DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #16
December 2004
(Replaces Commissioner's Directive #16 dated May 1994)

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

SUBJECT: New or Replacement Tires on Vehicles

REFERENCES: IC 13-11-2-231; IC 13-11-2-245; and IC 13-20-13-7

I. INTRODUCTION

The purpose of this Directive is to outline the procedures to be followed in collecting and remitting the tire fee enacted by HB 1427 of the 1993 Indiana General Assembly. The statute does not apply to the sale of used or retreaded tires.

II. IMPOSITION OF FEE

There is a $0.25 fee imposed on each new tire sold in Indiana for use on a motor vehicle, and types of equipment, machinery, implements or other devices used in transportation, manufacturing, agriculture, construction or mining. New tire means a tire that has never been mounted on the wheel of a vehicle.

The fee is also imposed on each new tire mounted on a vehicle at the time the vehicle is sold, and any spare tire that is included with the vehicle. Purchases by governmental units and nonprofit organizations **are not** exempt from the tire fee. The fee imposed shall be collected by the person selling the new tire to the ultimate consumer of the tire or vehicle. If an out-of-state seller is registered to collect and remit the sales and use tax, then the out-of-state seller is required to collect the fee.

III. EXEMPTIONS

The fee is not imposed on tires used on lawn mowers and garden tractors that are propelled by motors with less than twenty (20) horsepower. The fee is not imposed on tires used on a semi trailer. The fee is not imposed on new tires mounted on a non self-propelled vehicle for personal use such as a boat trailer or a camper trailer. Tires purchased for resale without being mounted on a motor vehicle are exempt from the tire fee.

IV. REMITTANCE OF THE FEE

The law requires the tire fee to be remitted at the same time and in the same manner as the sales tax. If a taxpayer is required to file by the 20th of the month through electronic funds transfer, the taxpayer is also required to remit the tire fee by the 20th of the month through electronic funds transfer.

The taxpayer that is remitting the tire fee is entitled to retain one percent (1%) of the amount collected as compensation for filing and remitting the fee.

In the past, the tire fee was calculated and remitted on the Form ST-103, or ST-103MP along with the sales tax. Passage and implementation of the Streamline Sales Tax Project requires that the tire fee be remitted on its own form.

The tire fee is to be remitted using Form TF-103, which is a new form to be used beginning with the January, 2005 collections remitted in February, 2005. This form is required to be filed with the remittance of the tire fee unless the payment is remitted through electronic funds transfer and then only a quarterly recap is required to be filed.

V. USAGE OF THE FEES COLLECTED

Revenue from the tire fee is deposited in the waste tire management fund. All money deposited in the fund under this subdivision may be used by the Department of Environmental Management for waste reduction, recycling, removal, or remediation projects.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
Departmental Notice #2
December 1, 2004
Prepayment of Sales Tax on Gasoline

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

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

1) the statewide average retail price per gallon of gasoline (excluding the Indiana gasoline tax, the federal gasoline tax, and the Indiana gross retail tax); multiplied by

2) the state gross retail tax rate [6%]; multiplied by

3) ninety percent (90%); and then

4) rounded to the nearest one-tenth of one cent ($0.001)

The prepayment rate of sales tax on gasoline for the six – (6) month period beginning January 1, 2005, is seven and six-tenths cents ($0.076) per gallon.

Using the most recent retail price of gasoline available (as required by IC 6-2.5-7-14(b)), the Department has determined the statewide average retail price per gallon of gasoline to be one dollar and forty one and six tenths cents ($1.416). The most recent retail price of gasoline available was based on data contained in the November 2004 Petroleum Marketing Monthly as published by the Energy Information Agency.

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

Period			Rate Per Gallon
July 1, 1994	to	December 31, 1994	2.9 cents
January 1, 1995	to	June 30, 1995	3.7 cents
July 1, 1995	to	December 31, 1995	3.3 cents
January 1, 1996	to	June 30, 1996	3.3 cents
July 1, 1996	to	December 31, 1996	3.4 cents
January 1, 1997	to	June 30, 1997	4.0 cents
July 1, 1997	to	December 31, 1997	3.9 cents
January 1, 1998	to	June 30, 1998	4.0 cents
July 1, 1998	to	December 31, 1998	2.9 cents
January 1, 1999	to	June 30, 1999	3.0 cents
July 1, 1999	to	December 31, 1999	2.4 cents
January 1, 2000	to	June 30, 2000	3.6 cents
July 1, 2000	to	December 31, 2000	4.6 cents
January 1, 2001	to	June 30, 2001	4.9 cents
July 1, 2001	to	December 31, 2001	4.9 cents
January 1, 2002	to	June 30, 2002	4.9 cents
July 1, 2002	to	December 31, 2002	3.2 cents
January 1, 2003	to	June 30, 2003	5.3 cents
July 1, 2003	to	December 31, 2003	6.6 cents
January 1, 2004	to	June 30, 2004	6.5 cents
July 1, 2004	to	December 31, 2004	6.6 cents
January 1, 2005	to	June 30, 2005	7.6 cents

Indiana Department of State Revenue
Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE

IN REGARDS TO THE MATTER OF:
WESTWOOD COUNTRY CLUB OF SPEEDWAY, INC.
A/K/A WESTWOOD RECREATION CLUB
DOCKET NO. 29-2004-0108

AMENDED DEPARTMENTAL ORDER

An administrative hearing was held on Tuesday, May 11, 2004 in the office of the Indiana Department of State Revenue, 100 N. Senate Avenue, Room N248, Indianapolis, Indiana 46204 before Bruce R. Kolb, Administrative Law Judge acting on behalf of and under the authority of the Commissioner of the Indiana Department of State Revenue.

Petitioner, Westwood Country Club of Speedway, Inc., was represented by William J. Wood of Wood, Tuohy, Gleason, Mercer, & Herrin, Bank One Center Tower, 111 Monument Circle, Suite 3400, P.O. Box 44942, Indianapolis, Indiana 46244-0942. Attorney

Doug Klitzke appeared on behalf of the Indiana Department of State Revenue.

Petitioner was the subject of an investigation conducted on December 22, 2003 by the Criminal Investigation Division of the Indiana Department of Revenue. The Department issued a letter dated March 10, 2004, in which Petitioner's bingo license was suspended for two (2) years, and Petitioner was assessed civil penalties in the amount of seven thousand five hundred dollars ($7,500). The Petitioner protested in a timely manner. A decision was rendered August 10, 2004.

Attorney Steven Lovern, 7255 West 10th Street, Indianapolis, Indiana 46214, filed an appearance with the Department on August 25, 2004.

Following due consideration of the entire record, the Administrative Law Judge's Proposed Departmental Order is hereby amended and should read as follows:

The Petitioner's appeal is denied in part and sustained in part. Petitioner's license to conduct charity gaming is suspended for two (2) years. The Petitioner is hereby liable for civil penalties in the amount of three thousand five hundred dollars ($3,500).

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

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

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

Dated: ______________________ ______________________

Bruce R. Kolb / Administrative Law Judge

DEPARTMENT OF STATE REVENUE

0220010319.LOF

LETTER OF FINDINGS: 01-0319
Indiana Corporate Income Tax
For 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. Denominator of the Sales Factor – Adjusted Gross Income Tax.

