:

> "Listed taxes" or "taxes" includes only the pari-mutuel taxes (IC 4-31-9-3 through IC 4-31-9-5); the riverboat admissions tax (IC 4-33-12); the riverboat wagering tax (IC 4-33-13); the gross income tax (IC 6-2.1) (repealed); the utility receipts tax (IC 6-2.3); the state gross retail and use taxes (IC 6-2.5); the adjusted gross income tax (IC 6-3); the supplemental net income tax (IC 6-3-8) (repealed); the county adjusted gross income tax (IC 6-3.5-1.1); the county option income tax (IC 6-3.5-6); the county economic development income tax (IC 6-3.5-7); the municipal option income tax (IC 6-3.5-8); the auto rental excise tax (IC 6-6-9); the financial institutions tax (IC 6-5.5); the gasoline tax (IC 6-6-1.1); the alternative fuel permit fee (IC 6-6-2.1); the special fuel tax (IC 6-6-2.5); the motor carrier fuel tax (IC 6-6-4.1); a motor fuel tax collected under a reciprocal agreement under IC 6-8.1-3; the motor vehicle excise tax (IC 6-6-5); the commercial vehicle excise tax (IC 6-6-5.5); the hazardous waste disposal tax (IC 6-6-6.6); the cigarette tax (IC 6-7-1); the beer excise tax (IC 7.1-4-2); the liquor excise tax (IC 7.1-4-3); the wine excise tax (IC 7.1-4-4); the hard cider excise tax (IC 7.1-4-4.5); the malt excise tax (IC 7.1-4-5); the petroleum severance tax (IC 6-8-1); the various innkeeper's taxes (IC 6-9); the various county food and beverage taxes (IC 6-9); the county admissions tax (IC 6-9-13 and IC 6-9-28); the oil inspection fee (IC 16-44-2); the emergency and hazardous chemical inventory form fee (IC 6-6-10); the penalties assessed for oversize vehicles (IC 9-20-3 and IC 9-30); *the fees and penalties assessed for overweight vehicles (IC 9-20-4 and IC 9-30)*; the underground storage tank fee (IC 13-23); the solid waste management fee (IC 13-20-22); and any other tax or fee that the department is required to collect or administer.
>
> (Emphasis added.)

Taxpayer believes that "the fees and penalties assessed for overweight vehicles" language is vague and that the reference to IC 9-20-4 and IC 9-30 limits the scope of IC 6-8.1-1-1. Taxpayer claims that no provision of IC 9-20-4 establishes any sort of fee system for overweight vehicles. Also, taxpayer states that the only penalty provision in IC 9-20-4 is found in IC 9-20-4-3, which states:

> (a) The gross weight declared by an applicant in an application for registration under this title determines and fixes the limit of the load, including the unladen weight of the vehicle or combination of vehicles fully equipped for service, that may be transported by a vehicle or combination of vehicles on the highways for the period for which the registration or license is granted. Except as provided in subsection (b), the transportation of a load on a registered and licensed vehicle or combination of vehicles in excess of the limit fixed in the application for registration subjects the person violating a provision of this title to the penalty provisions in this title or to the revocation of the license for the vehicle, or both.
>
> (b) Because of the various types of scales used and the variance in scale weights, a penalty may not be assessed if the actual scale weight of a vehicle or combination of vehicles with load does not exceed one and one-half percent (1 1/2%) of the registered weight of the vehicle or combination of vehicles, including load.
>
> (c) A person who violates this section commits a Class C infraction. In addition, the person shall pay the difference between the fee paid for registration of the vehicle and the fee for the registration of the vehicle plus a maximum load of a weight equal

to the excess load being transported. Until the fee is paid, the person transporting the excess load is not permitted to move the transporting vehicle.

The Department refers to IC 6-8.1-4-4, which states:

(a) The department shall establish a registration center to service owners of commercial motor vehicles.

(b) The registration center is under the supervision of the department through the motor carrier services division.

(c) An owner or operator of a commercial motor vehicle may apply to the registration center for the following:

(1) Vehicle registration (IC 9-18).

(2) Motor carrier fuel tax annual permit.

(3) Proportional use credit certificate (IC 6-6-4.1-4.7).

(4) Certificate of operating authority.

(5) Oversize vehicle permit (IC 9-20-3).

(6) Overweight vehicle permit (IC 9-20-4).

(7) Payment of the commercial vehicle excise tax imposed under IC 6-6-5.5.

(d) Funding for the development and operation of the registration center shall be taken from the motor carrier regulation fund (IC 8-2.1-23-1).

(e) The department shall recommend to the general assembly other functions that the registration center may perform.

Next the Department refers back to IC 6-8.1-1-1, which states in relevant part:

"Listed taxes" or "taxes" includes

....

the fees and penalties assessed for overweight vehicles (IC 9-20-4 and IC 9-30)

....

and any other tax or fee that the department is required to collect or administer.

Since IC 6-8.1-4-4 states that the Department shall establish a registration center to service owners of commercial motor vehicles, including overweight vehicle permits, the Department is required to collect or administer the overweight vehicle permit fees. According to IC 6-8.1-1-1, this fee that the Department is required to collect or administer is a listed tax. The Department has authority to audit taxpayers and issue assessments of a "listed tax".

Also, taxpayer protests that there is no statute or regulation that explains what records it should keep since there is no return filed for the permit fees. The Department refers to IC 6-8.1-5-4, which states:

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

(b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person filed:

(1) for an unlimited period, if the person fails to file a return or receives notice from the department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return; or

(2) in all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the department consents to earlier destruction.

In addition, if the limitation on assessments provided in section 2 of this chapter is extended beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.

(c) A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times.

(d) A person must, on request by the department, furnish a copy of any federal returns that he has filed.

As previously explained, taxpayer is subject to a listed tax since the overweight permit fee is a listed tax under IC 6-8.1-1-1. IC 6-8.1-5-4(a) explains that such a person must keep all source documents so that the department can determine the existence and size of a tax liability. IC 6-8.1-5-4(b)(2) explains that a taxpayer must keep such documents for a period of three years after the due date of such a tax.

Taxpayer's second point of protest is that the forty-two dollar and fifty cent ($42.50) overweight permit fee may be a flat tax, and as such may be unconstitutional. Taxpayer refers to the Indiana Tax Court's decision regarding a Supplemental Highway User fee (SHU) in Black Beauty Trucking, in which the court explained:

The SHU is a flat tax unapportioned to actual use of the highways, indistinguishable from Pennsylvania's tax. It fails the internal consistency test because if each state applied a flat tax of this type, i.e., $50 per commercial vehicle passing through its jurisdiction, an impermissible interference with free trade would result. The interstate carrier traveling from New York to Los Angeles through Indiana covers only a fraction of the miles traveled by an Indiana intrastate carrier, yet both pay the same tax. Furthermore, the interstate carrier my be subject to another flat tax in every other state, regardless of whether the miles traveled in a particular state amount to ten or ten thousand. At year's end, the interstate carrier and intrastate carrier might show the same mileage, but the interstate carrier would have paid as much as forty-eight times the tax paid by the intrastate carrier. The discriminatory impact on the interstate carrier is readily apparent.

Black Beauty Trucking, Inc. v. Indiana Department of State Revenue, 527 N.E.2d 1163, 1165 (Ind. Tax 1988)

Taxpayer believes that the overweight permit fee at issue in the instant case could result in a similar advantage for an intrastate carrier. The overweight permit fee at issue covers only one trip and the permit is good for only one twenty-four (24) hour period, unlike the annual Supplemental Highway User fee discussed in Black Beauty Trucking. Whereas the intrastate trucking company would have an entire year to get additional value from an annual fee, any trucking company has only 24 hours to use the overweight permit. Even then, once a trip is completed, anyone wanting to take another overweight load will need to pay for a new permit. Unlike the annual SHU fee, here there is no advantage for an in-state trucking company over an out-of-state trucking company, and so the decision in Black Beauty Trucking does not support taxpayer's position.

Taxpayer's third point of protest is that it was a broker rather than a transporter. Taxpayer explained that while it was listed as a carrier on its customer's transport agreements, and taxpayer's Director of Sales and Marketing signed them on taxpayer's behalf, those agreements were standard forms that the customer presented to anyone it was doing shipping with and taxpayer had no other forms to choose from. Also, taxpayer states that its employee on-site at its customer's business only organized and dispatched loads, with no personal observation of the actual loading operations. Taxpayer believes that, since it did not own the trucks doing the hauling, it was not responsible for paying the permit fee. Taxpayer refers to IC 9-20-1-1, which states:

Except as otherwise provided in this article, a person, including a transport operator, may not operate or move upon a highway in Indiana a vehicle or combination of vehicles of a size or weight exceeding the limitations provided in this article.

Taxpayer also refers to IC 9-20-1-2, which states:

Except as otherwise provided in this article, an owner of a vehicle may not cause or knowingly permit to be operated or moved upon a highway in Indiana a vehicle or combination of vehicles of a size or weight exceeding the limitations provided in this article.

Taxpayer also refers to IC 9-20-4-1(a), which states in part:

Except as provided in subsections (b) and (c), a person may not operate or cause to be operated upon an Indiana highway a vehicle or combination of vehicles having weight in excess of one (1) or more of the following limitations:

...

Taxpayer also refers to IC 9-13-2-121(a), which states:

(a) "Owner" means, except as otherwise provided in this section, when used in reference to a motor vehicle:

(1) a person who holds the legal title of a motor vehicle;

(2) a person renting or leasing a motor vehicle and having exclusive use of the motor vehicle for more than thirty (30) days; or

(3) if a motor vehicle is the subject of an agreement for the conditional sale or lease vested in the conditional vendee or lessee, or in the event the mortgagor, with the right of purchase upon the performance of the conditions stated in the agreement and with an immediate right of possession of a vehicle is entitled to possession, the conditional vendee or lessee or mortgagor.

Taxpayer reads these statutes collectively to mean that only a vehicle driver, the legal title holder or a motor carrier leasing the vehicle exclusively for more than thirty (30) days is responsible for purchasing the overweight permit. Since taxpayer leased the vehicles for single trips of less than 30 days, taxpayer believes that it does not qualify as an owner of the vehicles and therefore is not responsible for purchasing overweight permits for the vehicles which made the trips in question.

IC 9-20-4-1 does not mention IC 9-20-1-1 or IC 9-20-1-2, and taxpayer provides no analysis of why IC 9-20-4-1 should be limited in such a manner by the provisions of IC 9-20-1-1 and IC 9-20-1-2. IC 9-20-1-1 and IC 9-20-1-2 both describe duties of individuals regarding overweight trucks, but neither statute states that only those individuals are eligible or responsible to purchase overweight permits. In fact, both contain the phrase, "Except as otherwise provided in this articleY", which plainly means that even those two statutes for individuals regarding overweight trucks have exceptions and are not all-encompassing.

The Department notes that one of the exceptions referred to in IC 9-20-4-1(a), which provides that a person may not operate or *cause to be operated* upon an Indiana highway a vehicle or combination of vehicles having excess weight is IC 9-20-4-1(b), which states:

(b) The enforcement of weight limits under this section is subject to the following:

(1) It is lawful to operate within the scope of a permit, under weight limitations established by the Indiana department of transportation and in effect on July 1, 1956, as provided in IC 9-20-6.

Next, the Department refers to IC 9-20-6-1(a)(1), which states:

(a) This chapter applies to the issuance of the following permits:

(1) A permit for the transportation of oversized or overweight vehicles and loads under section 2 of this chapter.

Therefore, reading IC 9-20-4-1(a), IC 9-20-4-1(b) and IC 9-20-6-1(a)(1) together, a person who causes an overweight load to be transported may purchase the permit to do so. The owner of the truck is not the only one able to purchase an overweight permit.

Since taxpayer caused the trucks to operate with overweight loads either by owning or hiring them, taxpayer may be held responsible for purchase of the permits.

Taxpayer's fourth point of protest is that it charged its customer an amount less than the cost of the overweight permit load fee itself, and taxpayer would lose money on each load if it were responsible for the overweight fee. Taxpayer submits that this would be an illogical arrangement. Taxpayer does not refer to any statute, regulation or court decision to explain why this is relevant. Here, the Department is only concerned with its duty to collect overweight permit fees. The Department is not concerned with the profitability of a taxpayer's business.

Taxpayer's fifth point of protest is that the Department's calculations were based on documents provided by taxpayer's customer, and that those documents indicate that some trucks were listed as making multiple overweight trips in a single day. The documents upon which the Department relied listed: Carrier code, Ship date, Company code, Bill of lading number, Origin city, Destination city, State for destination city, Weight of load hauled for this shipment, Dollar amount paid for services for hauling and the Carrier vehicle number for load. Taxpayer states that the beginning and ending points of these trips are physically too far apart to allow the number of trips listed to have been completed in a single day by a single truck. Taxpayer believes that the listing of these trucks as making more trips than possible in a day brings into question the Department's assessments which were based on those listings.

The Department based the proposed assessments on the best information available to it. The relevant statute is IC 6-8.1-5-1(a), which states:

> If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to IC 6-8.1-10 concerning the imposition of penalties and interest. The department shall send the person a notice of the proposed assessment through the United States mail.

The Department notes that each load listed in the customer's records indicate a different load weight and cost. Elsewhere in its protest, taxpayer made the point that its customer did not tailor each document to individual companies it was doing business with. It appears that taxpayer's customer operated in a similar fashion here, paying more attention to the information it considered important (weight, cost, carrier) and less attention to the information it did not consider as important (truck identifying number). Despite the repetition of truck numbers, all other information on taxpayer's customer's records is nonrepetitive and it is reasonable for the Department to believe that taxpayer did not report the proper amount of tax (permit fees) due.

Additionally, taxpayer has not provided sufficient documentation verifying its position that the recorded trips were impossible to make in the recorded time. IC 6-8.1-5-1(b) provides in relevant part that the Department's notice of proposed assessment is prima facie evidence that the Department's claim for the unpaid tax is valid and that the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made. Taxpayer has not met this burden.

In conclusion, regarding taxpayer's first point of protest, the Department is authorized to administer the overweight trucking permits and fees. Second, the permit fee is not a flat tax and there is no advantage for in-state trucking firms over out-of-state firms, unlike the situation in <u>Black Beauty Trucking</u>. Third, the permits are not the sole responsibility of truck owners, but also of anyone who causes overweight loads to be transported. Fourth, the Department is charged with collecting overweight permit fees, and it is irrelevant if someone who owes a fee makes a profit or loss in its business. Fifth, the Department based its proposed assessments on the best information available to it, and it is reasonable for it to believe that the permit fees at issue were not properly paid. Taxpayer has not proven the proposed assessments wrong.

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Interest and Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of interest and a ten percent (10%) negligence penalty. 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." Therefore, the Department may not waive interest.

Taxpayer also protests the imposition of a ten percent negligence penalty. The relevant statute is IC 6-8.1-10-1(a), which states:

> If a person:
> (1) fails to file a return for any of the listed taxes;
> (2) fails to pay the full amount of tax shown on the person's tax return on or before the due date for the return payment;
> (3) *incurs, upon examination by the department, a deficiency that is due to negligence*;
> (4) fails to timely remit any tax held in trust for the state; or
> (5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department;
> the person is subject to a penalty.

(Emphasis added)

Negligence is described in 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 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.

Since taxpayer failed to pay all fees it was required to pay, taxpayer demonstrated carelessness, thoughtlessness, disregard or inattention to its duties placed upon it by the Indiana Code or department regulations. Therefore, taxpayer was negligent under 45 IAC 15-11-2(b). Taxpayer incurred, upon examination by the department, a deficiency that is due to negligence, and so is subject to a penalty under IC 6-8.1-10-1(a)(3).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20020029.LOF

LETTER OF FINDINGS: 02-0029
Indiana Corporate Income Tax
For Tax Periods 1993, 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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Sales of Equipment and Automobile Parts – Gross Income Tax.

Authority: IC 6-2.1-2-2(a)(1); IC 6-2.1-2-2(a)(2); IC 6-2.1-2-2(b); IC 6-2.1-2-3; IC 6-2.1-2-4; IC 6-2.1-2-5; IC 6-2.1-3-3; IC 6-8.1-5-1(b); Dept. of State Revenue v. Brown Boveri, 439 N.E.2d 561 (Ind. 1982); Indiana-Kentucky Elec. v. Dept. of State Revenue, 598 N.E.2d 647 (Ind. Tax Ct. 1992); 45 IAC 1.1-1-3(a); 45 IAC 1.1-3-3(c), (d); 45 IAC 1.1-3-3(d); 45 IAC 1.1-3-3(d)(7).

Taxpayer argues that the money it received from the sale of certain equipment and automobile parts was not subject to Indiana's gross income tax.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of manufacturing and selling metal parts and fasteners. It is organized into an "industrial group" and a "home construction group." These two groups are further divided into various operating divisions. Taxpayer has manufacturing plants and warehouses within Indiana. It does business with customers inside and outside the state.

The Department of Revenue (Department) conducted an audit review of taxpayer's business operations and tax returns. This audit review resulted in an assessment of additional gross income tax attributable to sales completed during 1993 through 1996. The taxpayer protested the additional assessments, an administrative hearing was conducted during which taxpayer explained the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. Sales of Equipment and Automobile Parts – Gross Income Tax.

Taxpayer's business is organized into a number of operating divisions. Taxpayer argues that money received by three of these divisions is not subject to gross income tax.

IC 6-2.1-2-2(a)(1) imposes a gross income tax on "the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana...." For a non-resident, the tax is imposed on, "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or domiciliary of Indiana." IC 6-2.1-2-2(a)(2) "The gross income tax is imposed at two rates, a "high rate" of 1.2 percent and a "low rate" of.3 percent. IC 6-2.1-2-3 "The rate of tax is determined by the type of transaction from which the taxable gross income is received." IC 6-2.1-2-2(b). The receipts from wholesale sales and from selling at retail are taxed at the low rate. IC 6-2.1-2-4. Receipts from service activities and other business activities are taxed at the high rate. IC 6-2.1-2-5.

However, taxpayer argues that the receipts here at issue were not subject to gross income tax because they were receipts attributable to business conducted between different states. Taxpayer's argument is based upon IC 6-2.1-3-3 which states that, "Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution."

However, not all gross income received from transactions in interstate commerce is exempt from gross income tax; only those transactions which the federal constitution proscribes. Indiana-Kentucky Elec. v. Dept. of State Revenue, 598 N.E.2d 647, 652 (Ind. Tax Ct. 1992). The decision as to whether a taxpayer's particular activities constitute protected interstate commerce "must be made on a case by case basis." Dept. of State Revenue v. Brown Boveri, 439 N.E.2d 561, 564 (Ind. 1982).

A. Division One.

Taxpayer's Division One is headquartered in Michigan; it is in the business of producing metal parts for automobiles. Division One owned and operated – during the years under consideration by the audit – two Indiana manufacturing plants. Taxpayer argues that the sales of the auto parts built in Indiana to customers outside the state are not subject to gross income tax. However, other than the suggestion that these receipts originate from sales of goods which cross the Indiana border, taxpayer has not provided sufficient information to determine whether the sales are exempt from tax or whether the receipts are subject to the tax. There is not enough information to determine whether these particular sales are "not completed in Indiana prior to or after shipment in interstate commerce" or whether the "sale is completed in Indiana prior to or after shipment in interstate commerce" 45 IAC 1.1-3-3(c), (d). Taxpayer has not met its burden of presenting sufficient information upon which to make a determination of whether the Division One Indiana source sales to out-of-state customers are exempt from gross income tax. "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1(b).

B. Division Two.

Taxpayer's Division Two manufactures metal and plastic parts for automobiles. Division Two had manufacturing facilities outside the state. It also had an Indiana manufacturing plant and an Indiana warehouse facility. The audit found that "[taxpayer] did not report [Division Two's] sales to Indiana customers shipped from out of state for which [taxpayer's] resident salesmen were responsible for gross income tax." The audit did not find that all of the Division Two's sales to Indiana customers were subject to gross income tax. Instead, "Only those sales shipped from out of state attributable to the Indiana resident salesmen are being subject to gross income tax. The Indiana destination sales not attributable to Indiana resident salesmen are not subject to gross income tax."

The audit correctly differentiated between those sales which gave rise to gross income tax liability and those which did not. By virtue of Division Two's manufacturing plant and warehouse facility and by virtue of its Indiana sales persons, Division Two established an Indiana "business situs." *See* 45 IAC 1.1-1-3(a). Division Two's sales of goods to Indiana customers – even when the goods originated from one of Division Two's out-of-state locations – are subject to gross income tax because the sales were "completed in Indiana prior to or after shipment in interstate commerce." 45 IAC 1.1-3-3(d). The regulation provides an example of a sale that is "completed in Indiana." "The following are situations where a sale is completed in Indiana prior to or after shipment in interstate commerce... [a] sale to an Indiana buyer by a nonresident seller if the sale: (A) originated from; (B) was channeled through; or (C) was otherwise connected with; an Indiana business situs established by the seller." 45 IAC 1.1-3-3(d)(7). In addition, a sale is "completed in Indiana" when it is "[a] sale to an Indiana buyer by a resident seller even though such goods are shipped from outside Indiana." These sales were completed upon acceptance of the Indiana customer's order by one of Division Two's Indiana salespersons and/or at the time the Indiana customer accepted delivery of the goods at the customer's Indiana location.

C. Division Three.

Division Three manufactures and distributes fasteners, metal assemblies, and metal stamps. Division Three has an Indiana plant which manufactures construction fasteners. Division Three also has an Illinois manufacturing plant which builds automobile parts. The audit found that "[Division Three] did not report receipts from the sale of goods to customers in Indiana which were shipped from out of state for gross income tax at the low rate." The audit review concluded that the receipts from these sales were subject to gross income tax.

Taxpayer suggests that money received from the sale of parts to Indiana customers is not subject to gross income tax. Although taxpayer does not state as much, presumably taxpayer's argument is based upon Division Three's sales of its Illinois automobile parts to Indiana customers.

As a non-domiciliary, taxpayer's Division Three gross receipts are taxable only if the receipts were "derived from activities or businesses or any other sources within Indiana." IC 6-2.1-2-2(a)(2).

Division Three's sales of its Illinois auto parts are subject to Indiana gross income tax because the sales were "completed in Indiana." The regulation states that, "Gross income derived from the sale of tangible personal property in interstate commerce *is* subject to the gross income tax if the sale is completed in Indiana." 45 IAC 1.1-3-3(d) (*Emphasis added*). "The following are situations where a sale is completed in Indiana prior to or after shipment in interstate commerce... [a] sale to an Indiana buyer by a nonresident seller if the sale: (A) originated from; (B) was channeled through; or (C) was otherwise connected with; an Indiana business situs established by the seller." 45 IAC 1.1-3-3(d)(7). In addition, a sale is "completed in Indiana" when it is "[a] sale to an Indiana buyer by a resident seller even though such goods are shipped from outside Indiana." The sales at issue took place because Indiana customers contacted taxpayer's Indiana based salespersons and because the Indiana salespersons worked with the individual customers to obtain suitable goods at an acceptable price.

The Division Three Illinois-to-Indiana sales are interstate transactions. However, taxpayer – by virtue of its Indiana manufacturing and distribution facilities and by virtue of the activities of its Indiana-based salespersons – has established a substantial nexus with this state. *See* 45 IAC 1.1-1-3(a). Under 45 IAC 1.1-3-3(d) these sales were completed in Indiana because the sales originated when the Indiana customers contacted one of taxpayer's Indiana-based salespersons and because the transaction was completed when the goods were delivered to and received by the Indiana customer. The Division Three sales receipts – derived from the sale of Illinois sourced goods to Indiana customers – are subject to Indiana's gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

6520020090.LOF

LETTER OF FINDINGS NUMBER: 02-0090
Motor Carrier
For Tax Period 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.

ISSUES

I. Motor Carrier–Overweight Vehicle Permits

Authority: Black Beauty Trucking, Inc. v. Indiana Department of State Revenue, 527 N.E.2d 1163, 1165 (Ind. Tax 1988); IC 6-8.1-1-1; IC 6-8.1-4-4; IC 6-8.1-5-2; IC 6-8.1-5-4; IC 9-13-2-121; IC 9-20-1-1; IC 9-20-1-2; IC 9-20-4-1; IC 9-20-4-3; IC 9-20-6-1

Taxpayer protests the imposition of fees for overweight vehicle permits.

II. Tax Administration–Interest and Negligence Penalty

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

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

STATEMENT OF FACTS

Taxpayer operates a trucking company which serves customers in the steel industry in Indiana. The Indiana Department of Revenue ("Department") determined that taxpayer had not paid for enough oversized and overweight permits to cover the number of oversized and overweight loads it had trucked for its customers. The Department assessed the fees and imposed a ten percent negligence penalty and interest. Taxpayer protests the imposition of fees, penalty and interest. Further facts will be supplied as necessary.

I. Motor Carrier–Overweight Vehicle Permits

DISCUSSION

Taxpayer protests the imposition of fees for oversized and overweight permits for trucks carrying overweight loads. The Department reviewed taxpayer's records and taxpayer's customer's records and determined that taxpayer should have purchased overweight trucking permits for some loads it was carrying for its customer. The Department issued proposed assessments for the permit fees as well as penalties and interest. Taxpayer protests that the assessments are not valid.

Taxpayer's first point of protest is that the Department is not authorized to audit and assess it for overweight permit fees, penalties and interest, and that no statute or regulation affords feepayers notice of what records they should maintain for an audit with which they will be able to defend themselves in the event of an assessment. Taxpayer believes that the Department based its audit and assessment powers on IC 6-8.1-1-1, but that IC 6-8.1-1-1 only contains vague references to the fees and penalties assessed for overweight vehicles. IC 6-8.1-1-1 states:

> "Listed taxes" or "taxes" includes only the pari-mutuel taxes (IC 4-31-9-3 through IC 4-31-9-5); the riverboat admissions tax (IC 4-33-12); the riverboat wagering tax (IC 4-33-13); the gross income tax (IC 6-2.1) (repealed); the utility receipts tax (IC 6-2.3); the state gross retail and use taxes (IC 6-2.5); the adjusted gross income tax (IC 6-3); the supplemental net income tax (IC 6-3-8) (repealed); the county adjusted gross income tax (IC 6-3.5-1.1); the county option income tax (IC 6-3.5-6); the county economic development income tax (IC 6-3.5-7); the municipal option income tax (IC 6-3.5-8); the auto rental excise tax (IC 6-6-9); the financial institutions tax (IC 6-5.5); the gasoline tax (IC 6-6-1.1); the alternative fuel permit fee (IC 6-6-2.1); the special fuel tax (IC 6-6-2.5); the motor carrier fuel tax (IC 6-6-4.1); a motor fuel tax collected under a reciprocal agreement under IC 6-8.1-3; the motor vehicle excise tax (IC 6-6-5); the commercial vehicle excise tax (IC 6-6-5.5); the hazardous waste disposal tax (IC 6-6-6.6); the cigarette tax (IC 6-7-1); the beer excise tax (IC 7.1-4-2); the liquor excise tax (IC 7.1-4-3); the

wine excise tax (IC 7.1-4-4); the hard cider excise tax (IC 7.1-4-4.5); the malt excise tax (IC 7.1-4-5); the petroleum severance tax (IC 6-8-1); the various innkeeper's taxes (IC 6-9); the various county food and beverage taxes (IC 6-9); the county admissions tax (IC 6-9-13 and IC 6-9-28); the oil inspection fee (IC 16-44-2); the emergency and hazardous chemical inventory form fee (IC 6-6-10); the penalties assessed for oversize vehicles (IC 9-20-3 and IC 9-30); *the fees and penalties assessed for overweight vehicles (IC 9-20-4 and IC 9-30)*; the underground storage tank fee (IC 13-23); the solid waste management fee (IC 13-20-22); and any other tax or fee that the department is required to collect or administer.

(Emphasis added.)

Taxpayer believes that "the fees and penalties assessed for overweight vehicles" language is vague and that the reference to IC 9-20-4 and IC 9-30 limits the scope of IC 6-8.1-1-1. Taxpayer claims that no provision of IC 9-20-4 establishes any sort of fee system for overweight vehicles. Also, taxpayer states that the only penalty provision in IC 9-20-4 is found in IC 9-20-4-3, which states:

(a) The gross weight declared by an applicant in an application for registration under this title determines and fixes the limit of the load, including the unladen weight of the vehicle or combination of vehicles fully equipped for service, that may be transported by a vehicle or combination of vehicles on the highways for the period for which the registration or license is granted. Except as provided in subsection (b), the transportation of a load on a registered and licensed vehicle or combination of vehicles in excess of the limit fixed in the application for registration subjects the person violating a provision of this title to the penalty provisions in this title or to the revocation of the license for the vehicle, or both.

(b) Because of the various types of scales used and the variance in scale weights, a penalty may not be assessed if the actual scale weight of a vehicle or combination of vehicles with load does not exceed one and one-half percent (1 1/2%) of the registered weight of the vehicle or combination of vehicles, including load.

(c) A person who violates this section commits a Class C infraction. In addition, the person shall pay the difference between the fee paid for registration of the vehicle and the fee for the registration of the vehicle plus a maximum load of a weight equal to the excess load being transported. Until the fee is paid, the person transporting the excess load is not permitted to move the transporting vehicle.

The Department refers to IC 6-8.1-4-4, which states:

(a) The department shall establish a registration center to service owners of commercial motor vehicles.

(b) The registration center is under the supervision of the department through the motor carrier services division.

(c) An owner or operator of a commercial motor vehicle may apply to the registration center for the following:

(1) Vehicle registration (IC 9-18).
(2) Motor carrier fuel tax annual permit.
(3) Proportional use credit certificate (IC 6-6-4.1-4.7).
(4) Certificate of operating authority.
(5) Oversize vehicle permit (IC 9-20-3).
(6) Overweight vehicle permit (IC 9-20-4).
(7) Payment of the commercial vehicle excise tax imposed under IC 6-6-5.5.

(d) Funding for the development and operation of the registration center shall be taken from the motor carrier regulation fund (IC 8-2.1-23-1).

(e) The department shall recommend to the general assembly other functions that the registration center may perform.

Next the Department refers back to IC 6-8.1-1-1, which states in relevant part:

"Listed taxes" or "taxes" includes

...

the fees and penalties assessed for overweight vehicles (IC 9-20-4 and IC 9-30)

...

and any other tax or fee that the department is required to collect or administer.

Since IC 6-8.1-4-4 states that the Department shall establish a registration center to service owners of commercial motor vehicles, including overweight vehicle permits, the Department is required to collect or administer the overweight vehicle permit fees. According to IC 6-8.1-1-1, this fee that the Department is required to collect or administer is a listed tax. The Department has authority to audit taxpayers and issue assessments of a "listed tax".

Also, taxpayer protests that there is no statute or regulation that explains what records it should keep since there is no return filed for the permit fees. The Department refers to IC 6-8.1-5-4, which states:

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

(b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person filed:

(1) for an unlimited period, if the person fails to file a return or receives notice from the department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return; or

(2) in all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the department consents to earlier destruction.

In addition, if the limitation on assessments provided in section 2 of this chapter is extended beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.

(c) A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times.

(d) A person must, on request by the department, furnish a copy of any federal returns that he has filed.

As previously explained, taxpayer is subject to a listed tax since the overweight permit fee is a listed tax under IC 6-8.1-1-1. IC 6-8.1-5-4(a) explains that such a person must keep all source documents so that the department can determine the existence and size of a tax liability. IC 6-8.1-5-4(b)(2) explains that a taxpayer must keep such documents for a period of three years after the due date of such a tax.

Taxpayer's second point of protest is that the forty-two dollar and fifty cent ($42.50) overweight permit fee may be a flat tax, and as such may be unconstitutional. Taxpayer refers to the Indiana Tax Court's decision regarding a Supplemental Highway User fee (SHU) in Black Beauty Trucking, in which the court explained:

The SHU is a flat tax unapportioned to actual use of the highways, indistinguishable from Pennsylvania's tax. It fails the internal consistency test because if each state applied a flat tax of this type, i.e., $50 per commercial vehicle passing through its jurisdiction, an impermissible interference with free trade would result. The interstate carrier traveling from New York to Los Angeles through Indiana covers only a fraction of the miles traveled by an Indiana intrastate carrier, yet both pay the same tax. Furthermore, the interstate carrier my be subject to another flat tax in every other state, regardless of whether the miles traveled in a particular state amount to ten or ten thousand. At year's end, the interstate carrier and intrastate carrier might show the same mileage, but the interstate carrier would have paid as much as forty-eight times the tax paid by the intrastate carrier. The discriminatory impact on the interstate carrier is readily apparent.

Black Beauty Trucking, Inc. v. Indiana Department of State Revenue, 527 N.E.2d 1163, 1165 (Ind. Tax 1988)

Taxpayer believes that the overweight permit fee at issue in the instant case could result in a similar advantage for an intrastate carrier. The overweight permit fee at issue covers only one trip and the permit is good for only one twenty-four (24) hour period, unlike the annual Supplemental Highway User fee discussed in Black Beauty Trucking. Whereas the intrastate trucking company would have an entire year to get additional value from an annual fee, any trucking company has only 24 hours to use the overweight permit. Even then, once a trip is completed, anyone wanting to take another overweight load will need to pay for a new permit. Unlike the annual SHU fee, here there is no advantage for an in-state trucking company over an out-of-state trucking company, and so the decision in Black Beauty Trucking does not support taxpayer's position.

Taxpayer's third point of protest is that the automated call-in center advises callers that the overweight permit is good for 24 hours and the carriers would therefore be misled into believing that they could make multiple trips with one permit within the twenty-four hour period. The permit form itself (Form M-233ST) specifically states that it is a Special Weight/Single Trip Permit. Therefore, taxpayer should have understood that the validity of the permit would expire with the completion of a single trip or at the end of 24 hours regardless of whether or not a trip was completed.

Taxpayer's fourth point of protest states that a related company may have paid some of the permit fees which have been imposed here. The related company also shipped steel during the audit period and taxpayer believes that, since the Department conducted an audit of that company at approximately the same time it conducted the audit of taxpayer, the Department may have information that shows that the other company paid some of the permit fees which have been imposed on taxpayer.

The related company is not part of the audit conducted on taxpayer, and was not factored into the proposed assessments on taxpayer. The Department refers to IC 6-8.1-5-2(b), which explains in relevant part that the burden of proving a proposed assessment is wrong rests with the person against whom the proposed assessment is made. While the Department will review any documentation a taxpayer wishes to submit in support of its protest, it will not search through other taxpayer's records to support a taxpayer's protest. Since taxpayer states that the other company may have paid the permit fees in question, the two companies would presumably have a close enough relationship for the other company to supply taxpayer with the documentation to support this contention. Taxpayer did not supply documentation to support this contention, and has not met its burden under IC 6-8.1-5-2(b).

Taxpayer's fifth point of protest is that it was not the owner of the trucks which were hauling the steel and that, since it did not own the trucks, it was not responsible for paying the permit fee. Taxpayer refers to IC 9-20-1-1, which states:

Except as otherwise provided in this article, a person, including a transport operator, may not operate or move upon a highway in Indiana a vehicle or combination of vehicles of a size or weight exceeding the limitations provided in this article.

Taxpayer also refers to IC 9-20-1-2, which states:

Except as otherwise provided in this article, an owner of a vehicle may not cause or knowingly permit to be operated or moved upon a highway in Indiana a vehicle or combination of vehicles of a size or weight exceeding the limitations provided in this article.

Taxpayer also refers to IC 9-20-4-1(a), which states in part:

Except as provided in subsections (b) and (c), a person may not operate or cause to be operated upon an Indiana highway a vehicle or combination of vehicles having weight in excess of one (1) or more of the following limitations:

...