Authority: IC 6-3-2-2(b); IC 6-3-2-2(b) to (n); IC 6-3-2-2(e); Sherwin-Williams Co. v. Indiana Dept. of State Revenue, 673 N.E.2d 849 (Ind. Tax Ct. 1996); 45 IAC 3.1-1-50(1); 45 IAC 3.1-1-50(5); 45 IAC 3.1-1-51; AT&T v Director, Division of Taxation, 476 A.2d 800 (N.J. Super. A.D. 1984).

Taxpayer argues that it correctly reported the denominator of its sale factor and that the Department of Revenue (Department) erred in reducing the denominator to reflect "sales everywhere" as reported on the taxpayer's corresponding federal return.

II. Indiana Commodity Sales – Gross Income Tax.

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

Taxpayer maintains that – in the absence of specific sales records to the contrary – the audit review overestimated the amount of Indiana commodity sales by applying an inventory turnover ratio of six.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the chemical manufacturing business. It is also a licensed commodity broker buying and selling base and precious metals. In addition, it also provides services to its customers related to its brokerage business.

During 1996 and 1997, taxpayer maintained an inventory of commodities within Indiana. Taxpayer sold some of these commodities to Indiana customers.

During 2001, the Department of Revenue (Department) conducted an audit review of taxpayer's state and federal tax returns. As a result of that audit review, the Department determined that taxpayer erred in reporting certain amounts of its income. The Department concluded that taxpayer owed additional Indiana corporate income tax. Taxpayer disagreed and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Denominator of the Sales Factor – Adjusted Gross Income Tax.

On its federal return for 1996, taxpayer reported 6 billion dollars in total sales. On its 1997 federal return, taxpayer reported 7 billion dollars in total sales.

However, on taxpayer's 1996 Indiana return, taxpayer reported 10 billion dollars in total sales. On taxpayer's 1997 Indiana return, taxpayer reported 11 billion dollars in total sales.

As might be expected, the audit review noticed this apparent discrepancy and adjusted the Indiana returns to mirror taxpayer's federal returns.

Taxpayer questions the audit's decision stating that it correctly reported its 1996 and 1997 total sales on the original Indiana returns. Taxpayer explains the discrepancy between the federal and Indiana numbers as follows. According to taxpayer – for purposes of reporting its federal income – taxpayer reported its income from trading precious metals on an "earnings basis." Specifically, it eliminated certain sales when it reported its 1996 and 1997 federal income. The sales that were eliminated were what it terms "non-industrial" sales of commodities. According to taxpayer's description, "non-industrial" sales occur when precious metal – such as gold – is sold for investment purposes. For example, taxpayer decides that it has an excess of gold on reserve and sells an amount of gold to another broker. In these "non-industrial" sales, the buyer does not obtain physical custody of the gold from taxpayer; taxpayer does not transfer physical custody of the gold to the buyer. Because of the high value of these precious metals and the security concerns related to storing or transporting the metals, the only thing which changes is the title to the gold.

The "non-industrial" sales are in contrast with the taxpayer's core business which is selling commodities to industrial customers. In those cases a buyer – such as a manufacturer of electronic components – purchases precious metal but takes physical possession of the metal because the metal is incorporated into the buyer's manufactured product.

In the case of "non-industrial" sales, taxpayer reports these amounts – for federal purposes – on a net basis because these particular sales "would have no impact on the computation of total income or taxable income for federal income tax purposes."

The issue is whether the gross amount of these "non-industrial" sales should have been included in determining in the denominator of the sales factor for the purpose of determining its Indiana adjusted gross income.

For purposes of calculating their adjusted gross income tax liability, corporations subject to the apportionment provisions of IC 6-3-2-2(b) to (n) are required to apportion their income according to a three-factor formula. "[I]f business income of a corporation or a nonresident person is derived from sources within the state of Indiana and from sources without the state of Indiana, then the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana by fraction, the numerator of which is the property factor plus the payroll factor, plus the sales factor, and denominator of which is three (3)." IC 6-3-2-2(b).

The portion of the three-factor calculation taxpayer now questions is the "sales factor" which is defined at IC 6-3-2-2(e) which states that, "The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year."

The term "sales" is defined in the Department's regulation which states, "If the taxpayer's business activity consists of manufacturing and selling and purchasing and reselling goods or products, 'sales' includes all gross receipts of such goods or products... held by the taxpayer for sale in the ordinary course of business." 45 IAC 3.1-1-50(1).

Thereafter, the taxpayer's sales income is reported in the "sales factor" as income received from sales attributable to Indiana or to sales everywhere. Taxpayer's argument stems from the amount which should or should not be included in the denominator of the sales factor – the amount attributable to sales everywhere.

45 IAC 3.1-1-51 states in part that, "The denominator of the sales factor includes all gross receipts from the taxpayer's sales...."

Taxpayer concludes that the denominator should include the gross amount of its "non-industrial" sales of precious metals which were eliminated for purposes of reporting its income on the federal returns. The audit found that the gross amount of these "non-industrial" sales should not be included in the denominator on the ground that including the gross amount of sales would "unfairly represent the Indiana sales factor because the commodities are not traded in this state."

The issue is whether the gross amount of these non-industrial sales should be included in the denominator of the sales factor or whether the net amount of sales should be included in the denominator of the sales factor. It is taxpayer's contention that the gross amount should be included; it is the audit's contention that the net amount should be included.

When taxpayer makes a "non-industrial" sale, it is essentially entering into a contract agreement to sell precious metals at a fixed price. Presumably, this "fixed price" is for an amount greater than what it originally paid for those same precious metals.

The Indiana Tax Court has addressed the specific issue raised by taxpayer and held, "'Gross Receipts' for the purpose of the sales factor includes *only* the interest income and not the rolled over capital or return of principal realized from the sale of investment securities." Sherwin-Williams Co. v. Indiana Dept. of State Revenue, 673 N.E.2d 849, 853 (Ind. Tax Ct. 1996) (*Emphasis added*). The Court found that "[P]rincipal included in the proceeds of sale or redemption of short term-investments is not includible in the receipts factor." Id. at 852. In arriving at that conclusion, the Tax Court cited to AT&T v Director, Division of Taxation, 476 A.2d 800, 802 (N.J. Super. A.D. 1984) which – in addressing the same issued raised by taxpayer – stated that "To include such receipts in the factor would be comparable to measuring business activity by the amount of money that a taxpayer repeatedly deposited and withdrew from its own bank account" and that to hold "otherwise produces an absurd interpretation of [the relevant statute]." Id.

Taxpayer is attempting to measure its business activity by the gross amount of money it obtains from buying and selling contracts for precious metals such as gold. The actual quantity of precious metals in these non-industrial contract sales remains the same; taxpayer generates profits (or losses) by buying and selling a fixed amount of precious metal. In effect, taxpayer is buying and selling the same fungible commodity and then measuring its business activity by the amount of gross sales. In measuring the amount of return on these contracts, taxpayer wants to have the best of both worlds; it wants to exclude the turnover on principal for federal income tax purposes, but it wants to include that same amount for purposes of measuring its Indiana sales activity. The taxpayer's inconsistent proposal is inherently flawed and does not result in an accurate reflection of taxpayer's Indiana income. The Department concludes that to allow the taxpayer to measure its business activity – the amount of its sales – in this manner would not accurately reflect taxpayer's Indiana business activity and would not lead to an equitable apportionment of taxpayer's Indiana income. Taxpayer may not include the return on principal realized each time it sells these precious metal contracts because including both the principal and profit would distort the sales factor by giving extra weight to out-of-state sales. As stated in 45 IAC 3.1-1-50(5), "In some cases, certain gross receipts should be disregarded in determining the sales factor to effectuate an equitable apportionment."