Taxpayer also refers to IC 9-13-2-121(a), which states:

(a) "Owner" means, except as otherwise provided in this section, when used in reference to a motor vehicle:

(1) a person who holds the legal title of a motor vehicle;

(2) a person renting or leasing a motor vehicle and having exclusive use of the motor vehicle for more than thirty (30) days; or

(3) if a motor vehicle is the subject of an agreement for the conditional sale or lease vested in the conditional vendee or lessee, or in the event the mortgagor, with the right of purchase upon the performance of the conditions stated in the agreement and with an immediate right of possession of a vehicle is entitled to possession, the conditional vendee or lessee or mortgagor.

Taxpayer reads these statutes collectively to mean that only a vehicle driver, the legal title holder or a motor carrier leasing the vehicle exclusively for more than thirty (30) days is responsible for purchasing the overweight permit. Since taxpayer leased the vehicles for single trips of less than 30 days, taxpayer believes that it does not qualify as an owner of the vehicles and therefore is not responsible for purchasing overweight permits for the vehicles which made the trips in question.

IC 9-20-4-1 does not mention IC 9-20-1-1 or IC 9-20-1-2, and taxpayer provides no analysis of why IC 9-20-4-1 should be limited in such a manner by the provisions of IC 9-20-1-1 and IC 9-20-1-2. IC 9-20-1-1 and IC 9-20-1-2 both describe duties of individuals regarding overweight trucks, but neither statute states that only those individuals are eligible or responsible to purchase overweight permits. In fact, both contain the phrase, "Except as otherwise provided in this article...", which plainly means that even those two statutes for individuals regarding overweight trucks have exceptions and are not all-encompassing.

The Department notes that one of the exceptions referred to in IC 9-20-4-1(a), which provides that a person may not operate or *cause to be operated* upon an Indiana highway a vehicle or combination of vehicles having excess weight is IC 9-20-4-1(b), which states:

(b) The enforcement of weight limits under this section is subject to the following:

(1) It is lawful to operate within the scope of a permit, under weight limitations established by the Indiana department of transportation and in effect on July 1, 1956, as provided in IC 9-20-6.

Next, the Department refers to IC 9-20-6-1(a)(1), which states:

(a) This chapter applies to the issuance of the following permits:

(1) A permit for the transportation of oversized or overweight vehicles and loads under section 2 of this chapter.

Therefore, reading IC 9-20-4-1(a), IC 9-20-4-1(b) and IC 9-20-6-1(a)(1) together, a person who causes an overweight load to be transported may purchase the permit to do so. The owner of the truck is not the only one able to purchase an overweight permit. Since taxpayer caused the trucks to operate with overweight loads either by owning or hiring them, taxpayer may be held responsible for purchase of the permits.

Taxpayer's sixth point of protest is that it did not own the business until November 1, 1999, and that it should not be held responsible for assessments for overweight permits prior to that time. Taxpayer provided documentation establishing that it bought the business from a third party on November 1, 1999. The trucking business was disincorporated under the old ownership and reincorporated under the new ownership with the result that two different corporations with identical names and business functions, but otherwise different account and identifying numbers, existed for the first ten months of 1999 and the last two months of 1999 and thereafter. Therefore, taxpayer is correct that it is not responsible for the assessments for overweight permits for the first ten months of 1999.

In conclusion, regarding taxpayer's first point of protest, the Department is authorized to administer the overweight trucking permits and fees. Second, the permit fee is not a flat tax and there is no advantage for in-state trucking firms over out-of-state firms, unlike the situation in Black Beauty Trucking. Third, whether or not taxpayer was confused by the automated call center's message, taxpayer should have known that the permits were good for one load or twenty-four hours. Fourth, taxpayer has not provided sufficient documentation to support its assertion that another company may have paid some of the permit fees at issue. Fifth, the permits are not the sole responsibility of truck owners, but also of anyone who causes overweight loads to be transported. Sixth, taxpayer is not responsible for the permit fees for the first ten months of 1999.

FINDING

Taxpayer's protest is denied in part and sustained in part.

II. Tax Administration–Interest and Negligence Penalty

DISCUSSION

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

Therefore, the Department may not waive interest.

Taxpayer also protests the imposition of a ten percent negligence penalty. The relevant statute is IC 6-8.1-10-1(a), which states:

If a person:

(1) fails to file a return for any of the listed taxes;

(2) fails to pay the full amount of tax shown on the person's tax return on or before the due date for the return payment;

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

(4) fails to timely remit any tax held in trust for the state; or

(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department;

the person is subject to a penalty.

(Emphasis added)

Negligence is described in 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 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.

Since taxpayer failed to pay all fees it was required to pay, taxpayer demonstrated carelessness, thoughtlessness, disregard or inattention to its duties placed upon it by the Indiana Code or department regulations. Therefore, taxpayer was negligent under 45 IAC 15-11-2(b). Taxpayer incurred, upon examination by the department, a deficiency that is due to negligence, and so is subject to a penalty under IC 6-8.1-10-1(a)(3).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420020259.LOF

LETTER OF FINDINGS NUMBER: 02-0259
Sales and Use Tax
For the Tax Year's 1999-2000

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

ISSUES

I. Sales and Use Tax-Imposition of Use Tax

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-3-2, IC 6-8.1-5-4(a), 45 IAC 2.2-4-22(d).

The taxpayer protests the imposition of use tax on property purchased pursuant to time and materials contracts.

II. Tax Administration-Penalty

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

The taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

The taxpayer is a real estate corporation. During the audit period, the taxpayer had homes built on property it owned. The taxpayer later sold these homes. A contractor, who billed the taxpayer on a time and materials basis, failed to collect sales tax on the materials used in many of the homes built for the taxpayer. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional use tax, interest, and penalty for the tax years 1999 and 2000. The taxpayer protested the assessment of tax on the materials the taxpayer purchased pursuant to the time and materials contracts and penalty. A telephone hearing was held and this Letter of Findings results.

I. Sales and Use Tax-Imposition of Tax

DISCUSSION

Indiana imposes an excise tax, the use tax, on tangible personal property stored, used, or consumed in Indiana when no sales tax was paid at the time of purchase. IC 6-2.5-3-2.

The responsibility for payment of gross retail (sales and use) tax in situations where a contractor is installing tangible personal property on real estate owned by another is set out at 45 IAC 2.2-4-22(d) as follows:

> Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:
>
> > (1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax);

Clearly, pursuant to the cited Regulation, the contractor should have collected sales tax from the taxpayer and remitted that sales tax to the state. All parties agree that the contractor did not collect and remit the sales tax on the protested items. Therefore, since the taxpayer used the construction materials in Indiana and did not pay sales tax at the time of purchase, the taxpayer owes tax on the use of those construction materials.

Pursuant to IC 6-8.1-5-1 (b), all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-4(a) requires the taxpayer to "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 taxpayer and audit indicate that during 1999, the contractor was also in the building supply business. The taxpayer contends that it does not owe the assessed use tax on materials used during the period the contractor was in the building supply business, the contractor collected sales tax and remitted it to the state. The contractor was not, however, registered with the state as a retail merchant. There is no evidence that the contractor ever remitted the allegedly collected sales tax to the state.

The taxpayer contends that after the contractor closed its building supply business, the contractor passed the cost of the building supplies through to the taxpayer. In these cases, the taxpayer contends that the contractor paid sales tax on the supplies at the time of purchase. There were not, however, adequate books and records to indicate that the contractor stopped marking up the cost of the materials. Further, the audit determined that the contractor did not always pay sales tax on building supplies at the time of purchase.

The audit indicates that the contractor was given credit for sales taxes it paid on building materials used in the taxpayer's situation. The protested assessment properly assesses the use tax against the taxpayer.

FINDING

The taxpayer's protest is denied.

II. Tax Administration-Penalty

DISCUSSION

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

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

The taxpayer contends that it did not know the contractor should have been collecting sales tax on the sales of construction supplies pursuant to the time and materials contracts. However, earlier in the relationship between the taxpayer and the contractor, the contractor was collecting sales tax. Since there was no change in the transaction, it was negligent that the taxpayer did not realize it should continue to pay the sales tax to the contractor.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20020317.LOF

LETTER OF FINDINGS NUMBER: 02-0317
Sales/Use Tax
For the Years 1998, 1999, 2000

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

ISSUES

I. Tax Administration-Best information available

Authority: IC 6-8.1-5-1

Taxpayer protests the Department's assessment of sales tax with respect to Indiana sales at auctions, based on auditor reliance on bank deposit records and lack of properly completed exemption certificates.

STATEMENT OF FACTS

Taxpayer is a self-employed auctioneer doing business in both Indiana and Kentucky. During those years, taxpayer deposited sums of money into his personal bank account in excess of reported sales for taxable years 1998, 1999, and 2000. During the course of audit, taxpayer was asked about the excess deposits. Taxpayer provided sales tickets for several sales and documents that taxpayer maintained showed that several sales took place in Kentucky. Taxpayer also attempted to show that various sales were made for exempt purposes, primarily for goods that would be resold. After discussions with the taxpayer's representative regarding the proposed assessment and alternative methodology for determining the liability, the auditor accepted some of the information provided as showing that sales were not subject to Indiana sales tax. However, audit did not accept certain information, and accordingly assessed sales tax against taxpayer. Taxpayer protested audit's assessment, and accordingly a Departmental hearing was held via telephone.

I. Tax Administration-Best information available

DISCUSSION

Under Ind. Code § 6-8.1-5-1(a), "[i]f the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department." Further, under Ind. Code § 6-8.1-5-1(b), "[t]he notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." This is the nature of the Department's assessment.

Taxpayer has no issue with the Department's use of taxpayer's bank deposits as a starting place for determining taxable sales. Taxpayer, however, takes issue with a portion of the deposits being subjected to tax. In addition, taxpayer takes issue with Department's review of exemption certificates for several purchasers, and refusal to accept taxpayer's sampling of sales. Further, taxpayer has noted that, since taking on additional compliance measures, taxpayer's sales taxes for the past years have been an amount much lower than the Department's assessments.

First, taxpayer has stated that the nature of taxpayer's business caused taxpayer to engage in significant withdrawals and deposits of the same cash. An example of these transactions is this: taxpayer receives $10,000 in an auction, and makes a deposit of the cash. Taxpayer withdraws $9,000 to buy articles from an estate to sell at auction. Taxpayer buys $1,000 of items, and deposits the $8,000 back into the bank. While this is plausible, and would permit the Department to reconsider taxpayer's liability, taxpayer has not provided documentation, such as bank records and supporting documentation, that would show that a deposit of taxable proceeds was made, and then a cash withdrawal followed by subsequent redeposit was made.

Second, with respect to exemption certificates, taxpayer has not provided further evidence to permit review of the certificates. Also, taxpayer has not made a presentation of information consistent with an alternative method that would permit the Department to make an alternative determination. Thus the auditor's determination, with a presumption of correctness, has not been rebutted.

Third, with respect to the years after the audit period, even if the last three years are a better reflection of taxpayer's true tax liability, the nature of the liability is for the three years at issue, and is presumed to be correct per Ind. Code § 6-8.1-5-1(b). Taxpayer's burden is to show, by virtue of appropriate records and/or legal arguments, that the auditor's determination is incorrect for the years in question. For the years in question, taxpayer has not met that burden.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20020567.LOF

LETTER OF FINDINGS NUMBER: 02-0567
Sales and Use Tax
For The Period: 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.

ISSUES

I. Sales and Use Tax: Tax Records

Authority: IC 6-2.5 *et seq.*; IC 6-8.1-5-1(a); IC 6-8.1-5-4(a); IC 6-8.1-5-1(b**)**

The taxpayer protests the proposed assessment of retail sales tax.

II. Tax Administration: Penalty and Interest

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2; IC 6-8.1-10-1(e)

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

STATEMENT OF FACTS

Taxpayer operated a retail vehicle dealership in Indiana. In January 2001 a fire occurred at the taxpayer's place of business, destroying most of its sales records. The taxpayer protests the Department's proposed sales tax assessment for the years 1999 and 2000. The taxpayer disagrees with the Department's reliance on information provided by the Bureau of Motor Vehicles (BMV).

I. Sales and Use Tax: Tax Records

DISCUSSION

As noted, the taxpayer lost most of its business records for 1999 and 2000 in a fire. Given this, the Auditor relied on BMV information to come up with a proposed assessment. The Auditor describes the BMV information relied upon thusly:

> The purchaser presents the ST-108 to the Bureau of Motor Vehicles (BMV) when the vehicle is registered. The BMV records the ST-108 data, including sales tax collected, using the dealer identification number as an account number. At year-end, all sales tax collected by that dealer is totaled. Those year-end reports are available to [the] Indiana Department of Revenue.

The Auditor goes on to describe her methodology:

> Taxpayer was given the BMV list of vehicle sales attributed to their dealer number and asked to identify them using the Vehicle Identification Number (VIN). Since a large volume of records was lost in a fire, taxpayer prepared a list of vehicle sales that were definitely their sales, giving all the information available. Taxpayer's list included vehicles sold to out-of-state purchasers and leased vehicles. Audit compared taxpayer's list to the BMV list.

After doing the comparing, over a hundred vehicles in each year were "unidentified." Or as the taxpayer puts it,

> For 1999 and 2000 … the Department did find material discrepancies between the amounts reported by the taxpayer on the Form ST-103 and certain records of the Indiana Bureau of Motor Vehicles ("BMV").

Regarding the unidentified vehicles, the Auditor had a title check performed, for the year 2000, through the BMV. The Auditor then "attempted to contact the registered owner of each vehicle." As the Auditor describes it:

> Some registered owners have an unlisted telephone number and others have no listing at all. Eventually, forty-one owners were contacted by audit. All but one confirmed they had purchased their vehicle at taxpayer's dealership. That one vehicle was removed from the BMV list. Of those customers not contacted, all resided in [taxpayer's county] or neighboring counties; those sales remain on the taxpayer's BMV list.

The Auditor further notes that additionally "[t]wo obvious keying errors were made by BMV when the sales tax was entered." The Auditor "adjusted" those figures to reflect "the actual tax collected."

The taxpayer states that

> [t]he Department admits that "obvious keying errors were made by the BMV when the sales tax was entered." This alone makes any reliance on the BMV records unreasonable. In all likelihood, there were additional keying errors that were not obvious to the auditor

The taxpayer also states that the BMV "probably [made] additional keying errors" while "entering the sales tax amount from the ST-108s" and that the dealer number data may have also suffered from errors.

The taxpayer goes on to note that it used "the same procedures to report 1999 and 2000 tax liability as it did to report its 2001 tax liability." The taxpayer concludes that since the 2001 records were deemed accurate by audit, and that there were what the taxpayer characterizes as "manifest errors in the BMV records" that another method should be used. The taxpayer proposes two such methods: (1) accept its 1999 and 2000 reported tax; or (2) accept its alternate records.

IC 6-8.1-5-4(a) requires the taxpayer to "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 taxpayer's records were destroyed in a fire. The Department, based on IC 6-8.1-5-1(a), made a "proposed assessment of the amount of unpaid tax on the basis of the *best information available* to the department." (*Emphasis* added) The taxpayer argues in essence that the BMV information is not the best information available.

First the taxpayer argues that the Department should accept its reported tax liability for 1999 and 2000:

> The taxpayer used the same procedures to report its 1999 and 2000 tax liability as it did to report its 2001 tax liability. Based upon the undisputed accuracy of the taxpayer's 2001 records, and the manifest errors in the BMV records, the Department should accept the taxpayer's reported amount of tax due for 1999 and 2000.

The taxpayer's position--in a sense--begs the question, since it presupposes there were no discrepancies for 1999 and 2000 when in fact the Auditor found discrepancies. The Auditor reviewed the year-end reports "from the BMV and [the] Indiana

Department of Revenue" and found only 2001 to be "materially correct."

Next, the taxpayer argues that its additional records should be used. The taxpayer describes these records as follows:

These records survived the fire because they were in the dealership's safe. They were rejected by the auditor, however, because they did not contain vehicle identification numbers ("VIN numbers").

The taxpayer goes on to state that VIN numbers were obtained for "substantially all of the vehicles" by using service records. However the alternate records provided by the taxpayer show neither the sales amount, nor the tax collected. And as the taxpayer stated, it does not include all of the VIN numbers.

It should be kept in mind that under IC 6-8.1-5-1(b) the taxpayer bears the burden of proving the proposed assessment is wrong, and that the Department's proposed assessment is considered "prima facie evidence that the department's claim … is valid." The steps outlined above that Auditor used (*viz.*, BMV information, title search, verifying with a large block of purchasers that they in fact purchased from the taxpayer, etc.) did result in the best information available being used for the audit.

FINDING

Taxpayer's protest is denied.

II. Tax Administration: Penalty and Interest

DISCUSSION

Indiana Code 6-8.1-10-2.1(d) states, in part, that if "the deficiency determined by the department was due to reasonable cause and not willful neglect, the department shall waive the penalty." Regulation 45 IAC 15-11-2 also states,

(b) "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.

The taxpayer states that it was not negligent and that it "has always made a diligent effort to timely pay the proper tax." The taxpayer also states that business records were lost in the fire.

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

FINDING

The taxpayer's penalty protest is sustained; the protest of the interest is denied.

DEPARTMENT OF STATE REVENUE

6520020574.LOF

LETTER OF FINDINGS NUMBER: 02-0574
Motor Carrier
For Tax Period 1998-2000

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

ISSUES

I. Motor Carrier—Overweight Vehicle Permits

Authority: IC 6-8.1-5-1

Taxpayer protests the imposition of overweight vehicle permit fees.

II. Tax Administration—Interest and Negligence Penalty

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

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

STATEMENT OF FACTS

Taxpayer operates a trucking company which serves customers in the steel industry in Indiana. The Indiana Department of Revenue ("Department") determined that taxpayer had not paid for enough oversized and overweight permits to cover the number of overweight loads it had trucked for its customers. The Department assessed the fees and imposed a ten percent negligence penalty and interest. Taxpayer protests the imposition of fees, penalty and interest. Further facts will be supplied as necessary.