FINDING

Taxpayer's protest is respectfully denied.

II. Indiana Commodity Sales – Gross Income Tax.

During 1996 and 1997, taxpayer maintained an inventory of commodities within Indiana. The audit confirmed that sales from this Indiana location were made to customers within Indiana. However, the taxpayer could not provide details of these Indiana sales. Finding that the money received from these sales was subject to Indiana gross income tax pursuant to 45 IAC 1.1-2-1, the audit prepared an estimate of the Indiana sales and assessed tax accordingly. The audit estimated the receipts by applying an inventory turnover ratio of 6 along with an estimated gross profit. The taxpayer challenged the methodology arguing that the turnover ratio of 6 "may not accurately reflect the proper taxable receipts related to the Indiana inventory." As an alternative, taxpayer proposes that an inventory turnover ratio of two be employed to more accurately reflect the taxpayer's gross income tax liability.

The Department is authorized to prepare an assessment of taxes in situations where the taxpayer has underestimated its tax liability. IC 6-8.1-5-1(a) states that, "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department." There is no question that taxpayer failed to report "the proper amount of tax due" because, despite the fact that it was selling commodities to Indiana customers from an Indiana location, it failed to report any of these sales for gross income tax purposes. Therefore, the audit was entirely justified in preparing a sales receipts estimate based upon the best information available.

Having prepared that estimate, it is taxpayer's responsibility to refute the estimated conclusion if it believes that the audit erred in its conclusion. "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 is made." IC 6-8.1-5-1(b). Other than making an off-hand suggestion that it would prefer the Department employ an inventory ratio of 2, taxpayer has failed to meet its burden of demonstrating that the proposed assessment of gross income tax is erroneous. Taxpayer failed to provide the requested Indiana sales information at the time the audit report was prepared. In its initial protest of the assessment, taxpayer provided no information which would serve as a basis for challenging the assessment. Despite a specific request to do so, taxpayer failed to provide the detailed sales information following the hearing which would substantiate the basis for its challenge to the gross income tax assessment.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420020237.LOF

LETTER OF FINDINGS NUMBER: 02-0237
Sales & Use Tax
For the Calendar 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.

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

II. Tax Administration - Interest
Authority: IC 6-8.1-10-1

The taxpayer protests the interest assessment.

STATEMENT OF FACTS

The late penalty and interest were assessed on a Department audit covering the periods 1998, 1999, and 2000.

The taxpayer is a company located out-of-state.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be waived as the error was (1) unintentional, (2) the error was only 5%, and (3) the taxpayer has implemented a self-assessing use tax system since the audit.

With regard to the 5% error, the amount of the audit assessment was about $200,000. The taxpayer remitted about $90,000 in each year of the audit. This equates to a 40% error. The Department considers this error to be material.

With regard to the self-assessing use tax system, this system should be helpful to the taxpayer in the remittance of use tax in the future. However, with regard to the audit period in the instant case, the new use tax system was not in place, and therefore, is not a factor in the consideration of the waiver of penalty.

The regulation which provides the guideline for penalty is as follows:

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

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

FINDING

The taxpayer's penalty protest is denied.

II. Tax Administration – Interest

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

DEPARTMENT OF STATE REVENUE

0420030015.LOF

LETTER OF FINDINGS NUMBER: 03-0015
SALES AND USE TAX
FOR TAX PERIODS: 1999-2001

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

ISSUE

Sales and Use Tax: Manufacturing Exemptions
Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-3, IC 6-2.5-5-5.1, 45 IAC 2.2-5-10 (c), 45 IAC 2.2-5-10 (h)(2), 45 IAC 2.2-5-12, *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983). *Rotation Products v. Indiana Department of State Revenue*, 690 N.E.2d 795, 803 (Ind. Tax. Ct. 1998).

The taxpayer protests the assessment of use tax on certain items of tangible personal property.

STATEMENT OF FACTS

The taxpayer is in the business of manufacturing, repairing, and sharpening saw blades. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use tax, interest, and penalty. The taxpayer protested a portion of the assessment. At the taxpayer's request, this Letter of Findings is based on the documentation in the file.

Sales and Use Tax: Manufacturing Exemptions

The taxpayer's protest concerns its tax liability in the alleged rebuilding or remanufacturing of certain saw blades. The taxpayer's first step in the process is removing all carbide teeth by torch. A plate is put on the Nitshushita Saw Grinder to grind in new gullets. These new gullets are programmed into the grinding machine computer according to the saw blade application. Proper wheel width is determined for the gullet and secured to the spindle. After gulleting, the taxpayer establishes a new seat pocket for the new carbide tip. This is also completed on the computer controlled Nitshushita grinding machine. The seat pocket angle is determined by the application of the blade. This angle is programmed into the machine. The blade is then cleaned and is ready for brazing new carbide teeth. Next the plate is brushed with brazing flux. After determining size and grade of carbide tip, the tips are cleaned. Then the screws on the retipping table are adjusted to center tooth on the plate. The torch is lit and flame adjusted for the size of the carbide teeth. The teeth are placed into the new seat pocket. The torch is then brought to the tooth and brazes the tooth to the plate. After the complete brazing of the blade, it is left to cool. A shock test is done to several teeth to ensure proper brazing. After the cooling and shock test, the teeth are inspected for the proper setting of teeth in the seat pockets. The rim of the saw blade is then sand blasted on both sides and the teeth are reinspected. The blade is put on a dual side grinding machine to grind in a new radial and tangential clearance angle. These angles are programmed into the grinding machine and are determined by the application. After the width (Kerf) of the saw blade is established, the blade is ready for top grinding. The application determines what top and back clearance angles are programmed into the grinding machine. After the top grind is completed, the face grinding begins. The teeth are face ground parallel to the back of the seat pocket. This angle is programmed into the grinding machine. After the blade passes the final inspection, the blade is dipped into a protective plastic coating. The department's audit assessed use tax on many items used in this process. The taxpayer protested the assessment of use tax on the items it used in this process.

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. There is no exemption available for tangible personal property used in the provision of a service.

A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication... of tangible personal property." (the equipment exemption) In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production. 45 IAC 2.2-5-10 (h)(2) further clarifies the exemption by allowing the exemption of "Replacement parts, used to replace worn, broken, inoperative or missing parts or accessories on exempt machinery and equipment..." IC 6-2.5-5-5.1 provides for the exemption of tangible personal property "... if the person acquiring the property acquires it for the direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing,..." (the consumption exemption) Pursuant to 45 IAC 2.2-5-12, consumption of tangible personal property in the direct production process means "dissipation or expenditure by combustion, use, or application..." of the tangible personal property in an "essential and integral part of an integrated process which produces tangible personal property."

Both the equipment and consumption manufacturing exemptions require that the subject item be used in a production process. The taxpayer contends that the protested items qualify for either the equipment or consumption exemption. The department assessed use tax on the protested items because the department determined that the items were used in the service of repairing saw blades rather than a true production process. The first issue to be determined here is whether the protested items were actually used in the provision of a service or in a production process as the taxpayer contends.

To support its contention that the taxpayer is actually remanufacturing the saw blades in a production process rather than providing a repair service, the taxpayer cites *Rotation Products v. Indiana Department of State Revenue*, 690 N.E.2d 795, 803 (Ind. Tax. Ct. 1998). In that case, Rotation Products Corporation successfully argued that it took raw materials in the form of unusable roller bearings and created an entirely new product, i.e., the remanufactured roller bearings. The Court found that this was a production process and not the provision of a service. To reach this conclusion, the Court instituted the following four-prong test to distinguish a production process from the provision of a service. First, a production process must be complex and substantial and produce a different end product. Secondly, the property must become more valuable in the process. Thirdly, the end product of the process must compare favorably with newly manufactured articles of its kind. Finally, the process must not be part of the normal life cycle of the original product.