I. Motor Carrier—Overweight Vehicle Permits

DISCUSSION

Taxpayer protests the imposition of overweight vehicle permit fees. The Department issued proposed assessments for unpaid overweight vehicle permit fees after reviewing the best information available to it, as provided in IC 6-8.1-5-1(a). Also of relevance is IC 6-8.1-5-1-(b), which states in pertinent part:

…

The notice of proposed assessment is prima facie evidence that the department's claim for 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.

In the course of its protest, taxpayer has provided sufficient documentation to prove that it is not liable for the unpaid permit fees. Therefore, taxpayer has met its burden under IC 6-8.1-5-1(b).

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Interest and Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of interest and a ten percent (10%) negligence penalty. 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." Therefore, the Department may not waive interest.

Taxpayer also protests the imposition of a ten percent negligence penalty. The relevant statute is IC 6-8.1-10-1(a), which states:

If a person:

(1) fails to file a return for any of the listed taxes;

(2) fails to pay the full amount of tax shown on the person's tax return on or before the due date for the return payment;

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

(4) fails to timely remit any tax held in trust for the state; or

(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department;

the person is subject to a penalty.

(Emphasis added)

Negligence is described in 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 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.

Since taxpayer was sustained in Issue I of this protest, it has not failed to use such reasonable care as would be expected of an ordinary taxpayer. Therefore, taxpayer was not negligent under 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

6520020575.LOF

LETTER OF FINDINGS NUMBER: 02-0575
Motor Carrier
For Tax Period 1998-2000

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

ISSUES

I. Motor Carrier—Overweight Vehicle Permits

Authority: IC 6-8.1-5-1

Taxpayer protests the imposition of overweight vehicle permit fees.

II. Tax Administration—Interest and Negligence Penalty

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

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

STATEMENT OF FACTS

Taxpayer operates a trucking company which serves customers in the steel industry in Indiana. The Indiana Department of Revenue ("Department") determined that taxpayer had not paid for enough oversized and overweight permits to cover the number of overweight loads it had trucked for its customers. The Department assessed the fees and imposed a ten percent negligence penalty and interest. Taxpayer protests the imposition of fees, penalty and interest. Further facts will be supplied as necessary.

I. Motor Carrier—Overweight Vehicle Permits

DISCUSSION

Taxpayer protests the imposition of overweight vehicle permit fees. The Department issued proposed assessments for unpaid overweight vehicle permit fees after reviewing the best information available to it, as provided in IC 6-8.1-5-1(a). Also of relevance is IC 6-8.1-5-1-(b), which states in pertinent part:

…

The notice of proposed assessment is prima facie evidence that the department's claim for 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.

In the course of its protest, taxpayer has provided sufficient documentation to prove that it is not liable for the unpaid permit fees. Therefore, taxpayer has met its burden under IC 6-8.1-5-1(b).

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Interest and Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of interest and a ten percent (10%) negligence penalty. 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." Therefore, the Department may not waive interest.

Taxpayer also protests the imposition of a ten percent negligence penalty. The relevant statute is IC 6-8.1-10-1(a), which states:

If a person:

(1) fails to file a return for any of the listed taxes;

(2) fails to pay the full amount of tax shown on the person's tax return on or before the due date for the return payment;

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

(4) fails to timely remit any tax held in trust for the state; or

(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department;

the person is subject to a penalty.

(Emphasis added)

Negligence is described in 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 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.

Since taxpayer was sustained in Issue I of this protest, it has not failed to use such reasonable care as would be expected of an ordinary taxpayer. Therefore, taxpayer was not negligent under 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

04-20030164P.LOF

LETTER OF FINDINGS NUMBER: 03-0164P

Sales & Use Tax

For the Years 1997, 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.

ISSUES

I. Tax Administration – Interest

Authority: Ind. Code § 6-8.1-10-1; 11 U.S.C. § 502(b)(2).

Taxpayer protests the imposition of interest after the date taxpayer filed for bankruptcy.

II. Tax Administration - Penalty
Authority: Ind. Code § 6-8.1-10-2.1; 45 IAC 15-11-2.

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

STATEMENT OF FACTS

Taxpayer is a business engaged in automobile glass repair and replacement. From 1997 to 1999, taxpayer claimed sales tax exemption with respect to one customer, and did not remit sales or use tax with respect to several purchases of both capital and non-capital equipment and tangible personal property that taxpayer rented. As a result of Department audit, taxpayer was assessed additional sales and use tax as well as interest and a ten percent (10%) penalty for negligence. Taxpayer has agreed with the Department's sales and use tax assessment; however, taxpayer protests the Department's imposition of interest after the date on which it filed for bankruptcy. Taxpayer also protests the imposition of the statutory penalty for negligence.

I. Tax Administration – Interest

DISCUSSION

Taxpayer protests the imposition of interest from the date taxpayer filed for bankruptcy to present. Taxpayer argues that the ruling on the bankruptcy petition precludes the Department from assessing interest against the taxpayer, and therefore this should be waived.

Under Ind. Code § 6-8.1-10-1(e), interest cannot be waived by the Department. However, due to 11 U.S.C. §502(b)(2), the Bankruptcy Court's ruling prohibiting post-petition interest must be permitted to stand.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration-Penalty

DISCUSSION

Taxpayer protests the imposition of the ten percent (10%) negligence penalty for all taxes that the Department has imposed.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10-2.1. The Indiana Administrative Code further provides:

> (b) "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.
>
> (c) 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. Factors which may be considered in determining reasonable cause include, but are not limited to:
>
> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
>
> Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

45 IAC 15-11-2.

Taxpayer argues that penalty should be waived in this case for two reasons. First, it argues that the taxpayer took immediate steps to correct the issue that gave rise to the tax in question. Second, taxpayer argues that it has had an excellent compliance history with the Department. While its changes in procedures are certainly commendable, taxpayer's failure to utilize the other appropriate procedures in the first place did not meet the duty of reasonable care expected of a taxpayer. Further, even accepting taxpayer's statement of an excellent compliance history, in this instance taxpayer's operations did not meet the duty of ordinary business care expected of taxpayers.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

18-20030276.LOF

LETTER OF FINDINGS NUMBER: 03-0276
FINANCIAL INSTITUTIONS TAX
For Year 1999

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. Financial Institutions Tax – Regularly conducted business

Authority: 45 IAC 17-2-1(b)(1); 45 IAC 17-2-6(a)(8); 45 IAC 17-2-9

Taxpayer protests the imposition of the Financial Institutions Tax on the proceeds from the sale of the servicing rights associated with an Indiana mortgage.

STATEMENT OF FACTS

Taxpayer is an approved mortgagee by HUD/FHA, FNMA, and GNMA. Affiliated entities provide a substantial portion of the revenues and expenses of the company. Taxpayer reports the following types of income: financing fees, service fees, and interest income.

During 1999, taxpayer sold its servicing rights on an Indiana mortgage. On audit, the Financial Institutions Tax (FIT) was assessed on the proceeds of this sale.

Taxpayer owns no property, has no presence, and services no other loans in Indiana.

I. Financial Institutions Tax – Regularly conducted business

DISCUSSION

The Financial Institutions Tax is a franchise tax imposed upon a corporation that is transacting the business of a financial institution in Indiana. 45 IAC 17-2-1(b)(1). A taxpayer is transacting business within Indiana if the taxpayer *regularly* engages in transactions with Indiana customers that involve intangible property, including loans. 45 IAC 17-2-6(a)(8). (Emphasis added)

Taxpayer, with its corporate domicile in a taxing jurisdiction outside Indiana, conducts the business of a financial institution.

45 IAC 17-2-9 lays the groundwork for determining whether a taxpayer regularly conducts business within Indiana. It reads:

A taxpayer is presumed, subject to rebuttal, to regularly solicit business within Indiana during a taxable year if at any time during the taxable year, the sum of the taxpayer's assets, including the assets arising from loan transactions, and the absolute value of the taxpayer's deposits attributable to Indiana, equal at least five million dollars ($ 5,000,000), or if the taxpayer does any of the following during the taxable year:

(1) Sells products or services of any kind or nature to twenty (20) or more Indiana customers who receive the product or service in Indiana.

(2) Solicits business from twenty (20) or more potential Indiana customers.

(3) Performs services outside Indiana that are consumed within Indiana by twenty (20) or more customers.

(4) Engages in transactions with twenty (20) or more Indiana customers that involve intangible property, including loans, but not property described in section 7 of this rule and result in receipts flowing to the corporation from such customers within Indiana.

While the regulation creates a rebuttable presumption of regular business activity when a taxpayer meets the above criteria, it also *ipso facto* creates a rebuttable presumption that a taxpayer does not regularly conduct business activity in Indiana when it fails to meet the above criteria. Therefore, the fact that taxpayer does not meet the above criteria (its loan servicing rights were sold for less than $50,000, and it services only one Indiana customer) does not automatically mean that taxpayer does not regularly conduct business in Indiana; rather, it creates a presumption that the Department may rebut.

However, the Department has failed to show any indication that taxpayer's activities show a pattern of regular business. Indeed, the fact that taxpayer has but one Indiana customer shows not a pattern of regular business, but an isolated occurrence.

Taxpayer therefore does not fit the standard for which the FIT may be applied.

FINDINGS

The taxpayer is sustained.

DEPARTMENT OF STATE REVENUE

1820030370.LOF

LETTER OF FINDINGS: 03-0370
FINANCIAL INSTITUTIONS TAX
For the 1997 and 1998 Tax Years

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. Statute of Limitations – Financial Institutions Tax.

Authority: IC 6-5.5-1-17(a); IC 6-5.5-2-1(a); IC 6-5.5-6-1; IC 6-8.1-1-1; IC 6-8.1-5-2(a); IC 6-8.1-5-2(e); 45 IAC 15-5-7; 45 IAC 15-5-7(f); 45 IAC 17-2-3(a); 45 IAC 17-3-5; 45 IAC 17-3-5(a); 45 IAC 17-3-5(c); 45 IAC 17-3-5(d).

Taxpayer maintains that the Financial Institutions Tax (FIT) assessment for the years 1997 and 1998 is barred by the three-year statute of limitations.

STATEMENT OF FACTS

Taxpayer is a holding company which directly or indirectly controls financial institution subsidiaries throughout the United States and in foreign countries. The Department of Revenue (Department) conducted an audit review of taxpayer's business records and various tax returns for 1997 and 1998. In an audit report completed May 2003, the Department concluded that taxpayer owed additional FIT. As a result, in July 2003, the taxpayer issued notices of "Proposed Assessment." Taxpayer received the notices, submitted a protest challenging the propriety of the FIT assessment, an administrative hearing was conducted during which taxpayer explained the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. Statute of Limitations – Financial Institutions Tax.

Taxpayer argues that the assessment of additional 1997 and 1998 FIT is barred by the statute of limitations because taxpayer "[did] not have an executed waiver extending the statute of limitations for these years."

The statute of limitations is defined under IC 6-8.1-5-2(a) which states that, "Except as otherwise provided in this section, the department may not issue a proposed assessment under section 1 of this chapter more than three (3) years after the latest of the date the return is filed...." IC 6-8.1-5-2(e) defines certain circumstances under which the three-year limitations period is tolled. "If a person files a fraudulent, unsigned, or substantially blank return, or if a person does not file a return, there is no time limit within which the department must issue its proposed assessment." Id. *See also* 45 IAC 15-5-7.

On their face, the proposed assessments are untimely because the audit report was completed in May 2003 and the consequent assessments were issued by the Department in July 2003; both dates are well outside the three-year limitations period for assessing additional 1997 and 1998 taxes pursuant to IC 6-8.1-5-2(a).

The issue is whether one of the exceptions contained within IC 6-8.1-5-2(e) is applicable under taxpayer's own circumstances and that – as a result – the usual three-year limitations period was tolled by virtue of that exception.

Taxpayer is a holding company which owns, controls, and operates a large of number of financial institutions including a number of Indiana based institutions.

Within Indiana, "There is imposed on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana." IC 6-5.5-2-1(a). For purposes of determining the FIT liability, a "'[t]axpayer' means a corporation that is transacting the business of a financial institution, including any of the following:

(1) A holding company
(2) A regulated financial corporation.
(3) A subsidiary of a holding company or regulated financial corporation.
(4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution." IC 6-5.5-1-17(a).

The term "Financial Institution" is defined at 45 IAC 17-2-3(a) which states as follows:

The "business of a financial institution" means the activities of a holding company, a regulated financial corporation, or a subsidiary of either that each is authorized to perform under federal or state law, including the activities authorized by regulation or order of the Federal Reserve Board for such a subsidiary under Section (4)(C)(8) of the Bank Holding Act of 1956 (12 U.S.C. 1843(c)(8)).

Because taxpayer is a "holding company" it comes within the definition of a "financial institution" as set out in IC 6-5.5-1-17(a) and 45 IAC 17-2-3(a). Therefore, taxpayer was itself required to file 1997 and 1998 FIT returns as a "holding company." It is evident that, upon a fair reading of the statute and regulation, that this particular filing requirement was not met when certain constituent Indiana members of the holding company filed individual FIT returns for that period.

In addition, 45 IAC 17-3-5 requires that members of a "Unitary Group" file a single, combined return for the purposes of determining the unitary group's FIT liability. The regulation states, in relevant part, as follows:

> A "unitary business" means business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually, or as a group, in transacting the business of a financial institution. Unity of ownership exists when a corporation is a member of a group of two (2) or more entities and more than fifty percent (50%) of the voting stock of each member of the group is directly or indirectly owned by: (1) a common owner or common owners, either corporate or noncorporate.... 45 IAC 17-3-5(c).

The regulation further specifies that "A unitary group for purposes of the FIT is composed of those taxpayer members that are engaged in a unitary business transacted wholly or partially within Indiana." Id. Once it has been determined that a unitary group is conducting the business of a financial institution, "A designated taxpayer who is a member of a unitary group shall file a *combined return covering all the operations of the unitary business and including all taxpayer members of the unitary group.*" 45 IAC 17-3-5(a) (*Emphasis added*). "Therefore, if one (1) member of a unitary group is conducting the business of a financial institution in Indiana, then all members of the unitary group engaged in a unitary business must file a combined return, even if some of the members are not transacting business in Indiana." 45 IAC 17-3-5(d). The language of both the statute and the regulation indicate that the annual filing requirement is mandatory and not merely advisory or suggestive.

Therefore, whether as a holding company or as a unitary group, taxpayer was required to file a FIT combined return in which it reported all the operations of its business including those entities within the state and those without. Taxpayer failed to meet its reporting requirement because it did not file the combined return.

The regulation provides that, "The running of the statue of limitations for purposes of assessing unpaid taxes will not start if the taxpayer fails to file a return which is required under any listed tax provision." 45 IAC 15-5-7(f). The term "listed tax" is defined at IC 6-8.1-1-1 which specifically includes "financial institutions tax" as one of Indiana's "listed taxes." Under that portion of the Indiana Code outlining a taxpayer's responsibilities under the Financial Institutions Tax, IC 6-5.5-6-1 states that "[a]nnual returns with respect to the tax imposed by this article *shall* be made by every taxpayer: (1) having for the taxable year adjusted gross income or apportioned income subject to taxation under this article...." (*Emphasis added*). The filing requirement is repeated at 45 IAC 17-3-5(a) which states, "A designated taxpayer who is a member of a unitary group *shall* file a combined return covering all the operations of a unitary business and including all taxpayer members of the unitary group." (*Emphasis added*).

Taxpayer – as a holding company – failed to file the necessary combined 1997 and 1998 returns covering all the operation of its unitary group. Therefore, under IC 6-8.1-5-2(e), the three-year statute of limitations did not begin to run and does not now preclude the Department from an assessment of taxes for those two reporting periods.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420030371.LOF

LETTER OF FINDINGS NUMBER: 03-0371
Sales Tax
For The Tax Period 1998-2000

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

ISSUES

1. Sales and UseTax-Services

Authority: IC 6-8.1-5-1(b), IC 6-2.5-4-1, IC 6-2.5-2-1, 45 IAC 2.2-4-2 (b),

The taxpayer protests the assessment of sales tax on certain service charges.

2. Tax Administration-Penalty

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

The taxpayer protests the assessment of penalty.

STATEMENT OF FACTS

The taxpayer is a retailer of toys and associated items. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use taxes, interest and penalty against the taxpayer for the tax period 1998-2000. The taxpayer protested a portion of the assessment of tax and penalty and a hearing was held.

1. Sales and UseTax-Services

DISCUSSION

The department assessed sales tax on the taxpayer's receipts from bicycle assembly and delivery charges. The taxpayer protests these assessments contending that they are nontaxable services. The Notice of Proposed Assessment is presumed to be accurate and taxpayers carry the burden of proving that a proposed liability is incorrect. IC 6-8.1-5-1(b).

Retail transactions made in Indiana are subject to sales tax. IC 6-2.5-2-1. A retail transaction is defined generally as the acquiring and subsequent selling of tangible personal property. IC 6-2.5-4-1. Sales of services are generally not retail transactions and are not subject to sales tax. There are, however, certain situations where services are subject to the sales tax.

The taxpayer sells bicycles and offers the buyers the option of an assembly service. Customers choosing to buy the assembly service first purchase the bicycle at the register in the normal manner. The customer is given a receipt including a line item for the bicycle assembly service and a pick-up date and time. After the bicycle is assembled, the customer picks up the bicycle.

The taxpayer also offers delivery service for its larger items such as swing sets. When purchasing a large item, the customer first pays for the item at the register as in any other transaction. A delivery fee is separately stated and included in the cost paid by the customer. The taxpayer contracts with an unrelated company for delivery of the item to the customer. If a problem develops after delivery of a large item, the taxpayer pays the delivery company to retrieve the malfunctioning item and deliver another to the customer.

The law governing the taxpayer's fact situation is very specific. To the extent service income represents "any bona fide charges which are made for the preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records," the income becomes part of the retail merchant's gross retail receipts. IC 6-2.5-4-l (e)(2).

The Regulations provide guidance on how to determine the taxability of a transaction at 45 IAC 2.2-4-2 (b) as follows:

> (b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

In Taxpayer's situation, the services are performed prior to the delivery of the product to the customer. Sales tax must be collected on the total price of the finished product.

FINDING

The taxpayer's protest is denied.

2. Tax Administration-Penalty

DISCUSSION

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

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

The taxpayer argued that the negligence penalty was improperly imposed because the sales tax was not assessed on the bicycle assembly and delivery charges in the 1990-1992 audit. That audit, however, was an income tax audit. The taxpayer disregarded the department's instructions and was inattentive to its duties to collect and remit sales tax as required by Indiana law. These breaches of the taxpayer's duty constitute negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030372.LOF

LETTER OF FINDINGS: 03-0372
Indiana Corporate Income Tax
For 1999 and 2000

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

ISSUE

I. Interest Assessment – Corporate Income Tax.

Authority: IC 6-3-4-4.1(d); IC 6-8.1-10-1; IC 6-8.1-10-1(a); IC 6-8.1-10-1(b); IC 6-8.1-10-1(b)(3); Income Tax Information Bulletin #64 (January 2003).

Taxpayer argues that interest charges – levied against unpaid 1999 and 2000 corporate income taxes – should be abated in their entirety.

STATEMENT OF FACTS

Taxpayer is an out-of-state company doing business within Indiana. During 2001 and 2002, the Department of Revenue (Department) conducted an audit review of taxpayer's business records and previous tax returns.

Following the review, the Department concluded that taxpayer owed approximately $5,000 in additional corporate income taxes for 1999 and 2000. In 2003, the Department sent taxpayer a bill for the unpaid tax. In addition to the amount of unpaid tax, the Department also included interest charges of approximately $1,000.

Taxpayer agreed with the Department's conclusion that it owed the additional $5,000 in tax. However, it concluded that the $1,000 in interest charges was ill-advised and that the interest charges should be abated. Therefore, the taxpayer submitted a protest. An administrative hearing was conducted during which taxpayer explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Interest Assessment – Corporate Income Tax.

Taxpayer's argument goes back to the time it reported its 1998 income. Taxpayer filed a corporate income tax return in early 1999. In that return, taxpayer indicated that it had overpaid its 1998 taxes by $6,000. However, rather than asking for a $6,000 refund, it directed the Department to carry forward the $6,000 to cover any unexpected 1999 liability.

Taxpayer filed a tax return in early 2000. Taxpayer did not owe any income tax for 1999. Again, taxpayer asked that the same $6,000 be carried forward to cover any unexpected 2000 liability.

In November of 2000, taxpayer filed a "short period" return. Again, taxpayer did not owe any additional taxes. However, taxpayer failed to indicate that the $6,000 should be carried forward. Instead taxpayer asked for a refund. The Department obligingly issued a refund check. Taxpayer decided that it did not want the $6,000 check; taxpayer wanted the $6,000 carried forward, and it returned the uncashed check asking that the amount be applied toward any potential 2001 liability.

When taxpayer submitted its 2001 return, it determined that it did not owe any additional taxes. It asked that the $6,000 be carried forward again to cover any unexpected 2002 liability.

For reasons not related to the stray $6,000, the Department decided it was time that taxpayer's business records and past tax returns should be audited. That audit was conducted during 2001 and 2002. The "Audit Summary" was completed in May 2003. The audit report's bottom-line conclusion was that taxpayer had erroneously underreported its 1999 and 2000 income and that it owed additional taxes. Therefore, the Department sent taxpayer notices of "Proposed Assessment" stating that taxpayer owed approximately $5,000 in taxes together with $1,000 in accrued interest.

Taxpayer does not challenge the $5,000 tax assessment. What it does challenge is the $1,000 interest charge. Taxpayer's argument is based on the fact that it had carried over the $6,000 overpayment from year-to-year-to-year. In effect, taxpayer argues that – in taxpayer's words – the $6,000 was in its "account" at all relevant times. Taxpayer believes that the $6,000 was available at all times to offset any unexpected liability including the tax liability for its underreported 1999 and 2000 income.

IC 6-8.1-10-1 imposes an interest charge when a taxpayer has not paid the proper amount of taxes due.

IC 6-8.1-10-1(a) provides that, "If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on his return by the due date for the return or the payment, or *incurs a deficiency upon a determination by the department*, the person is subject to interest on the nonpayment." (*Emphasis added*).

The statute also establishes the amount against which interest is calculated. IC 6-8.1-10-1(b) states that, "The interest for a failure described in subsection (a) is the adjusted rate established by the commissioner under subsection (c), from the due date for payment. The interest applies to: (1) the full amount of the unpaid tax due if the person failed to file the return; (2) the amount of the tax that is not paid, if the person filed the return but failed to pay the full amount of tax shown on the return; or (3) the amount of the deficiency."

Income Tax Information Bulletin #64 (January 2003) reflects the Department's interpretation of IC 6-8.1-10-1. "If a taxpayer fails to file a return, fails to pay the full amount of tax, or files a late return with tax due, the taxpayer is subject to interest (and possible penalty) on any outstanding balance of tax due after the due date of the return under IC 6-8.1-10-1. The interest on nonpayment of tax accrues at the rate established by the Commissioner from the due date until the date on which full payment of the tax is received."

It is not disputed that taxpayer owed additional corporate income tax for 1999 and 2000. Therefore, it would seem apparent that the amount of unpaid tax is subject to an interest charge pursuant to IC 6-8.1-10-1(b)(3) which states that an interest charge is imposed on "the amount of the deficiency." Similarly, Income Tax Information Bulletin #64 restates the statutory imperative; interest is charged "on any outstanding balance of tax due after the due date of the return...." That interest charge "accrues... from the due date until the date on which full payment of the tax is received."

The statutory language reads in the imperative and does not vest in the Department any discretion regarding whether or not to impose the interest charge. "If a person... incurs a deficiency upon a determination by the department, the person *is* subject to interest on the nonpayment." IC 6-8.1-10-1(a) (*Emphasis added*).

Nevertheless, taxpayer maintains that because it previously had overpaid its taxes by $6,000 and repeatedly directed that the full amount be carried forward, the interest charge on the 1999 and 2000 assessment should be abated. Taxpayer's argument is that it deposited into its account a discretionary, free-floating asset which could be shuttled back-and-forth in order to instantly meet whatever tax liability – past, present, or future – might arise. In effect, taxpayer argues that the $6,000 should have been shuttled backwards to cover the 1999 – 2000 assessment the moment that particular liability arose. However, taxpayer misapprehends the status of the $6,000 overpayment once taxpayer directed that the amount be carried forward. At the time taxpayer filed its 2001 tax return, taxpayer had two choices; it could request that the $6,000 be returned or it could request that the amount be carried forward to pay its 2002 tax liability. During the time taxpayer considered its options, taxpayer had discretionary control over the $6,000. However, once taxpayer directed the Department to carry forward the $6,000, taxpayer lost control over and possessory interest in the money.

Once the amount was carried-forward, the $6,000 was no longer taxpayer's asset. Instead, the carryforward was a "locked-in" payment of 2002 corporate income tax liability. IC 6-3-4-4.1(d) provides, "Every corporation subject to the adjusted gross income tax liability... shall be required to report and pay an estimated tax equal to twenty-five (25%) of such corporation's estimated adjusted gross income tax liability for the taxable year...." In other words, while taxpayer had the momentary discretion to obtain a refund check or carry forward the amount, it nonetheless had to pay *something* (25%) on its estimated 2000 tax liability. Once taxpayer carried forward the $6,000, that amount was *gone*. The $6,000 was not on deposit in taxpayer's "account." The $6,000 was a fixed payment of 2002 taxes.

In addition, IC 6-8.1-10-1 provides no leeway whatsoever on the question of whether or not to impose interest against a tax deficiency or on the question of when that interest begins to accrue. Under IC 6-8.1-10-1(b), the interest clock started ticking on the day that the 1999 and 2000 taxes first became due. The 1999 and 2000 taxes became due on the date that taxpayer first reported its 1999 and 2000 income. The fact that taxpayer had directed the $6,000 overpayment be carried forward in order to pay for future tax liability did nothing to change the fact that its 1999 and 2000 tax liability was originally underreported. Taxpayer seems to liken the Department to a quasi-financial institution; taxpayer deposited $6,000 into its "account," the $6,000 was available to offset any unexpected charge against taxpayer, and the Department had enjoyed the "use" of the $6,000 until 2003 when the notices of proposed assessment were first issued. The Department must decline the opportunity to cast itself into such a role. In addition, it must be fairly pointed out that taxpayer had the "use" of the $5,000 in unpaid taxes since 1999 and 2000.

Taxpayer underreported its 1999 and 2000 tax liability. Interest statutorily accrued on that particular liability from the moment that the 1999 and 2000 taxes first became due until the liability was ultimately satisfied in 2003. The fact that taxpayer carried forward an overpayment of earlier taxes as a payment on its estimated 2002 liability is an irrelevancy. The $6,000 carryforward did nothing to stop interest from accruing on the 1999 and 2000 tax liability.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02-20030384.LOF

LETTER OF FINDINGS: 03-0384
ADJUSTED GROSS INCOME, GROSS INCOME, and FINANCIAL INSTITUTIONS TAXES
For the Years 1996 through 2000

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

ISSUES

I. Taxpayer's Qualifications to File Under Indiana's Financial Institutions Tax.

Authority: IC 6-5.5 et seq.; IC 6-5.5-1-17(d)(1); IC 6-5.5-1-17(d)(2)(A), (B); IC 6-5.5-1-17(d)(2)(B); IC 6-5.5-3-1; 45 IAC 17-2-1(a); 45 IAC 17-2-4(b), (c); 45 IAC 17-2-4(b)(1)-(3); 45 IAC 17-2-4(e)(2).

Taxpayer argues that it is qualified to file under Indiana's Financial Institutions Tax and that further review of taxpayer's previous arguments will support that conclusion.

II. Lease Payments Subject to Gross Income Tax.

Authority: IC 6-2.1-2-2(a); IC 6-2.1-2-2(a)(2); Comdisco, Inc. v. Indiana Dept. of Revenue, No. 49T10-9903-TA-19, 2002 Ind. Tax LEXIS 93 (Ind. Tax Dec. 18, 2002); Enterprise Leasing v. Indiana Dept. of Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002); First National Leasing 598 N.E.2d 640 (Ind. Tax. Ct. 1992); 45 IAC 1.1-1-3(a), (b).

Taxpayer maintains that if it is not qualified to file under the state's Financial Institutions Tax, money received from sales/lease agreements with Indiana customers is not subject to the state's gross income tax.

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

Authority: IC 6-3-2-2(b); IC 6-3-2-2(c).

Taxpayer argues that the value of equipment leased to its Indiana customers and clients should not have been included in its property factor for purposes of calculating taxpayer's adjusted gross and supplemental net income taxes.

STATEMENT OF FACTS

Taxpayer is a Delaware corporation headquartered in Illinois. Taxpayer is in the business of leasing and financing the purchase of construction equipment and engines. The equipment and engines are manufactured by a related company and are made available through a related network of local dealerships. Taxpayer earns money by entering into various forms of transactions with taxpayer's local dealerships, municipalities, and with individual customers. The "lease" transactions hereinafter described are – to a substantial degree – "sales/lease" agreements which provide a means by which the lessee acquires ownership of the leased equipment but which permit taxpayer to retain a security interest in the equipment during the term of the lease itself.

DISCUSSION

I. Taxpayer's Qualifications to File Under Indiana's Financial Institutions Tax.

Taxpayer submitted Financial Institutions Tax (FIT) returns for 1996 through 1997 on the ground that it was properly classified as a "Financial Institution" and that it was entitled to pay Indiana tax on that basis.

The Department of Revenue (Department) conducted an audit of those returns after which it concluded that taxpayer was not qualified to file as a Financial Institution. Under the Department's analysis, taxpayer did not meet the 80 percent threshold set out in IC 6-5.5-1-17(d)(2)(B). Therefore, the Department found that taxpayer should pay Indiana tax under the state's gross income, adjusted gross income, and supplemental net income scheme.

Taxpayer submitted a protest to the Department's decision, an administrative hearing was conducted, and a Letter of Findings (LOF) was issued in which it was concluded that "a cursory review of the taxpayer's 1996 and 1997 federal tax returns indicate that taxpayer is ineligible to qualify to file under the Indiana FIT."

In a request for a rehearing on the matter, taxpayer asked the Department to reconsider its decision; taxpayer was granted the opportunity for a second administrative hearing. The Department reexamined taxpayer's sales/lease transactions, reconsidered the taxpayer's arguments, and reviewed taxpayer's business transactions in light of the FIT statutes and regulations. A Supplemental Letter of Findings (SLOF) was issued which concluded that, "No matter upon which basis [taxpayer's] numbers are calculated, the percentages fall short of the 80% FIT benchmark. Taxpayer is not qualified to file under the state's Financial Institutions Tax."

Taxpayer was dissatisfied with the conclusions contained in the SLOF. Taxpayer requested and was granted a second rehearing. That second rehearing was held, taxpayer's business transactions and lease arrangements were again reviewed, and a second SLOF was issued. The second SLOF concluded that "taxpayer fails to meet the 80 percent benchmark necessary to file under the state's Financial Institution's tax."

Subsequent to the issuance of the second SLOF, taxpayer sought a clarification of the means by which it was required to calculate its gross income for purposes of qualifying to file under the FIT. The Department responded by issuing a Revenue Ruling (RR) in January of 2003. The RR stated that taxpayer was "required to include the gross income derived from finance lease/conditional sales in calculating the 80% test to determine the requirement to file and pay under the Indiana Financial Institutions Tax."

Taxpayer requested further clarification of the RR. After receiving that clarification dated May 26, 2003, taxpayer submitted requests for refunds based upon it 1996 and 1997 tax payments. Those requests were denied. In October 29, 2003, the Department issued a second clarification letter in which it essentially repudiated the first clarification letter.

Taxpayer now asks the Department to revisit the FIT issue, to arrive at a conclusion that taxpayer is entitled to report its Indiana income under the state's FIT, and to arrange for a refund of taxes paid as a result of the Department's purportedly mistaken decisions.

Indiana imposes a franchise tax, known as the Financial Institution Tax (FIT), on corporations transacting the business of a financial institution inside the state. IC 6-5.5 et. seq. The FIT is imposed on resident financial institutions, nonresident financial institutions, and on certain non-bank entities that transact the business of a financial institution. 45 IAC 17-2-1(a). Non-resident corporations, such as the taxpayer, transacting the business of a financial institution, are included in the FIT, after they first meet one of the eight tests set out in IC 6-5.5-3-1 whereby the non-resident corporation demonstrates that it has established an economic presence in Indiana. It is not disputed that taxpayer has established an economic presence in Indiana. That particular issue will not be revisited.

Because the taxpayer is not conducting the business of a traditionally regulated financial institution as defined in IC 6-5.5-1-17(d)(1), the taxpayer predicates its claim to FIT status under the provisions of IC 6-5.5-1-17(d)(2)(A), (B) which grant FIT status to those corporations which receive 80 percent of their gross income from the "[m]aking, acquiring, selling, or servicing loans or extensions of credit" or from the "leasing [of] real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes"

The benchmark for determining whether a taxpayer is "conducting the business of a financial institution" is if 80 percent of the corporation's gross income is derived from the economic equivalent of extending credit. 45 IAC 17-2-4(b), (c). The taxpayer may reach this 80 percent benchmark in one of three ways. It may do so by deriving 80 percent of its income from "(1) Extending credit... (2) Leasing that is the economic equivalent of extending credit [or] (3) Credit card operations." 45 IAC 17-2-4(b)(1)-(3).

An explanation of "the economic equivalent of the extension of credit" is found within the Department's regulations. 45 IAC 17-2-4(b), (c). The corporation must not only derive 80 percent of its income from collecting interest, that interest must be derived from a lease that is "*not* treated as a lease for federal income tax purposes." 45 IAC 17-2-4(e)(2) (Emphasis added). Therefore, to satisfy the requisite 80 percent benchmark, the interest must be both "the economic equivalent of the extension of credit" and from a lease "*not* treated as a lease for federal income tax purposes."

The Department has previously considered taxpayer's qualifications to file under the state's Financial Institution's Tax and has concluded that it is not entitled to do so. The Department has considered and reconsidered taxpayer's various lease transactions and determined that some of the lease agreements are "qualifying transactions" – the proceeds of which can be accumulated to reach the 80 percent threshold – while some of the leases are not qualifying transactions – the proceeds may not be accumulated to reach that threshold.

Taxpayer's lease agreements and business practices have been closely reviewed. The Department has carefully considered taxpayer's arguments on repeated occasions. The Department has issued a number of documents explaining the state's FIT and whether taxpayer is qualified to file under that tax regime. Despite taxpayer's obvious persistence, the Department is not prepared to expend further resources in revisiting these same issues in yet another detailed reanalysis of these same Indiana transactions. Neither the facts nor the law warrant yet further consideration of taxpayer's argument that it is entitled to report its Indiana income under the FIT; taxpayer is not.

FINDING

Taxpayer's protest is denied.

II. Lease Payments Subject to Gross Income Tax.

Taxpayer maintains that it is not subject to gross income tax on the money it received as sales/lease payments from Indiana customers. Taxpayer's argument is that it has a de minimis amount of property located within the state, that the sales/lease agreements were negotiated and accepted by taxpayer at a location outside of Indiana, and that the sales/lease payments were received at locations all of which were outside the state. In effect, taxpayer concludes that these receipts were not Indiana source income for gross income tax purposes.

Taxpayer describes its sales/lease business as follows. A potential Indiana customer will contact one of taxpayer's local Indiana dealerships. If the customer decides to finance or lease the equipment, the dealer will forward the customer's application to taxpayer's regional office in Chicago. Taxpayer will review the customer's information, determine the customer's credit-worthiness, and decide on the terms of the sales/lease agreement. That draft agreement is returned to the dealership. If the customer decides to accept the proposed agreement, customer signs the agreement, and it is returned to the Chicago office. The agreement is again reviewed to assure that everything is in order; if the taxpayer gives final approval, the financing is completed, and the customer arranges to accept delivery of the equipment.