First, like the taxpayer in Rotation Products, this taxpayer performs substantial and complex work and significantly changes the saw blades. When received, the blades are unusable and unable to be sharpened. They are in worse shape than a "blank" which is the raw material purchased for manufacturing. The previous recitation of the steps involved in the process indicate the substantial and complex changes the taxpayer makes in the saw blades.

Secondly, the property must become more valuable in the process. The taxpayer takes nonusable saw blades and transforms them into marketable saw blades. Before the remanufacturing process, there is no market for the saw blades except possibly as scrap metal. After the remanufacturing process, the saw blades are a functional and marketable product.

The taxpayer guarantees its customers that the processed saw blades are as good as and often better than a new saw blade. The blades receive all new carbide tips as in the accepted manufacturing process for new blades. The blades are also computer precision sharpened like new blades. Therefore, the performance of the new saw blade is as good as a new saw blade.

Finally, the taxpayer's processing of the saw blades is not part of such property's normal life cycle. In *Rotation Products*, the Court noted that even if the cleaning and polishing of bearings is routine maintenance that is a normal part of such bearings' lifecycle;

grinding bearing surfaces and replacing roller cages and elements are not. *Id.* at 803-04. Similarly, the taxpayer's replacement of the tips, angling of the tips, and computer grinding and sharpening is significantly more than the mere cleaning and sharpening in the normal lifecycle of a saw blade.

Since it has been determined that the taxpayer actually produces a marketable product in a production process, the second issue is to determine whether the protested items actually qualify for the equipment and consumption manufacturing exemptions. The taxpayer's explanations of the use of the items in the production process indicate that they qualify for either the equipment or consumption manufacturing exemption.

FINDING

The taxpayer's protest as to the equipment and materials used in the remanufacturing of saw blades is sustained.

DEPARTMENT OF STATE REVENUE

04-20030095.LOF

LETTER OF FINDINGS NUMBER: 03-0095
Sales/Use Tax
For the Years 1999-2001

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

ISSUE

I. Sales and Use Tax-Prizes

Authority: Ind. Code § 6-2.5-3-1; Ind. Code § 6-2.5-3-6; Ind. Code § 6-2.5-4-1; *Maurer v. Indiana Dept. of State Revenue*, 607 N.E.2d 985 (Ind. Tax 1993).

Taxpayer protests the assessment of use tax with respect to automobiles given away as part of a promotional giveaway.

II. Sales and Use Tax-Out-of-State Mailings

Authority: Ind. Code § 6-2.1-3-3.5; Ind. Code § 6-2.5-5-24.

Taxpayer protests the assessment of sales tax with respect to mailings Taxpayer claims were sent to out-of-state addresses.

STATEMENT OF FACTS

Taxpayer is a company that operates a riverboat casino in Indiana. Periodically, Taxpayer engaged in prize giveaways of automobiles and boats to customers. The nature of the giveaways would work in this manner: a contestant would enter a sweepstakes held by the Taxpayer for a car to be provided by an automobile or boat dealer. Taxpayer would display the automobile at its casino during the contest period; however, the dealer would be responsible for insuring the automobile. If the contestant was the winner of the drawing, Taxpayer would pay the dealer that provided the prize the fair market value of the prize. The contestant would go to the dealer and the car would be handed over to the contestant, who would be responsible under the terms of the contest for all applicable taxes and registration of the automobile or boat.

Taxpayer was audited by the Department for sales tax. As a result of the audit, Taxpayer was assessed use tax, based on the theory that it used the automobiles or boats in Indiana as part of its giveaway as part of its business. Taxpayer was also assessed sales and use tax on flyers, a portion of which Taxpayer maintained was sent outside Indiana. Taxpayer has protested the assessment, and separately filed a claim for refund with respect to unrelated issues not discussed in this Letter of Findings.

I. Sales and Use Tax-Prizes

DISCUSSION

Taxpayer argues that it is not subject to sales and use tax because it does not use the automobiles or boats in Indiana, and because it never owned the automobiles or boats. Taxpayer argues that the relevant transaction is actually a transaction between the winning contestant and the car or boat dealer, and that this transaction is the one that should result in the imposition of sales and use tax as appropriate. Taxpayer further provides copies of contracts with car dealers to buttress its claim, with the relevant conditions stated above.

With respect to the issue of sales tax for the automobiles and boats that were part of its prize giveaways, the case of *Maurer v. Indiana Dept. of State Revenue*, 607 N.E.2d 985 (Ind. Tax 1993) is directly on point. In that case, a charity raffle was held for an automobile. Under the contract between the charity and the automobile dealer, the charity was to pay the fair market value of the automobile to the dealer. *Id.* at 988. Taxpayer went to dealer to get the car; however, the dealer refused to issue the car until the taxpayer paid the sales tax on the automobile. *Id.* Taxpayer paid the tax, filed a claim for refund which was denied by the Department, and appealed. The Tax Court held that the title of the car transferred from the dealer to the charity, and that this constituted the retail transaction subject to tax (but for the charity's exemption from taxation). *Id.* Thus, the transaction between dealer and taxpayer was not a retail transaction. Further, the Tax Court held that the transaction between the taxpayer and the charity was one of a raffle ticket, and not one for an automobile, thus allowing taxpayer's refund for sales tax. *Id.* at 989. Finally, the court held that the taxpayer was not subject to use tax because the car was not acquired in a retail transaction. *Id.* at 990.

In this case, almost exactly the same fact situation arose as the one in *Maurer*. The only difference in this case is that Taxpayer in the current case is not an exempt entity. The effective result of the drawing was a retail transaction between the car or boat dealer and Taxpayer, followed by a transfer to the winning contestant, even though Taxpayer never had registered title in its name. *Id.* at 988. Accordingly, Taxpayer and the automobile or boat dealer engaged in a transaction subject to sales and use tax. Ind. Code § 6-2.5-3-2(a) (occasional sales); Ind. Code § 6-2.5-4-1(b) (retail transactions). Further, by giving the automobile away at its Indiana casino, Taxpayer has exercised a right or power of ownership- used, within the statutory meaning- the product in Indiana, regardless of the ultimate location to which the winning contestant ultimately takes the automobile or boat and regardless of Taxpayer's status as a listed owner on the automobile or boat title. Ind. Code § 6-2.5-3-1(a).

Taxpayer raised the issue that audit's logic seemed to apply use tax only to situations where the winner was a non-resident. After a review of relevant case law, the sales/use tax liability is that of the current taxpayer in all circumstances, not that of the winner, contractual terms notwithstanding.

FINDING

Taxpayer's protest is denied.

II. Sales and Use Tax-Out-of-State Mailings

Taxpayer also had protested the sales tax imposed with respect to direct mailings sent to addresses outside Indiana. Audit subsequently determined that 51.6 percent of its mailings were tax exempt per Ind. Code § 6-2.5-5-24 and Ind. Code § 6-2.1-3-3.5. Taxpayer has indicated that it accepts this finding.

FINDING

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

DEPARTMENT OF STATE REVENUE

0320030188.LOF

LETTER OF FINDINGS NUMBER: 03-0188
Withholding Tax
For the Years 1998-2001

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. Withholding Tax - Imposition

Authority: IC 6-8.1-5-1(b), IC 6-3-4-8(a).