Taxpayer summarizes, "All Lease Agreements entered into by [taxpayer] were created, negotiated, and accepted by [taxpayer] outside of Indiana." Under those conditions, taxpayer concludes that the sales/lease payments were not Indiana source income for gross income tax purposes. The issue is whether Indiana can tax the gross income earned as a result of sales/lease agreements with Indiana customers.

IC 6-2.1-2-2(a) imposes a gross income tax on the receipt of "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or domiciliary of Indiana." IC 6-2.1-2-2(a)(2).

There is no disagreement that the sales/lease payments are "gross income." However, in order for the payments to be subjected to Indiana gross income tax, the payments must have been derived from "sources within Indiana." Id. Income is from a "source[] within Indiana" if the taxpayer has an Indiana "commercial domicile" or an Indiana "business situs." First National Leasing 598 N.E.2d 640, 643 (Ind. Tax. Ct. 1992). Since taxpayer maintains that it does not have a commercial domicile within the state, the issue becomes whether it has established an Indiana "business situs."

45 IAC 1.1-1-3(a), (b) provides that, "A 'business situs' arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile. A taxpayer may establish a business situs in many ways, including, but not limited to.... [o]wnership. leasing, rental, or other business activity connected with income-producing property...." However, taxpayer maintains that it does have an Indiana business situs because all the activities associated with the

sales/lease agreements were conducted outside the state. Taxpayer states that although it maintained a secured ownership interest in the leased equipment, it did not exercise any control over the equipment once it was leased to the Indiana customer.

Taxpayer believes its own circumstances are similar to that of the petitioner-taxpayers in Enterprise Leasing v. Indiana Dept. of Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002). In that case, the Tax Court found that an out-of-state company did not receive Indiana source income when it rented Indiana-titled cars to its customers; therefore, the rental income was "not subject to Indiana's gross income tax." Id. at 1292. The court found that that money received from renting Indiana-titled cars was not Indiana source income because it was not the petitioners who decided to register and operate the cars within the state. Id. at 1291. Rather, it was the decision of the individual customers to register and operate the cars in Indiana. Id. The petitioners' activities in sending the cars to its customers "did not rise to the level of 'active participation' in the 'ownership, leasing' or rental' of property in Indiana." Id. The court determined that the "critical transaction" related to the leasing of the cars occurred at the petitioners' out-of-state location. Id. at 1290. Therefore, because the petitioners' activities within the state were "not more than minimal" and were "remote and incidental to the lease transaction from which [petitioners'] income [was] derived," and because the critical transaction occurred outside the state, the petitioners did not have an Indiana "tax situs." Id. at 1292. The court concluded that the petitioners' lease income was not "derived from sources within Indiana" and was not subject to the state's gross income tax. Id.

In further support of its own position, taxpayer cites to Comdisco, Inc. v. Indiana Dept. of Revenue, No. 49T10-9903-TA-19, 2002 Ind. Tax LEXIS 93 (Ind. Tax Dec. 18, 2002), in which the court found that income received from leasing "high technology and medical equipment" to customers within Indiana was not subject to gross income tax. Id. at *5. The court found that the "critical transaction" took place outside Indiana and that "sole activity by the Petitioners in Indiana is ownership of high technology equipment that is located [in Indiana] pursuant to the lessees' direction." Id. at *23. The court concluded that the "[p]etitioners' ownership of equipment located in Indiana is an activity that is not more than minimal, and is remote and incidental to the lease transaction from which [petitioners'] gross income is derived." Id. at *24.

Taxpayer's various Indiana sales/lease transactions are somewhat more complicated than those described in the Enterprise and Comdisco decisions. For example, taxpayer enters into "Conditional Sales Contracts" whereby taxpayer purchases an item of equipment from one of its dealers and simultaneously sells the machine to the Indiana customer by means of a "conditional sales contract." Under this form of agreement, the customer is able to purchase the equipment at the end of the lease term for a nominal amount. The arrangement is less like a lease and more like arrangement in which the taxpayer finances a customer's purchase of the equipment; the customer nominally owns the equipment but the taxpayer maintains a security interest in the equipment during the term of the contract.

Taxpayer also enters into "Installment Sales Agreements" with Indiana customers. In this form of arrangement, one of taxpayer's local dealers sells an item of equipment to an Indiana customer and enters into an installment sales agreement between itself (the dealership) and the customer. Thereafter, taxpayer purchases the installment sales agreement from the dealership. As a result, the relationship between taxpayer and customer is similar to that found under a conditional sales contract; the customer nominally owns the equipment but makes monthly payments until the term of the agreement is complete. After the last payment is made, the customer owns the equipment free-and-clear, and taxpayer's security interest in the equipment is relinquished.

These are representative of the forms of sales/lease agreements by which taxpayer conducts business in this state. What all the agreements have in common is that they enable an Indiana customer to acquire equipment by means of sales/lease transaction. However, taxpayer's sales/lease transactions are not similar to the lease agreements described in either Comdisco or Enterprise. In both those cases, the court found that because the leased equipment had little or no connection with the state of Indiana, the petitioner-lessors did not acquire an Indiana tax situs. Instead, the automobiles and medical equipment was simply cast adrift into a stream of commerce by means of a "critical transaction" which occurred entirely outside the state; that the cars and medical equipment happened to find their way into Indiana, was an occurrence beyond the contemplation or control of the petitioner-lessors. As the court described, "The Petitioners do not exert control over their lessees' use or possession of the leased equipment. The decision as to where the equipment is located and used rests with the lessees alone." Comdisco, 2002 Ind. Tax LEXIS 93, at *23. However, in taxpayer's sales/lease agreements, the Indiana customer (lessee) does not control the location of the equipment. Instead, it is taxpayer which decides whether the equipment will be located in Indiana or whether the lessee may change the location to another state. "Lessee shall not... change the use of a Unit from that specified in the Application Survey/Usage Rider attached hereto or *change the location of a Unit from that specified above*, without the prior written consent of the [taxpayer]." The meaning of this proviso in the parties' sales/lease agreement is plain; the leased equipment will not be used in a way not anticipated by the contracting parties and will not be removed from the state unless taxpayer explicitly gives permission.

Taxpayer's sales/lease agreements are essentially sales devices by which taxpayer maintains a security interest in the equipment until the customer completes purchasing the equipment. During the term of the sales/lease agreement, taxpayer exercises a substantial degree of control over the use and location of that equipment. By means of these agreements, taxpayer has created for itself an Indiana "tax situs" such that the income attributable to the agreement is subject to Indiana gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

III. Including the Value of Leased Equipment in Taxpayer's Property Factor – Adjusted Gross Income tax.

Taxpayer suggests that except for "a de minimis amount of repossessed property and property returned at the end of the lease," it has no other property located within Indiana; taxpayer maintains that because the "lessees exercise complete control over the use and location of the leased equipment," the leased equipment should not be included in the apportionment formula for determining its Indiana adjusted gross income and supplemental net income tax."

Indiana imposes the adjusted gross income tax on each corporation's adjusted gross income derived from sources within this state. IC 6-3-2-2(b). Where a corporation – such as taxpayer – receives income from both Indiana and out-of-state sources, the amount of tax is determined by the apportionment formula set out in IC 6-3-2-2(b). That formula operates by multiplying taxpayer's total business income by a fraction composed of a property factor, a payroll factor, and a sales factor. IC 6-3-2-2(b). The property factor consists of a fraction "the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the taxable year." IC 6-3-2-2(c).

Taxpayer owns equipment located within this state which it leases to Indiana customers. Taxpayer retains title and ownership over the equipment until such time that the lessee decides to buy the equipment or – by the terms of the parties' agreement – the lease term is complete and ownership passes to the lessee. During the term of the agreement, taxpayer retains all the attributes of ownership including the right to unilaterally transfer title to the equipment to a third-party, to prevent the lessee from using the equipment in a manner not originally anticipated by the contracting parties, and to restrict the lessee from moving the equipment to a location not contemplated within the terms of that agreement.

The Department disagrees with taxpayer's contention that – except for the de minimis property cited above – it "has no property located within Indiana" and that the "lessees exercise complete control over the use and location of the leased equipment."

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20030477P.LOF

LETTER OF FINDINGS NUMBER: 03-0477P
Negligence 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- 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

Taxpayer is a distributor of medica and surgical supplies. Taxpayer sells over 140,000 different medical and surgical supplies such as gloves, syringes, dressings, intravenous products, gowns, and wound-closure products. Taxpayer sells the supplies throughout the Midwest and Northeast. Taxpayer has a distribution warehouse in Indiana. The majority of Indiana's sales are shipped from the distribution warehouse located in Indiana. Taxpayer ships the products in company-owned vehicles. Taxpayer's customers include hospitals, nursing homes, medical clinics, doctors, surgery centers, group purchasing organizations, and other distributors. Taxpayer negotiates long-term contracts to provide all medical and surgical supplies to larger customers.

A review of taxpayer's records revealed exempt sales for which taxpayer had no valid exemption certificate. Taxpayer was given an opportunity to obtain a valid exemption certificate for all exempt sales. The sales by year for all three years was prorated over the audit period as the best information available. An adjustment was made to assess sales tax on sales exempted in error.

For all three years under audit, a statistical sample was used to determine the expense purchases subject to use tax. The adjustment for purchases subject to use tax was determined in the following manner: A sample of invoices was reviewed for each expense account. Those invoices on which no sales tax was charged and no use tax was remitted were considered errors. The total errors were divided by the total of the sample for each expense account to determine the error rate. The error rate was applied to the total expense for each account for each year.

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

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana

Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

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

Determining whether a negligence penalty applies is a factual determination. In this case, taxpayer was assessed sales tax on items for which exemption certificates could not be produced and use tax for items for which sales tax was not paid and which were not purchased for resale. This was taxpayer's first audit, and despite the complexity of the transactions involved, taxpayer maintained a less than 2% error rate.

Taxpayer has paid the liability and the corresponding interest without protest. Taxpayer has shown a good faith effort to comply with the tax laws of Indiana.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0120030482.LOF

LETTER OF FINDINGS: 03-0482
Indiana Adjusted Gross Income Tax
For 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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sufficiency of Taxpayer's Indiana Tax Return.

Authority: IC 6-3-1-3.5; Clifford R. Eibeck v. Ind. Dept of Revenue, 779 N.E.2d 1212 (Ind. Tax Ct. 2003); Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); 45 IAC 3.1-1-1; I.R.C. § 62.

Taxpayer maintains that he has fulfilled his obligation under state and federal law by filing federal and state income tax returns which are filled out with "zeroes."

II. Definition of "Income" for Purposes of Imposing the State's Individual Adjusted Gross Income Tax.

Authority: U.S. Const. amend. XIV; New York v. Graves, 300 U.S. 308 (1937); Merchant's Loan & Trust Co. v. Smietanka, 255 U.S. 509 (1921); Doyle v. Mitchell, 247 U.S. 179 (1918); Eisner v. Macomber, 252 U.S 189 (1920); United States v. Connor, 898 F2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F2d 1328 (7th Cir. 1984); United States v. Romero, 640 F2d 1014 (9th Cir. 1981); Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994); *Report of Committee on Ways and Means to Accompany HR. Res. 8300,* 83rd Cong. (1954); *Report of the Committee on Finance to Accompany H.R. Res. 8300,* 83rd Cong. (1954).

Taxpayer argues that the money he received during 2002 was not subject to the state's adjusted gross income tax because only corporate income is subject to income tax.

III. Voluntary Nature of Indiana's Adjusted Gross Income Tax.

Authority: IC 6-3-2-1(a); IC 6-8.1-11-2; Couch v. United States, 409 U.S. 322 (1975); Helvering v. Mitchell, 303 U.S. 391 (1938); United States v. Gerads, 999 F.2d 1255 (9th Cir. 1993); McLaughlin v. United States, 832 F.2d 986 (7th Cir. 1987); McKeown v. Ott, No. H 84-169, 1985 WL 11176 (N.D. Ind. Oct. 30, 1985); Black's Law Dictionary (7th ed. 1999).

Taxpayer maintains that payment of income taxes is voluntary and that nowhere in the law is an individual made "liable" for the payment of income tax.

STATEMENT OF FACTS

Taxpayer filed a federal and a state income tax return for 2002. On both those returns, taxpayer filled in all of the entries with zeroes. Taxpayer attached a note to the Indiana return indicating that "This Return Is Not Filed Voluntarily." Also attached to the return was a W-2 form containing information indicating that taxpayer obtained "wages" during 2002. The Department of Revenue (Department) determined that taxpayer had incorrectly reported his 2002 income; thereafter, the Department sent notices of

"Proposed Assessment" based on the information reported on the W-2 form. Taxpayer responded in writing challenging the Department's assessment. Additional correspondence between taxpayer and the Department followed; the upshot of the correspondence was that taxpayer eventually submitted a formal "protest" of the assessment. An administrative hearing was conducted during which taxpayer was provided an opportunity to explain the basis for his protest. This Letter of Findings results.

DISCUSSION

I. Sufficiency of Taxpayer's Indiana Tax Return.

Taxpayer maintains that he was not required to file an Indiana income tax return containing anything more than numerous "zeroes." According to taxpayer, because his corresponding federal return was also filled out with "zeroes," he was compelled by force of law to file his Indiana return as he did.

The Indiana tax return here at issue employs federal adjusted gross income as the starting point for determining the taxpayer's state individual income tax liability. Line one of the Indiana IT-40 form instructs the taxpayer to "Enter your federal adjusted gross income from your federal return (see page 10)."

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 Indiana statute defines specific addbacks and deductions peculiar to Indiana which modify the federal adjusted gross income amount. The Department's own regulation restates this formulation. 45 IAC 3.1-1-1 defines individual adjusted gross income as follows:

> Adjusted Gross Income for Individuals Defined. For Individual, "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 an Indiana taxpayer use the federal adjusted gross income calculation – as determined under I.R.C. § 62 – as the starting point for determining that taxpayer's Indiana adjusted gross income.

Taxpayer's contention – that he was compelled by force of law to declare "0" as Indiana adjusted gross income because he declared "0" federal adjusted gross income – is patently without merit. The statute is plainly written and is unambiguous. Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 62 not merely as reported by the taxpayer. *See* Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209, 1213 (Ind. Tax Ct. 1996). The directions contained within the Indiana income tax form provide the individual taxpayer with abbreviated directions for completing the form and not the means for determining the taxpayer's adjusted gross income. The Indiana tax form instructs the taxpayer to put what number in what box. However, the taxpayer must not only put *a* number in the box, he must put the *correct* number in the box. The directions on the tax form notwithstanding, taxpayer is nonetheless required to actually perform the calculations necessary to determine his liability for Indiana adjusted gross income tax.

The Indiana Tax Court addressed taxpayer's contention in Clifford R. Eibeck v. Ind. Dept of Revenue, 779 N.E.2d 1212 (Ind. Tax Ct. 2003). "[I]t must be remembered that tax forms are used merely as an aid for taxpayers in calculating their taxable income in accordance with the income tax law. Therefore, calculating Indiana's adjusted gross income begins with federal taxable income as *defined* by Section 61(a) of the United States Code, not as what a taxpayer *reports* on its federal tax form." Eibeck 779 N.E.2d at 1214 n.6 (*Emphasis in original*).

FINDING

Taxpayer's protest is denied.

II. Definition of "Income" for Purposes of Imposing the State's Individual Adjusted Gross Income Tax.

Taxpayer maintains that only corporate profits are subject to either state or federal income tax. According to taxpayer, because he is not a corporation and did not receive corporate profits, any money which he received during 2002 is not subject to the state's income tax. In partial support of this contention, taxpayer cites to *Report of Committee on Ways and Means to Accompany HR. Res. 8300,* 83rd Cong. (1954) and to *Report of the Committee on Finance to Accompany H.R. Res. 8300,* 83rd Cong. (1954). The reports respectively indicate that the term "gross income" is "based upon the 16th Amendment and the word 'income' is used in its constitutional sense;" the second report states that the term "is based upon the sixteenth amendment and the word 'income is used... in its constitutional sense."

Taxpayer takes these committee reports to mean that the "gross income" – as defined in the Internal Revenue Code – refers to money received by corporations and that the Congress never intended "gross income" to include the sort of income and wages received by ordinary citizens. In arriving at this conclusion, taxpayer cites specifically to Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921). In that case, the Court held that when a provision in a will created a trust, the increase of the value of the trust resulted in taxable "income" under the provisions of the U.S. Const. amend. XVI. Id. at 519. In arriving at that conclusion, the Court stated that "the word [income] must be given the same meaning and content in the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of [the] court." Id.

However, the case does not support taxpayer's contention that only corporate gain is subject to income tax. While the Court did conclude that the increase in the value of the trust resulted in taxable income, the Court never stated that only an increase in value or only corporate gain was subject to income tax. To the contrary, the court stated that, "Income may be defined as the gain derived from capital, *from labor*, or from both combined...." Id at 518 (*Emphasis added*). *See also* Eisner v. Macomber, 252 U.S. 189 (1920); Doyle v. Mitchell, 247 U.S. 179, 207 (1918).

There is not a single court case which has ever held that the ordinary wages or the income received by everyday citizens is not subject to income tax. The United States Supreme has clearly stated that the wages of individual citizens may be subjected to an adjusted gross income tax. In New York v. Graves, 300 U.S. 308 (1937), Justice Stone stated "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized." Id. at 312.

Since that 1937 decision, the Federal courts have consistently, repeatedly, and without exception, determined that individual wages are income. United States v. Connor, 898 F.2d 942. 943 (3rd Cir. 1990) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income"); Wilcox v. Commissioner of Internal Revenue, 848 F.2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); Coleman v. Commissioner of Internal Revenue, 791 F.2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); United States v. Koliboski, 732 F.2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable") (Emphasis in original); United States v. Romero, 640 F.2d 1014, 1016 (9th Cir. 1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable.... [Taxpayer] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves.").

In addressing the identical issue raised by taxpayer, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United Sates Supreme Court and Federal circuit courts, and this Court's opinion... all support the conclusion that wages are income for purposes of Indiana's adjusted gross income tax." Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). *See also* Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer's contention is not well taken because there is not a single shred of evidence that Congress and the Indiana General Assembly did not fully intend to subject the wages of ordinary citizens to income tax or that they lacked the constitutional authority to do precisely that.

FINDING

Taxpayer's protest is denied.

III. Voluntary Nature of Indiana's Adjusted Gross Income Tax.

Taxpayer argues that whether or not he received taxable income is academic because payment of income tax is voluntary. In addition, taxpayer sets out a somewhat parallel argument to the effect that there is nothing in the income tax laws which makes him "liable" for federal or state income tax.

Taxpayer's "voluntary" argument is apparently in reference to IC 6-8.1-11-2 which states as follows:

> The general assembly makes the following findings: (3) The Indiana tax system is based largely on *voluntary compliance*. (4) The development of understandable tax laws and the education of taxpayers concerning the tax laws will improve *voluntary compliance* and the relationship between the state and taxpayers. (*Emphasis added*).

Taxpayer's argument is without merit. In describing the nature of the federal tax system, the Court has stated that, "In assessing income taxes the Government relies primarily upon the disclosure by the taxpayer of the relevant facts. This disclosure it requires him to make in his annual return. To ensure full and honest disclosure, to discourage fraudulent attempts to evade the tax, Congress imposes sanctions. Such sanctions may confessedly be either criminal or civil." Helvering v. Mitchell, 303 U.S. 391, 399 (1938).

Taxpayer's basic contention – that Indiana depends on its citizens' voluntary compliance with the tax laws – is undeniable. Indeed, the state also depends on its licensed drivers to drive on the right side of the road. However, that does not mean that failure to comply with the law is without predictable consequences. "Any assertion that the payment of income taxes is voluntary is without merit. It is without question that the payment of income taxes is not voluntary." United States v. Gerads, 999 F.2d 1255, 1256 (9th Cir. 1993). "The notion that the federal income tax is contractual or otherwise consensual in nature is not only utterly without foundation, but despite [appellant's] protestation to the contrary, has been repeatedly rejected by the courts." McLaughlin v. United States, 832 F.2d 986, 987 (7th Cir. 1987). "[A]rguments about who is a 'person' under the tax laws, the assertion that 'wages are not income', and maintaining that *payment of taxes is a purely voluntary function do not comport with common sense - let alone the law*." McKeown v. Ott, No. H 84-169, 1985 WL 11176 at *2 (N.D. Ind. Oct. 30, 1985) (*Emphasis Added*). Such arguments "have been clearly and repeatedly rejected by this and every other court to review them." Id. at *1.

The Supreme Court has stated that the government's entire tax system is "largely dependent upon honest self-reporting." Couch v. United States, 409 U.S. 322, 335 (1975). Taxpayer's bare assertion, that, based on the precatory language contained within IC

6-8.1-11-2, he no longer "volunteers" to pay income taxes and that it is sufficient to fill in his tax returns with numerous "zeroes," does not fall within any reasonable definition of "honest self-reporting."

Taxpayer's secondary argument – stating that there is nothing in the tax law which makes him liable for income tax – is also meritless. Taxpayer's argument is no more than an exercise in semantic word-games. IC 6-3-2-1(a) states that, "Each taxable year, a tax at the rate of three and four-tenths percent (3.4%) of adjusted gross income is *imposed* upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every non-resident person." (*Emphasis added*). The word "impose" means "to levy or exact a tax or duty." Black's Law Dictionary 759 (7th ed. 1999); "levy" means the "imposition of a fine or tax." Id. at 919. As a matter of law and simple common sense, whether a tax is levied or imposed, the person against whom the levy is made is "liable" for that amount.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040015.LOF

LETTER OF FINDINGS: 04-0015
GROSS RETAIL TAX
For 2002 and 2003

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

I. Aircraft Lease Payments – Gross Retail Tax.

Authority: IC 6-2.5-4-10(a); IC 6-2.5-4-10(b); IC 6-2.5-2-1; IC 6-2.5-5-1 to 70; IC 6-2.5-5-8; 45 IAC 2.2-4-27(a); 45 IAC 2.2-4-27(c); 45 IAC 2.2-4-27(d); 45 IAC 2.2-4-27(d)(1); Blacks Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue (Department) erred when it calculated the amount of gross retail (sales) tax taxpayer purportedly should have been collecting from pilot/lessee.

STATEMENT OF FACTS

In August of 2002, taxpayer entered into an "Aircraft Hourly Rental Agreement" with pilot/lessee. Pilot/lessee agreed to pay an "hourly rent" of $1,275. In addition, pilot/lessee agreed to assume the costs of maintaining, repairing, hangering, and insuring the aircraft. Pilot/lessee also agreed to pay for fuel, crew expenses, landing fees, and taxes. Thereafter, the amount of "hourly rent" would be offset by the amount pilot/lessee spent for these specific aircraft-related expenses.

In September 2002, taxpayer submitted an "Application for Aircraft Registration or Exemption." On that form, taxpayer indicated that the initial purchase price of the aircraft – approximately three million dollars – was not subject to sales tax because the aircraft was purchased for "Rental or Lease to others per IC 1971-6-2.5-5-8."

In June of 2003, the Department sent a letter to taxpayer indicating that the Department was conducting a review to determine if the taxpayer's aircraft "is being predominately used in the exempt manner claimed." In that letter, the Department requested that taxpayer provide certain documentation substantiating the proposition that the aircraft was purchased for an exempt purpose and that the aircraft was thereafter used for that purpose.

Later that same month, taxpayer responded by providing the requested information.

The Department reviewed the submitted information, and – in a letter dated August 2003 – issued its decision finding that "sales/use tax due was computed incorrectly." The Department concluded that taxpayer should have been collecting sales tax on the $1,275 base amount listed in the parties' "Aircraft Hourly Rental Agreement." However, the Department stated that taxpayer was not entitled to "a deduction for expenses incurred in operating and maintaining the aircraft from the gross rental amount." In other words, the Department found that the provision in the parties' agreement permitting pilot/lessee to deduct from the base hourly rate the amount pilot/lessee spent on maintaining, repairing, and operating the aircraft was a nullity for purposes of determining sales tax liability. Thereafter, the Department issued notices of "Proposed Assessment" imposing sales tax calculated on the base hourly rate of $1,275.

In October of 2003, the taxpayer protested the assessment of additional sales tax arguing that taxpayer was only required to collect sales tax based upon the formula contained in the parties' lease agreement. Taxpayer maintains that amount charged to the pilot/lessee – the base-hourly rate less the amount of the pilot/lessee's aircraft expenses – was "the fair market value of the underlying equipment of a comparable charter."

An administrative hearing was conducted during which taxpayer's representative explained the basis for the protest. This Letter of Findings results.

DISCUSSION

I. Aircraft Lease Payments – Gross Retail Tax.

Taxpayer maintains that the Department erred when it decided that taxpayer should have been collecting sales tax on the base-hourly rate provided for in the lease agreement between taxpayer and pilot/lessee.

Indiana imposes a gross retail (sales) tax on retail transactions in Indiana. IC 6-2.5-2-1. The state legislature has provided a number of exemptions to the imposition of that tax. *See* IC 6-2.5-5-1 to 70. One of those exemptions is found at IC 6-2.5-5-8 which states that, "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property."

Therefore, if taxpayer bought the aircraft for the purpose of leasing it to others, taxpayer was not required to pay sales tax on the purchase price because taxpayer bought the plane for "an exempt purpose."

However, once a person – such as taxpayer – gets into the business of leasing tangible personal property, that person is required to collect sales tax on the lease payments. IC 6-2.5-4-10(a) states that, "A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person."

The Department's regulation defines what it is that a person in the leasing business should be collecting sales tax on. 45 IAC 2.2-4-27(a) states that, "In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation [] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction."

The regulation defines "gross receipts" obtained from leasing tangible personal property. "The rental or leasing of tangible personal property, by whatever means effected and irrespective of any terms employed by the parties to such transaction is taxable." 45 IAC 2.2-4-27(d).

If the above language is in any way ambiguous, the regulation further explains that, "The amount of actual receipts means the gross receipts from the leasing of tangible personal property without any deduction whatever for expenses of costs incidental to the conduct of the business. The gross receipts include *any consideration* received from the exercise of an option contained in the rental [or] lease agreement...." 45 IAC 2.2-4-27(d)(1) (*Emphasis added*).

Taxpayer has a lease agreement with pilot/lessee which requires that pilot/lessee pay $1,275 for each hour that pilot/lessee uses the taxpayer's aircraft. If pilot/lessee uses taxpayer's aircraft for 10 hours, pilot/lessee owes taxpayer $12,750. However, the parties' agreement also provides that if pilot/lessee incurs expenses associated with maintaining and operating the aircraft, the pilot/lessee must pay those expenses but is thereafter entitled to deduct the amount of expenses from the base lease amount. Therefore, if pilot/lessee incurs $10,000 in aircraft-related expenses, pilot/lessee can deduct $10,000 from the example cited above. Instead of paying $12,750, pilot/lessee will pay $2,750; taxpayer will collect that amount along with the sales tax due on the lesser amount. If pilot/lessee should incur aircraft expenses equal to the amount of the base lease amount due during a particular period, pilot/lessee will owe $0 and taxpayer will collect $0 in sales tax.

When a lessor rents tangible personal property, it must collect sales tax on the "gross receipts" received. 45 IAC 2.2-4-27(c). The amount of the tax liability is never affected by the terms of the parties' lease agreement. As stated in the regulation, "The rental or leasing of tangible personal property, by *whatever means effected and irrespective of the terms employed* by the parties to describe such transaction, is taxable." 45 IAC 2.2-4-27(d) (*Emphasis added*). The term "gross receipts" means, "The total amount of money or other consideration received by a business taxpayer for goods sold or services performed in a year, before deductions." <u>Black's Law Dictionary</u> 710 (7th ed. 1999). The gross receipts means the amount of consideration received by the lessor "without any deduction whatever for expenses or costs incidental to the conduct of the business." 45 IAC 2.2-4-27(d)(1).

Taxpayer contends that it should collect sales tax based upon the hourly rate of $1,275 reduced by the amount of expenses the pilot/lessee incurred during a particular lease period. Under taxpayer's interpretation of the sales tax statute, taxpayer will collect sales tax on an amount somewhere between $1,275 and $0 depending on the extent of pilot/lessee's associated expenses.

Setting aside the issue of whether the parties' "Aircraft Hourly Rental Agreement" is actually a "lease" between two disinterested parties, taxpayer's argument fails because – in allowing a deduction for pilot/lessee's expenses – taxpayer is ignoring a substantial portion of the consideration it receives by virtue of that agreement. Pilot/lessee is paying to maintain and repair *taxpayer's* aircraft. Pilot/lessee is paying to insure *taxpayer's* aircraft. Pilot/lessee is paying to provide hanger space for *taxpayer's* aircraft. Pilot/lessee is paying the costs associated with taxpayer's ownership of *taxpayer's* aircraft and the operation of *taxpayer's* leasing business. All of these expenses are a portion of the consideration taxpayer receives from pilot/lessee, and taxpayer is ignoring the fact that it is required to collect sales tax on "any consideration" obtained as a result of the lease agreement between itself and pilot/lessee. "Consideration" is defined as "[s]omething of value (such as an act, a forbearance, or a return promise) received by a promisor from a promisee." <u>Black's Law Dictionary</u> 300 (7th ed. 1999). In the parties' lease agreement, taxpayer is receiving additional consideration from pilot/lessee beyond the adjusted $1,275 base hourly amount. Pilot/lessee is promising to pay for the entire cost of insuring, maintaining, and operating an aircraft which pilot/lessee does not own. Taxpayer owns this aircraft; therefore, the fact that the pilot/lessee pays for all the variable expenses attendant upon the operation of ownership and operation of the aircraft is a substantial benefit which flows in taxpayer's direction. The cost of the variable expenses is one portion for the consideration which taxpayer receives in exchange for which taxpayer grants pilot/lessee the right to use taxpayer's aircraft. Therefore, taxpayer should have been collecting sales tax on the total amount of consideration it received from pilot/lessee which would have included the adjusted base hourly rate together with the amount of money pilot/lessee spent on taxpayer's behalf in maintaining and operating the aircraft.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420040016.LOF

LETTER OF FINDINGS: 04-0016
GROSS RETAIL TAX
For 2002 and 2003

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

ISSUE

I. Aircraft Purchase – Gross Retail Tax.

Authority: IC 6-2.5-4-10(a); IC 6-2.5-4-10(b); IC 6-2.5-2-1; IC 6-2.5-5-1 to 70; IC 6-2.5-5-8; Gregory v. Helvering, 293 U.S. 465 (1935); Horn v. Commissioner of Internal Revenue, 968 F.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); 45 IAC 2.2-4-27(a); 45 IAC 2.2-4-27(d); 45 IAC 2.2-4-27(d)(1); 45 IAC 2.2-5-15(b)(1), (c)(2); Blacks Law Dictionary (7th ed. 1999).

Taxpayer argues that it was not required to pay gross retail (sales) tax when it purchased an airplane because the airplane was purchased in order to lease it to others during the regular course of taxpayer's business.

STATEMENT OF FACTS

Pilot/lessee formed and invested money in an S-Corporation (taxpayer). Taxpayer bought an airplane in August of 2002. The airplane cost $275,000.

In August of 2002, pilot/lessee and taxpayer entered into an "Aircraft Hourly Rental Agreement." Pilot/lessee agreed to pay a "base rent" of $2,000 as a "Deposit on the First Year's Rent." In addition, the pilot/lessee agreed to pay a regular hourly rate for the use of the aircraft. Under the terms of the agreement, the "[t]otal hourly rent shall be the sum of the hourly rent amount of $380 per hour, multiplied by flight time... reduced by offset expense payments...." Those "expense payments" were defined elsewhere in the agreement to include "scheduled and non-scheduled maintenance... hangar and storage charges while at home base, insurance premiums for insurance coverage... and property and ad valorem taxes."

In October 2002, taxpayer submitted to the Department an "Application for Aircraft Registration or Exemption." On that form, taxpayer indicated that the aircraft was purchased "for the following exempt use." Taxpayer specified that the aircraft was purchased for "Rental or Lease to Others per IC 1971-6-2.5-5-8."

In November 2002, taxpayer was issued by the Department a "Registered Retail Merchant Certificate." The certificate directed taxpayer to report its estimated sales – lease income – on a monthly basis and that the "first remittance [was] due on or before 09/30/2002."

The Department sent taxpayer a letter dated December 2002 in which it stated that – based upon the information taxpayer supplied to the Department – the aircraft was not being used for the purpose of rental to others. Therefore, the Department denied taxpayer the sought-after exemption directing that taxpayer pay the approximately $15,000 in sales tax based upon the original purchase price of the airplane. In January of that same year, taxpayer's representative protested the denial.

The Department sent taxpayer a letter dated June 2003 in which it noted that taxpayer had failed to file monthly sales tax returns for December of 2002 though April of 2003. In addition, the Department pointed out that taxpayer had filed "zero" returns for September, October, and November of 2002. In sum, taxpayer failed to file sales tax returns or filed "zero" returns for eight months. The Department requested clarification from taxpayer or indicated that "the claim for sales/use tax exemption on the purchase of the subject aircraft will be denied...."

Taxpayer's representative responded in July indicating that the $2,000 base rent amount – specified in the parties lease agreement – which had been due November 2002 was not paid until July 2003 and that this "payment and all future rental payments will be reported and paid timely."

The Department responded later that same month questioning the basis for the numerous "zero" returns. The Department pointed out the that parties' agreement specified that the pilot/lessee would pay $380 for each hour the plane was used; therefore, taxpayer was to pay sales tax on a monthly basis even if the taxpayer and the pilot/lessee chose to reconcile the amount due on a yearly basis.

In August of 2003, taxpayer's representative responded indicating that taxpayer "is a cash basis taxpayer that rents the aircraft on an annual basis." The representative pointed out that taxpayer had paid sales tax on the $2,000 "base lease" but that no other lease amounts had been invoiced and that "there are no rental invoices to provide to you."

The Department sent a letter dated September 2002 stating that taxpayer "has not provided any evidence of rental or lease transaction between [taxpayer] and the [pilot/lessee] including the billing and collection of the initial payment." The Department concluded that the "exemption from sales tax due on the purchase of the aircraft has been denied and a proposed assessment of sales tax due has been issued." True to its word, the Department issued notices of "Proposed Assessment" for the amount of the sales tax that would have been otherwise due on the initial purchase price of the airplane if taxpayer had not claimed that the airplane was being bought for an exempt purpose.

Additional correspondence between taxpayer and the Department followed. Taxpayer protested the assessment of additional sales tax, an administrative hearing was conducted during which taxpayer was given the opportunity to explain the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. Aircraft Purchase – Gross Retail Tax.

Taxpayer argues that the Department erred in rejecting its assertion that the aircraft was purchased for an exempt purpose.

Indiana imposes a gross retail (sales) tax on retail transactions in Indiana. IC 6-2.5-2-1. The legislature has provided a number of exemptions to the imposition of that tax. *See* IC 6-2.5-5-1 to 70. One of those exemptions is provided at IC 6-2.5-5-8 which states that, "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property."

Therefore, if taxpayer bought the airplane for the purpose of leasing it to others, taxpayer was not required to pay sales tax on the purchase price because taxpayer bought the plane for "an exempt purpose."

However, once a person – such as taxpayer – gets into the business of leasing personal property, that person is required to collect sales tax on the lease payments. IC 6-2.5-4-10(a) states that, "A person, other than a public utility, is a retail merchant making a retail transaction when he rent or leases tangible personal property to another person."

The Department's regulation defines what it is that a person in the leasing business should be collecting sales tax on. 45 IAC 2.2-4-27(a) states that, "In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation [] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction."

The regulation further defines "gross receipts" obtained from leasing tangible personal property. "The rental or leasing of tangible personal property, by whatever means effected and irrespective of any terms employed by the parties to such transaction is taxable." 45 IAC 2.2-4-27(d).