The taxpayer protests the assessment of withholding tax.

STATEMENT OF FACTS

The taxpayer is a corporation that operated a pharmacy in Indiana. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional withholding tax, interest, and penalty for the years 1998-2001. The taxpayer protested the imposition of withholding tax and a hearing was held. This Letter of Findings results.

I. Withholding Tax - Imposition

DISCUSSION

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

The taxpayer was required to withhold employee income taxes and remit those taxes to Indiana pursuant to the provisions of IC 6-3-4-8 (a) in pertinent part as follows:

> ... every employer making payments of wages subject to tax under IC 6-3, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department... Such employer making payments of any wages:
>
> (1) shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld...
>
> (2) shall make return of and payment to the department monthly of the amount of tax which under IC 6-3 and IC 6-3.5 he is required to withhold.

The taxpayer offers two explanations for why it did not submit withholding taxes to the state. In its original protest letter, the taxpayer argued that all withholding taxes on taxpayer's pharmacy were remitted to the state through a related business. In support of this contention, the taxpayer submitted documentation indicating that a payroll payment service remitted withholding taxes on employees of the related business. There was, however, nothing to substantiate that the wages were paid, withheld on, and remitted to the state for employees of the taxpayer rather than the related business. This argument is not persuasive.

Alternatively, the taxpayer argues that it had no employees. The taxpayer stated that the president of the company staffed the pharmacy during open hours without taking a salary. This explanation is not rational. The president offered evidence that he drove to Chicago quite frequently to obtain stock for the related business. Therefore, the pharmacy would have had to have been closed during the periods that the corporation president was traveling to Chicago. The argument that the taxpayer had no paid employees is also not persuasive.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030203.LOF

LETTER OF FINDINGS NUMBER: 03-0203
Sales and Use Tax
For the Years 1999-2000

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

ISSUES

I. Sales and Use Tax - Imposition and Remittance of Sales Tax

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-2-1(a), IC 6-2.5-4-1(b), IC 6-2.5-2-1(b).

The taxpayer protests the imposition of additional sales tax.

II. Tax Administration - Penalty

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

The taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

The taxpayer is in the business of selling and leasing new and used vehicles, parts, and accessories. The taxpayer also repairs vehicles and operates a body shop. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales tax, use tax, interest, and penalty for the years 1999 – 2000. The taxpayer protested a portion of the sales tax assessment and the penalty and a hearing was held. This Letter of Findings results.

I. Sales and Use Tax - Imposition and Remittance of Sales Tax

DISCUSSION

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

Retail transactions made in Indiana are subject to sales tax. IC 6-2.5-2-1(a). A retail transaction is defined generally as the acquiring and subsequent selling of tangible personal property. IC 6-2.5-4-1(b). The retail merchant is charged with the duty of collecting the tax from the purchasers and remitting the collected tax to the state. IC 6-2.5-2-1(b). There is agreement that the taxpayer sold vehicles in retail sales that were subject to the sales tax. There is also agreement that the taxpayer had the duty to collect and remit sales taxes on those sales.

The taxpayer argued that the department failed to give the taxpayer credit for all of the sales tax it collected. The taxpayer based this contention on work papers included in the audit. In these work papers, there were no figures in the column concerning tax collected by the taxpayer for some of the sales. The taxpayer presented invoices indicating that sales tax was actually collected for each of these blanks. The taxpayer contends that the department did not give it credit for collecting those sales taxes.

The taxpayer errs in its conclusion that it was not given credit for all sales taxes collected. The amount of sales tax due was not calculated from the work papers cited by the taxpayer. The department's auditor reviewed all the taxpayer's sales invoices. From this information, the auditor tallied the amount of sales tax collected. Then the auditor compared the monthly sales taxes collected according to the invoices to the monthly sales tax returns filed by the taxpayer. Since the auditor was unable to balance the taxpayer's invoices to the returns on a monthly basis, the auditor attempted to reconcile them on an annual basis. The auditor then compared the annual collections to the annual returns and remittances. In both 1999 and 2000 there were discrepancies between the amounts of sales tax actually collected per the taxpayer's invoices and the taxpayer's returns and accompanying payments to the state. In each of these years, the taxpayer collected more sales taxes than it reported and remitted to the state. The department correctly assessed the difference between sales taxes collected and sales taxes remitted to the state.

FINDING

The taxpayer's protest is denied.

II. Tax Administration - Negligence Penalty

DISCUSSION

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

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

The taxpayer had a duty to remit all the sales taxes collected. The taxpayer also had a duty to pay use tax on the use of clearly taxable items such as shirts, key chains, fleeces, hats, ties, and vests when no sales tax was paid at the time of purchase. The taxpayer's carelessness and inattention to detail caused it to fail to remit all sales taxes collected and pay the use tax on the use of many items when no sales tax was paid at the time of purchase. These breaches of the taxpayer's duties constitute negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030244.LOF

LETTER OF FINDINGS NUMBER: 03-0244
Sales and Use Tax
For the Years 1998-2001

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-Computation

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

The taxpayer protests the computation of sales tax due.

II. Tax Administration-Penalty

Authority: IC 6-8.1-10-3, 6-8.1-10-3.

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

III. Tax Administration-Interest

Authority: IC 6-8.1-10-1(a),(e).

The taxpayer protests the imposition of interest.

STATEMENT OF FACTS

The taxpayer is a corporation that operated a pharmacy in Indiana. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales tax, interest, and penalty for the years 1998-2001. The taxpayer protested the imposition of sales tax, penalty, and interest. A hearing was held. This Letter of Findings results.

I. Sales and Use Tax-Calculation

DISCUSSION

The sales tax due was calculated from the best information available. The auditor applied percentages determined from a research guide to the taxpayer's gross sales to calculate the sales tax due. The taxpayer protests this assessment of sales tax.

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

The taxpayer contends that it was not necessary to reconstruct the tax in this manner since it provided adequate records. The taxpayer did provide some books and records to the auditor. These records produced, however, were for a related business. Later the taxpayer provided the department with certain books and records. There were twelve (12) boxes of books and records that were not organized in any discernable fashion. The documents provided were not in a consistent form or verifiable. The register sales tapes were loose and could not be matched to any other records. The daily records of sales did not match the monthly totals of sales. The monthly totals of sales did not tie in appropriately to the annual sales records as asserted by the taxpayer. There were no exemption certificates, verifiable actual ledgers, or verifiable journals. There was no way to tie together the information provided by the taxpayer and use it to reconstruct the taxpayer's sales tax returns.

FINDING

The taxpayer's protest is denied.

II. Tax Administration-Penalty

DISCUSSION

The taxpayer protests the imposition of the twenty percent (20%) penalty pursuant to IC 6-8.1-10-3 as follows:

(a) If a person fails to file a return on or before the due date... the department may prepare a return for him, based on the best information available to the department. The department prepared return is prima facie correct.

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

The taxpayer contends that it made at least seven payments during the audit period. The department is unable to find any evidence that it ever received the returns and accompanying payments. The taxpayer also contends that it filed an amount due in its bankruptcy filing. That is not, however, the periodic filing required by the statute.

The taxpayer did not file sales and use tax returns as required. The state auditor prepared the taxpayer's sales tax returns. Under these circumstances, the twenty percent (20%) penalty is appropriate.

FINDING

The taxpayer's protest is denied.