For the benefit of those lessors who feel that the above language is in anyway ambiguous, the regulation further states that, "The amount of actual receipts means the gross receipts from the leasing of tangible personal property without any deduction whatever for expenses of costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental [or] lease agreement...." 45 IAC 2.2-4-27(d)(1).

Taxpayer has a lease agreement with pilot/lessee. The agreement provides that the pilot/lessee will pay $380 for each hour that the pilot/lessee uses the aircraft. Therefore, if pilot/lessee uses the aircraft for 10 hours, the pilot/lessee owes taxpayer $3,800. However, the parties' agreement also provides that if taxpayer incurs expenses associated with the aircraft, the total amount due from the pilot/lessee will be reduced by the amount of those expenses. For example, if taxpayer incurs $3,000 in related expenses during the lease period cited in the example above, pilot/lessee will owe $800. If – by sheer happenstance – taxpayer incurs $3,800 in expenses during this same period, pilot/lessee will owe $0.

It may be reasonably assumed that taxpayer will incur substantial expenses in maintaining, hangaring, and insuring this aircraft; thus, it may also be assumed the pilot/lessee's lease payments will be reduced by a corresponding amount.

The specific agreement provision – reflecting an unparalleled spirit of generosity on the part of taxpayer – offsetting lease payment by the amount of aircraft expenses, is in derogation of 45 IAC 2.2-4-27(d)(1). That regulation requires a lessor to collect sales tax on gross receipts "without any deduction whatever for expenses or costs incidental to the conduct of the [lessor's] business." Id. Taxpayer may not side-step this requirement by means of the parties' artfully drafted agreement. In plain words, the regulation provides that "The rental or leasing of tangible personal property, *by whatever means effected and irrespective of the terms employed by the parties to describe such transaction*, is taxable." 45 IAC 2.2-4-27(d) (*Emphasis added*). However, whether taxpayer should have been collecting sales tax on the basis of the $380 per-hour charge or on the basis of a $0 per-hour charge is finally irrelevant. Similarly, whether taxpayer should have been collecting and paying sales tax on a monthly or yearly basis is also irrelevant because – as a matter of fact, law, and simple common sense – there is no lessee/lessor relationship here.

A lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Blacks Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the "Aircraft Hourly Rental

Agreement" falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long 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).

The Department was correct in determining that taxpayer owed sales tax on the initial purchase price of the aircraft because taxpayer was never engaged in leasing the aircraft in the ordinary course of its business. *See* IC 6-2.5-4-10(b); 45 IAC 2.2-5-15(b)(1), (c)(2). The "Aircraft Hourly Rental Agreement" was not an agreement to rent or lease an airplane but was a fanciful document drafted "for no other motive but to escape taxation." Transp. Trading and Terminal Corp., 176 F.2d 570, 572. The parties' lease agreement has no economic substance or rationale and, for purposes of determining sales tax liability, should be entirely ignored.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220040041.LOF

LETTER OF FINDINGS NUMBER: 04-0041
Corporate Income Tax
For the Years 2001

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

ISSUES

I. Gross Income Tax-Imposition of Tax

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

The taxpayer protests the imposition of tax on certain income.

II. Tax Administration-Penalty

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

The taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

The taxpayer sold direct broadcasting services (DBS) to customers in Indiana. The DBS services consisted of programming that was first collected by an affiliate of the taxpayer from numerous providers at "uplink" centers in states other than Indiana. At the uplink centers, sophisticated computer hardware and software was used to encrypt and reformat the signals. The signal was then transmitted to various satellites owned by one of taxpayer's affiliates. The satellites transmitted the programming signals to customers throughout the Untied States, including Indiana. The taxpayer sold its services primarily through independent retailers. These retailers solicited orders from potential customers and obtained approval of such customers from sales centers located outside of Indiana. Upon acceptance of his or her order, the customer may personally install or utilize a contractor affiliated with the retailer to install the satellite receiver and "set top" box at the customer's residence. In such instances, the independent retailers received the necessary equipment directly from manufactures. The taxpayer never acquired title to such equipment. In the recent past, the taxpayer sold its services directly to customers, complementing the sales by retailers. The taxpayer consummated all such direct sales from sales centers located outside Indiana. Until recently, all of the taxpayer's customers were required to purchase the equipment when they initiated programming service, and thereafter, retained title to the equipment. In approximately mid-1999, the taxpayer acquired the assets of a competitor, including that competitor's Indiana customers. Because certain of those customers had leased their equipment, the taxpayer allowed these customers to continue to lease the equipment after the acquisition. During the tax period, all the taxpayer's employees and offices were located outside Indiana. The taxpayer's records indicate that the company may have stored a small amount of inventory in Indiana in facilities owned by others.

After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional gross income tax, interest, and penalty for 2001. The taxpayer protested the assessment and penalty. A hearing was held and this Letter of Findings results.

I. Gross Income Tax-Imposition of Tax

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b). Indiana imposes a gross income tax on the "taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a)(2). The taxpayer contends that since its gross income in 1999 and 2000 was derived in the same manner as the 1998 nontaxable income, the 1999 and 2000 income is also not subject to Indiana gross income tax.

The distinction lies in the regulation promulgated by the department and effective as of January 1, 1999 that clarifies the department's interpretation of the gross income tax for the telecommunications industry. The definition of "services performed within Indiana," for the telecommunications industry is found at 45 IAC 1.1-2-5(f)(2) as follows:

> ...sale of telecommunications, including telephone, telegraph, and non-cable television, if the telecommunications originate or terminate in Indiana and are charged to an Indiana address, and the charges are not taxable under the laws of another state.

The taxpayer and department agree that the taxpayer is selling telecommunications that are received in Indiana and charged to an Indiana address. The taxpayer contends, however, that the income received from Indiana is taxable under the laws of California and Colorado. To substantiate this contention, the taxpayer submitted copies of federal tax returns, California tax returns, and Colorado tax returns. Those returns indicate that in California and Colorado the taxpayer pays tax on less than fifty percent (50%) of its total federal income. This does not satisfy the taxpayer's burden of proving that it is properly subject to tax in California and Colorado on the income derived from its Indiana customers.

The taxpayer also argues that the regulation is unconstitutional. An administrative hearing is not the proper forum to determine the constitutionality of an administrative regulation.

FINDING

The taxpayer's protest is denied.

II. Tax Administration-Penalty

DISCUSSION

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

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

The taxpayer ignored the listed regulations and failed to report its income as required by said regulation. This failure to follow department's instructions constitutes negligence.

FINDING

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

DEPARTMENT OF STATE REVENUE

0420040050.LOF

LETTER OF FINDINGS: 04-0050
GROSS RETAIL TAX
For 2001

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

ISSUE

I. Aircraft Purchase – Gross Retail Tax.

Authority: IC 6-2.5-4-10(a); IC 6-2.5-4-10(b); IC 6-2.5-2-1; IC 6-2.5-5-1 to 70; IC 6-2.5-5-8; Gregory v. Helvering, 293 U.S. 465 (1935); Horn v. Commissioner of Internal Revenue, 968 F.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); 45 IAC 2.2-4-27(a); 45 IAC 2.2-4-27(c); 45 IAC 2.2-4-27(d); 45 IAC 2.2-4-27(d)(1); 45 IAC

2.2-5-15(b)(1), (c)(2); Blacks Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue (Department) erred when it determined that the aircraft it bought in 2001 was not purchased for an exempt purpose and that – as a result – taxpayer now owes gross retail (sales) tax on the initial purchase price of that aircraft.

STATEMENT OF FACTS

Pilot/lessee organized and invested money in a Nevada Limited Liability Company (LLC). The LLC (hereinafter "taxpayer") bought an aircraft in January of 2001. The selling price of the aircraft was approximately $1,500,000. Taxpayer traded in another airplane worth approximately $600,000 and paid the dealer the $900,000 difference. Taxpayer paid no sales tax on the $900,000 claiming that the "the aircraft is purchased by a retail merchant to be rented or leased to others as provided in IC 1971-6-2.5-5-8." The pilot/lessee signed the Indiana "Application for Aircraft Registration or Exemption" listing the taxpayer as the owner of the aircraft and signing individually as the "Authorized Person." On that application, taxpayer specified that the purchase was exempt from sales tax because it was purchased for "Rental or Lease to others per IC 1971-6-2.5-5-8."

Prior to the date of the purchase, taxpayer and pilot/lessee entered into an "Aircraft Lease" agreement which was dated December 2000. Pilot/lessee signed the document indicating that he was the "lessee." Pilot/lessee signed the document – on behalf of taxpayer – indicating that he was the "lessor."

In September of 2003, the Department sent taxpayer a letter in which it sought documentation verifying that the aircraft was purchased for an exempt purpose. The Department asked for flight schedules, flight logs, and for a copy of the lease agreement.

Taxpayer – through its representative – responded in November providing a signed copy of the lease and indicating that a lease payment of $5,000 was made during 2001 and a second lease payment of approximately $7,000 was made during 2002.

The Department responded that same month "disallowing the exemption claimed for rental/leasing of the aircraft... as the lease agreement submitted contains a rental rate of $75 per hour for use of the aircraft." The Department indicated that it had verified with another aircraft dealer that a "fair market" hourly lease rate would be "substantially higher" than the $75 paid by pilot/lessee. In addition, the Department questioned whether the lease agreement was an "arms-length" transaction and noted that pilot/lessee had signed the agreement as both lessee and lessor. In its letter, the Department concluded that the aircraft was not purchased for an exempt purpose but that the lease "transaction is most beneficial to [pilot/lessee] at the expense of the State of Indiana." Accordingly, the Department indicated that it intended to propose an assessment for sales tax based on the original purchase price of the aircraft with an allowance made for the trade-in value of the predecessor airplane.

That same month, the Department sent taxpayer a notice of "Proposed Assessment" indicating that taxpayer owed approximately $50,000. That amount consisted of the original sales tax amount, a ten-percent penalty, and an additional amount of interest which had accumulated since the time that the aircraft was first purchased.

In January of 2004, taxpayer's representative responded, challenging the proposed assessment on the ground that the Department misunderstood or misinterpreted the terms of the parties' lease agreement. Taxpayer admitted that, under the terms of the agreement, pilot/lessee was required to pay taxpayer only $75 for each hour pilot/lessee used the aircraft. However, pilot/lessee was also required – under the terms of the lease agreement – to pay the costs of providing fuel, maintaining and repairing the aircraft, insuring the aircraft, and hangering the aircraft. Therefore, while only $75 was ever paid by the pilot/lessee each time he used the aircraft for an hour, the pilot/lessee's actual hourly costs were considerably greater than the $75 base rate. After factoring in fuel, repair, maintenance, insurance, and hanger expenses, the pilot/lessee purportedly spent approximately $630 for every hour the pilot/lessee used the aircraft. According to taxpayer, this $630 amount represents the "fair market value based on similar transactions between unrelated parties."

DISCUSSION

I. Aircraft Purchase – Gross Retail Tax.

Taxpayer maintains that the Department erred in concluding that the aircraft was not purchased for the purpose of leasing it to other persons and concluding that taxpayer should now be required to pay sales tax on the original purchase price of that aircraft.

Indiana imposes a gross retail (sales) tax on retail transactions in Indiana. IC 6-2.5-2-1. The state legislature has provided a number of exemptions to the imposition of that tax. *See* IC 6-2.5-5-1 to 70. One of those exemptions is found at IC 6-2.5-5-8 which states that, "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property."

Therefore, if taxpayer bought the aircraft for the purpose of leasing it to others, taxpayer was not required to pay sales tax on the purchase price because taxpayer bought the plane for "an exempt purpose."

However, once a person – such as taxpayer – gets into the business of leasing tangible personal property, that person is required to collect sales tax on the lease payments. IC 6-2.5-4-10(a) states that, "A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person."

The Department's regulation defines what it is that a person in the leasing business should be collecting sales tax on. 45 IAC 2.2-4-27(a) states that, "In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation [] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction."

The regulation further defines "gross receipts" obtained from leasing tangible personal property. "The rental or leasing of tangible personal property, by whatever means effected and irrespective of any terms employed by the parties to such transaction is taxable." 45 IAC 2.2-4-27(d).

For the benefit of those lessors who may find that the above language is in any way ambiguous, the regulation further states that, "The amount of actual receipts means the gross receipts from the leasing of tangible personal property without any deduction whatever for expenses of costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental [or] lease agreement...." 45 IAC 2.2-4-27(d)(1).

Taxpayer has a lease agreement with pilot/lessee. The agreement calls for pilot/lessee to pay taxpayer $75 for every hour that pilot/lessee uses the aircraft. In addition, the agreement requires that pilot/lessee assume the costs of operating, maintaining, and storing the aircraft. According to taxpayer's representative, because those costs – together with the $75 base rental – average out to approximately $630 per hour, pilot/lessee is paying a fair market price for the cost of using the aircraft even though taxpayer only reports $75 of that amount as subject to sales tax.

When a lessor rents tangible personal property it must collect sales tax on the "gross receipts" received. 45 IAC 2.2-4-27(c). The amount of the tax liability is never affected by the terms of the parties' lease agreement. As stated in the regulation, "The rental or leasing of tangible personal property, by *whatever means effected and irrespective of the terms employed* by the parties to describe such transaction, is taxable." 45 IAC 2.2-4-27(d) (*Emphasis added*). The term "gross receipts" means, "The total amount of money or other consideration received by a business taxpayer for goods sold or services performed in a year, before deductions." Black's Law Dictionary 710 (7th ed. 1999). The gross receipts means the amount of consideration received by the lessor "without any deduction whatever for expenses or costs incidental to the conduct of the business." 45 IAC 2.2-4-27(d)(1).

Nevertheless, taxpayer neatly side-steps this provision because taxpayer does not appear to deduct anything from the $75 base hourly rate. Taxpayer – in effect – argues that the Department should accept the proposition that it is renting a million-dollar-plus aircraft for $75 an hour and be content with collecting $3.75 in sales tax on that base amount. However, taxpayer's somewhat far-fetched argument fails because taxpayer is overlooking a major portion of the consideration it receives when it rents the aircraft to pilot/lessee and because taxpayer ignores the fact that it is required to collect sales tax on "any consideration" obtained as a result of the lease agreement between itself and pilot/lessee. "Consideration" is defined as "[s]omething of value (such as an act, a forbearance, or a return promise) received by a promisor from a promisee." Black's Law Dictionary 300 (7th ed. 1999). In the parties' lease agreement, taxpayer is receiving additional consideration from pilot/lessee beyond the $75 hourly base fee. Pilot/lessee is promising to pay for the entire cost of insuring, maintaining, and operating an aircraft which pilot/lessee does not own. Taxpayer owns this aircraft; therefore the fact that the pilot/lessee pays for all the variable expenses attendant upon the operation and ownership of the aircraft is a substantial benefit which flows in taxpayer's direction. The cost of the variable expenses is one portion of the consideration which taxpayer received in exchange for which taxpayer granted pilot/lessee the right to use taxpayer's aircraft. Therefore, taxpayer should have been collecting and paying sales tax on the total amount of consideration it received from pilot/lessee which would have included the $75 base fee and the amount of money pilot/lessee spent on taxpayer's behalf in maintaining and operating the aircraft.

Nonetheless, whether taxpayer should have been collecting sales tax on a $75 or $630 hourly rate is finally irrelevant because there simply is no lessee/lessor relationship here. As a matter of law and simple common sense, there is no "lessee" and there is no "lessor." The taxpayer and the pilot/lessee are wholly identical parties and the purported lease agreement is an entirely transparent effort to avoid sales tax liability. As such, the Department is entitled to entirely ignore the lease agreement and to treat – for tax purposes – the initial acquisition of the aircraft as undertaken for a non-exempt purpose because the self-styled "Aircraft Lease" agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long 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 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).

The Department was correct in determining that taxpayer owed sales tax on the initial purchase price of the aircraft because taxpayer was never engaged in leasing the aircraft in the ordinary course of its business. *See* IC 6-2.5-4-10(b); 45 IAC 2.2-5-15(b)(1), (c)(2). The "Aircraft Lease" agreement was not an agreement to rent or lease an airplane but was a fanciful document drafted "for no other motive but to escape taxation." Transp. Trading and Terminal Corp., 176 F.2d 570, 572. The parties' lease agreement has no economic substance or rationale and, for purposes of determining sales tax liability, should be entirely ignored.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20040061P.LOF

LETTER OF FINDINGS NUMBER: 04-0061P
Tax Administration—Penalty
For the Years 2000, 2001 &2002

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

ISSUES

I. Tax Administration—Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests the 10% negligence penalty.

STATEMENT OF FACTS

The penalty was proposed in the first instance because the auditor determined taxpayer had not self-assessed and remitted use tax even though taxpayer was aware of its duty to do so, and had an accrual system in place. Taxpayer argued it did not deliberately avoid paying its tax liabilities, and merely made normal mistakes.

I. Tax Administration-Penalty

DISCUSSION

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

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

The Department finds the taxpayer did not act with reasonable care because clerical omissions and/or mistakes constitute negligence. The Department denies taxpayer's request to abate the 10% penalty assessment.

FINDING

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

DEPARTMENT OF STATE REVENUE

0420040062P.LOF

LETTER OF FINDINGS NUMBER: 04-0062P
Sales and Use Tax
For the Years 2000-2002

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ISSUE

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

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

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

STATEMENT OF FACTS

The taxpayer wholesales automotive cooling systems, including radiators, radiator cores, radiator tanks, heater cores, and air-conditioning parts, tools, chemicals, and equipment. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales tax, interest, and penalty. The taxpayer protested the imposition of the ten percent (10%) negligence penalty. The taxpayer was given ample opportunity to schedule a hearing on the protest and/or submit additional information. Since the taxpayer did neither, this finding is based on the information in the file.

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

DISCUSSION

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

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

The taxpayer did not obtain and keep valid exemption certificates from several of its customers as clearly required by Indiana law and regulations. The taxpayer's inattention to this duty and failure to follow the department's instructions constitute negligence.

FINDING

The taxpayer's protest is denied.