III. Tax Administration-Interest

DISCUSSION

The taxpayer protests the imposition of interest pursuant to IC 6-8.1-10-1(a) as follows:

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.

The taxpayer did not pay the full amount of tax due. Therefore, interest was properly imposed. IC 6-8.1-10-1(e) goes on to state that "the department may not waive the interest imposed under this statute." Clearly, the department does not have the authority to grant the taxpayer's request for waiver of interest.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

03-20030260.LOF

LETTER OF FINDINGS NUMBER: 03-0260
Withholding Tax
Responsible Officer
or the Tax Period 1991-1992

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

ISSUE

1. Withholding Tax-Responsible Officer Liability

Authority: IC 6-3-4-8(f), IC 6-8.1-5-1(b), Indiana Department of Revenue v. Safayan 654 N.E. 2nd 279 (Ind.1995).

The taxpayer protests the assessment of responsible officer liability for unpaid corporate withholding taxes.

STATEMENT OF FACTS

The taxpayer was the President of a corporation that did not properly remit withholding taxes to the state during the tax period 1991-1992. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed the unpaid withholding taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax.

A hearing was held and this Letter of Findings results.

1. Sales and Use Tax-Responsible Officer Liability

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8-1-5-1(b).

The proposed withholding taxes were assessed against Taxpayer pursuant to IC 6-3-4-8(f), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

Pursuant to Indiana Department of Revenue v. Safayan 654 N.E. 2nd 279 (Ind.1995) any officer, employee, or other person who has the authority to see that they are paid has the statutory duty to remit sales and withholding taxes to the state. As the President of the corporation, the taxpayer had the responsibility to oversee the corporation. The taxpayer failed to insure that the corporation fulfilled its financial responsibilities by remitting trust taxes to the Indiana Department of Revenue. Therefore, the taxpayer had the statutory duty to remit the sales taxes and is personally liable for the payment of those taxes.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030309.LOF

LETTER OF FINDINGS: 03-0309
Indiana Gross Retail Tax
For the Years 1999 and 2000

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

ISSUES

I. Use Tax Exemption – Shipping Blocks.

Authority: IC 6-2.5-5-9(d); 45 IAC 2.2-5-16; 45 IAC 2.2-5-16(a); 45 IAC 2.2-5-16(c)(1); 45 IAC 2.2-5-16(d)(1).

Taxpayer argues that it was not required to pay sales tax when it purchased shipping blocks ("chocks") on the ground that the chocks are "wrapping materials" exempt from taxation.

II. Abatement of the Ten - Percent Negligence Penalty

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

Taxpayer asks that the Department of Revenue (Department) exercise its discretion to abate the ten-percent negligence penalty assessed following completion of the original audit review.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of developing, manufacturing, marketing, and distributing copper, aluminum, and fiber optic cable. Taxpayer operates out of various locations including locations within Indiana. Taxpayer's products are sold to and used by the communications, energy, industrial, and specialty markets.

The Department conducted an audit review of taxpayer's business and tax records. As a result of that audit, the Department determined that taxpayer owed additional gross retail (use) taxes. Accordingly, the Department sent taxpayer notices of "proposed assessment" which included the additional amount of tax and imposition of the ten-percent negligence penalty. Taxpayer disagreed with the audit results and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer's representative further explained the basis for the protest. This Letter of Findings results.

DISCUSSION

I. Use Tax Exemption – Shipping Blocks.

Taxpayer bought wooden blocks without paying sales tax. When the audit division reviewed taxpayer's records, it decided that taxpayer should have paid sales tax on these purchases. Accordingly, the audit assessed use tax on the purchases on the ground that the purchase of the blocks was not exempt from sales tax.

When taxpayer ships its cable products to customers, the cables are wound on steel or wooden reels. Depending on the nature of the cable, the reels may be wrapped in bubble-wrap or shrink-wrap. When the reels are loaded for transport to the customer, taxpayer fastens these wooden, wedge-shaped blocks to the outer rim of each reel. The wedge-shaped blocks serve to keep the reels from moving during shipment. After the reels are delivered to the customer, the blocks are removed by the customer and discarded; the blocks are not reused, and the blocks are not returned to taxpayer.

Taxpayer argues that these blocks are exempt for sales/use tax pursuant to IC 6-2.5-5-9(d) which states:

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

The Department's regulation, 45 IAC 2.2-5-16, interprets the extent of the exemption set out in IC 6-2.5-5-9(d). The regulation states that, "The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling." 45 IAC 2.2-5-16(a). Under this regulation, "Nonreturnable containers and wrapping materials [include] steel strap and shipping pallets to be used by the purchaser as enclosures for selling tangible personal property." 45 IAC 2.2-5-16(c)(1). In order to qualify for the exemption as a nonreturnable container or wrapping material, "The purchaser must add contents to the containers purchased; and the purchaser must sell the contents added." 45 IAC 2.2-5-16(d)(1).

It is clear that the wooden blocks are not returned to taxpayer and are, therefore, "nonreturnable." It is also clear that the wooden blocks are associated with sales of taxpayer's cable in transactions which constitute "selling at retail." Based on taxpayer's description, it is clear that the wooden blocks are a necessary – if not essential – aid in shipping the reels of cable. However, the blocks are not exempt from the state's gross retail tax because taxpayer does not "add contents to the containers purchased." IC 6-2.5-5-9(d) permits an exemption for nonreturnable items to which the taxpayer adds "contents." Taxpayer's blocks are used to facilitate the shipping of the reels, but they are not "enclosures or containers" into which taxpayers adds its product.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty

The audit imposed a ten-percent negligence penalty presumably on the ground that taxpayer failed to pay sales tax on certain taxable transactions and, thereafter, failed to self-assess use tax. Taxpayer argues that the negligence penalty is inappropriate because, although it admittedly failed to self-assess use tax on a number of taxable purchases, given the scope of taxpayer's multi-state business operations, the number of transactions it enters into each year, and the comparatively small number of transactions which the audit found were taxable, it did not act in a negligent manner.

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

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

Without excusing the taxpayer's initial failure to appropriately self-assess use taxes on all of its 1999 and 2000 transactions, the Department concludes that taxpayer's failure to exercise "ordinary business care" in neglecting to self-assess use tax on a limited number of transactions, does not necessitate imposition of the negligence penalty. The penalty should be abated in its entirety.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420030313.LOF

LETTER OF FINDINGS NUMBER: 03-0313
Sales and Use Tax
For the Years 1998-2001

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. Sales and Use Tax-Calling Cards

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-4-13.

The taxpayer protests the imposition of sales tax on calling cards.

STATEMENT OF FACTS

The taxpayer is an Indiana citizen doing business as an oriental grocery store. After an audit, the Indiana Department of

Revenue, hereinafter referred to as the "department," assessed additional sales tax, interest, and penalty for the years 1998-2001. The taxpayer protested the imposition of sales tax and a hearing was held. This Letter of Findings results.

I. Sales and Use Tax-Calling Cards

DISCUSSION

The taxpayer sold prepaid phone cards. IC 6-2.5-4-13 imposes sales tax on prepaid telephone calling cards. The taxpayer protests this assessment of sales tax on the calling cards for two reasons. First the taxpayer argues that many of the cards were voice over internet calling cards and not taxable as a typical calling card. Secondly, the taxpayer argues that the tax on the calling cards was computed incorrectly.

The taxpayer sold voice over internet calling cards for specific dollar amounts. These cards cost less than the typical phone calling card. The taxpayer contends that these cards were not taxable calling cards. The taxpayer errs in this conclusion. Customers purchased a card so they could use telephones to call persons in other locations for a predetermined number of minutes. This amounts to a telephone calling card subject to the Indiana sales tax.

The taxpayer also protests the method of calculating the tax due on the calling cards. The auditor calculated the sales tax due by accumulating the cost of the phone cards purchased by the taxpayer. The retail value was determined by multiplying the number of cards bought by the retail price of each card group. The wholesale price was divided into the retail value to determine the mark up of the cards. Where information was not available and only the wholesale value was known, the average markup was used to calculate the retail price for sales tax purposes.

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b). The taxpayer did not provide adequate verifiable documentation to refute this computation. Therefore, the sales tax due on the calling cards was computed in an appropriate manner.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120030434.LOF

LETTER OF FINDINGS NUMBER: 03-0434
Adjusted Gross Income Tax
For the Years 1998-2001

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. Adjusted Gross Income Tax-Calculation of Income

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

The taxpayer protests the calculation of his gross income.

II. Adjusted Gross Income Tax-Mileage Deduction

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

The taxpayer protests the disallowance of the mileage deduction.

STATEMENT OF FACTS

The taxpayer is an Indiana resident doing business as an oriental grocery store in Indiana. After an investigation, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional adjusted gross income tax, interest, and penalty for the years 1998-2001. The taxpayer protested the imposition of the adjusted gross income tax and a hearing was held. This Letter of Findings results.

I. Adjusted Gross Income Tax-Calculation of Income

DISCUSSION

The taxpayer is a sole proprietor who operated an oriental grocery store. He reported the income from the business on his schedule C. The taxpayer did not have accurate records to substantiate his schedule C filings. Therefore, the auditor had to reconstruct the taxpayer's income and expenses to arrive at the correct adjusted gross income tax liability. The taxpayer protests this reconstruction.

The auditor considered several factors in reconstructing the taxpayer's income. The taxpayer's filings indicate an average profit margin for the four years of only 3.8%. The industry average for grocery stores in the taxpayer's category is 25%. The taxpayer's sales were underreported based on the purchases made by the taxpayer. The taxpayer's income on food and other purchases was adjusted to reflect profit margins in line with the industry averages. The taxpayer's invoices listed the cost and retail price for most of the prepaid calling cards. Upon examination of the various phone card vendors, an average was calculated and used for the phone card invoices that could not be found. The auditor used a reasonable and appropriate method of reconstructing the taxpayer's income.

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b). The taxpayer was unable to submit adequate verifiable documentation to sustain its burden of proving that the reconstructed income was inaccurate.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Mileage Deduction

DISCUSSION

The taxpayer purchased a new car in 1996 or 1997 on which he put 178,000 miles in four years. The taxpayer argued that all the miles were business related and properly deducted from the grocery store's gross income. The auditor disallowed the taxpayer's listed mileage deductions and gave a mileage deduction based upon industry standards. The taxpayer protested the disallowance of the total mileage deduction.

The taxpayer presented a travel log and testified that the car was used to go to the bank, post office, drug stores, utility offices, convenience stores, department stores, grocery stores, hardware stores, office supply stores, restaurants, West Lafayette, and Chicago at least one time per week. It is irrational to assume that all of these trips were directly related to the business of the taxpayer's grocery store. Since there was no further information to determine which trips qualify for a business mileage deduction, the auditor made an appropriate estimate. The proposed assessment is presumed correct unless the taxpayer offers substantial, verifiable documentation refuting that presumption. IC 6-8.1-5-1 (b). The taxpayer did not meet that standard.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

03-20040020.LOF

LETTER OF FINDINGS NUMBER: 04-0020
Withholding Tax
Responsible Officer
For the Years 2001-2002

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

ISSUES

I. Withholding Tax-Responsible Officer Liability

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

The taxpayer protests the assessment of responsible officer liability for unpaid corporate withholding taxes.

STATEMENT OF FACTS

Taxpayer was a fifty percent shareholder in a corporation in which Taxpayer worked as an outside salesman. During the period ending in September 2001, Taxpayer's spouse handled bookkeeping and payroll for the corporation, with Taxpayer signing the relevant checks. Beginning in October 2001, Taxpayer did not sign any checks with the exception of his own payroll check and one other check. However, withholding taxes were not remitted to the Department for a period of several months, which resulted in an assessment against Taxpayer as a responsible officer of the corporation. Taxpayer protested the assessment, and a hearing was held.

I. Withholding Tax-Responsible Officer Liability

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that the assessment is incorrect. IC 6-8-1-5-1(b).

The proposed withholding taxes were assessed against Taxpayer pursuant to IC 6-3-4-8(f), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

Pursuant to Indiana Department of Revenue v. Safayan, 654 N.E. 2nd 270 (Ind. 1995) at page 273: "The statutory duty to remit trust taxes falls on any officer or employee who has the authority to see that they are paid." The factors considered to determine whether a person has such authority are the following:

1. The person's position within the power structure of the corporation;
2. The authority of the officer as established by the Articles of Incorporation, By-laws or employment contract; and
3. Whether the person actually exercised control over the finances of the business including control of the bank account, signing checks and tax returns or determining when and in what order to pay creditors.

With respect to the first aspect, Taxpayer was a fifty-percent owner of the company, and was listed as the secretary of the corporation in Secretary of State filings. With respect to the second aspect, the file and Taxpayer are silent. With respect to the third aspect, Taxpayer was still a signatory to the corporation's bank accounts until at least April 2002, even though the only checks signed by Taxpayer were his own payroll checks. Taxpayer still had the authority to write checks and provide for payments by the corporation of its liabilities, even if the corporation had actual control over the physical checks. Taxpayer had the opportunity to pay the relevant taxes from the corporation's accounts, but did not do so. Accordingly, Taxpayer is personally responsible for the taxes in question.

Taxpayer has provided an affidavit with respect to the situation. However, Taxpayer's affidavit does not provide sufficient information to conclude that Taxpayer lacked the ability to make corporate withholding tax payments at the time of the liabilities at issue.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01-20040023.LOF

LETTER OF FINDINGS NUMBER: 04-0023
ADJUSTED GROSS INCOME TAX
For Years 1995 TO 2001

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

ISSUES

I. Adjusted Gross Income Tax – Federal adjustments

Authority: IC 6-8.1-5-1(b); 45 IAC 15-5-4

Taxpayer protests the proposed assessments of Indiana's adjusted gross income tax.

II. Tax Administration – Interest

Authority: IC 6-8.1-10-1

Taxpayer protests interest assessment.

III. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); IC 6-3-4-6; 45 IAC 15-11-2

Taxpayer protests the penalty assessment.

STATEMENT OF FACTS

Taxpayer was assessed additional taxes and penalty for the underpayment of taxes for tax years 1995 to 2001. The taxes, interest, and penalty resulted from an IRS audit where the taxpayer's individual state income tax liability was increased and the penalty resulted from the taxpayer not notifying the department within the required one hundred and twenty (120) days of the federal adjustments.

Taxpayer requested the Department prove the validity of its assessments and that the department waive the negligence penalty and interest.

I. Adjusted Gross Income Tax – Federal Adjustments

DISCUSSION

Taxpayer was a signatory to the Federal adjustments and, as occurred at the meeting when taxpayer brought the Federal documentation with him, the adjustments to the Indiana return were (relatively) obvious. Taxpayer has not asserted any argument as to why the Department's assessment should be reduced or abated. At the hearing, and in subsequent meetings, taxpayer did not present an addressable argument as to the error in the Department's base assessment. After review of the Federal audit adjustments, provided by taxpayer at a meeting with the Department, no error in the Department's base assessment was identified. Consequently, pursuant to IC 6-8.1-5-1(b) – which states in relevant part: "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." no adjustment will be made. Pursuant to the above statute and the requirements of IC § 6-8.1-5-1 and 45 IAC 15-5-4, taxpayer has failed to establish a basis for reversal of this assessment.

FINDING

Taxpayer's protest is denied.

II. Tax Administration – Interest

Taxpayer has protested the interest charged on the adjustment. Taxpayer maintains that the interest rate was 10%, which was too high given prevailing rates. Department notes that while the interest rate in 1991 was 10%, each subsequent year reflects adjustments in the prevailing economic climate- as required by IC 6-8.1-10-1-, thus this year the interest rate is 4%. As to waiver, IC 6-8.1-10-1 does not permit waiver of interest by the Department.

FINDING

Taxpayer's protest is denied.

III. Tax Administration – Penalty

DISCUSSION

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 in section 45 IAC 15-11-2 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.

According to IC 6-3-4-6 (b) a taxpayer shall notify the department of any modification of:

(1) a federal income tax return filed by the taxpayer after January 1, 1978; or
(2) the taxpayer's federal income tax liability for a taxable year which begins after December 31, 1977.

The taxpayer shall file the notice, on the form prescribed by the department, within one hundred twenty (120) days after the modification is made. See also 45 IAC 3.1-1-94.

Taxpayer was assessed an underpayment penalty because it failed to report its Federal RAR adjustments as required by IC 6-3-4-6 for the years 1995 to 2000.

Taxpayer, protested penalties assessed and states that the underpayment of tax was not intentional. Taxpayer, according to IC 6-3-4-6 has one hundred and twenty (120) days to file its RAR adjustments with the Department. Taxpayer failed to comply. At the time of billing, the department had not received the amended returns or notice from the taxpayer that Federal RAR's were pending.

Taxpayer has not provided reasonable cause to allow the department to waive its negligence penalty. The Indiana Code and Regulations are clear regarding notification to the department of a taxpayer's RAR adjustments.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

03-20040107P.LOF

LETTER OF FINDINGS NUMBER: 04-0107P
Withholding Tax
For the calendar year ended December 31, 2002

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late filing of a WH-3 withholding tax return for the calendar year ended December 31, 2002.

The taxpayer is a company located in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be abated as the error was the result of the management changes and difficulty receiving payments from clients. Furthermore, the taxpayer claims to have a very good payment history. The taxpayer also stated that there were health problems during this period.

The Department realizes that occasionally a taxpayer will have health problems resulting in failure to timely file a return. In the instant situation, the taxpayer has a pattern of late filed returns. After the first late filed return, the taxpayer should have had alternative procedures in place. The procedures would have provided for the timely filing of returns.

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

The taxpayer's arguments taken together do not rise above negligence.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0320040240P.LOF

LETTER OF FINDINGS NUMBER: 04-0240P
Withholding Tax
For the Calendar Year 2003

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late filing and deposit of withholding for non-resident shareholders for the 2003 calendar year.

The taxpayer is a company located out-of-state.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the late penalty should be abated as the error was unusual.

The Department will waive penalty if the error is unusual and the taxpayer has an exemplary payment history with the Department.

With regard to the nature of the error, this is not the first complex return the taxpayer has filed. The return for the year 2002 was also a similar complex return. Because the taxpayer is used to filing complex returns of this nature, the Department does not feel this is a situation that is unusual and be a factor in the waiver of penalty.

With regard to the exemplary payment history, this is the first time the taxpayer has had to pay withholding tax. The department does not feel the taxpayer's payment history qualifies as exemplary. As such, the taxpayer's payment history would not be a factor in the waiver of penalty.

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

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

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

02-20040302P.LOF

LETTER OF FINDINGS NUMBER 04-0302P
ADJUSTED GROSS INCOME TAX FOR
THE PERIOD COVERING THE FISCAL YEARS ENDING
SEPTEMBER 26, 2000, SEPTEMBER 29, 2001 AND SEPTEMBER 28, 2002

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

ISSUE

I. Tax Administration—Negligence Penalty

Authority: IC §§ 6-8.1-5-1(b), -10-2.1 (1998); 45 IAC § 15-11-2 (1996) (2001)

STATEMENT OF FACTS

The Department conducted an income tax audit of the taxpayer for its fiscal years ending September 26, 2000, September 29, 2001 and September 28, 2002 (hereinafter "the audit period"). During the audit period the taxpayer was a corporation with its commercial domicile outside Indiana and engaged in the retail sporting goods trade. A holding company had acquired the taxpayer in 1998, but it kept filing Indiana Corporate Income Tax Returns (Forms IT-20) during the audit period. The taxpayer's business was unitary, with the taxpayer operating one retail outlet in Indiana during the audit period. None of the taxpayer's affiliate companies did business in Indiana during that time.

The auditor made adjustments to, and the Department's Audit Division issued Notices of Proposed Assessment of, the taxpayer's adjusted gross income tax (hereinafter "AGIT") liability for the fiscal years ending September 26, 2000 and September 28, 2002 (hereinafter "fiscal year 2000" and "fiscal year 2002," respectively). The audit changes arose from computational errors the taxpayer made in preparing its returns for fiscal years 2000 and 2002. Specifically, in computing Indiana adjusted gross income (hereinafter "AGI") for fiscal year 2000 the taxpayer erroneously added back the loss it had sustained on depreciable assets. IC § 6-3-1-3.5(b) (1998) and its implementing regulation, 45 IAC § 3.1-1-8, which set out the corporate AGI formula, did not and at this writing still do not permit taxpayers to add back such losses.

In addition, in both fiscal years 2000 and 2002 the taxpayer also had carried forward and deducted Indiana net operating losses (hereinafter "NOLs") it had incurred for short tax years ending January 9, 1998 and September 30, 1998. In calculating those NOLs the taxpayer failed to include adjustments for the state income and property taxes it had deducted on its federal income tax returns for the 1998 short years, as IC § 6-3-1-3.5 (1998) then required. (The adjustment for property taxes was later deleted from IC § 6-3-1-3.5 for reporting periods ending after December 31, 1998.) The auditor recalculated the NOLs for those periods and adjusted its Indiana NOL deductions for fiscal years 2000 and 2002 accordingly. The adjustments' effect was overwhelmingly on fiscal year 2002, but the adjustments did affect both fiscal years.

In addition to AGIT and interest, the Notices of Proposed Assessment also included 10% negligence penalties. The taxpayer paid the principal taxes assessed plus interest accrued to the date of payment, and filed a timely protest of the penalties. The employee of the taxpayer having responsibility for this matter called the Department's hearings officer on September 3, 2004, in response to an initial contact letter dated August 26, 2004 the hearings officer had sent. That letter indicated that the taxpayer could submit any additional evidence it might have, with or without a hearing. In that conversation the employee indicated that the taxpayer had no additional evidence to submit, nor did she request a hearing on the taxpayer's behalf. Accordingly, the Department finds the record of this protest to be complete and closed, and the protest ripe for decision.

DISCUSSION

A. TAXPAYER'S ARGUMENT

The taxpayer makes general allegations in support of its protest that the Department should abate the penalty because it tries to follow the tax laws and regulations that the Department administers, and that the taxpayer has always filed its returns on time.

B. ANALYSIS

IC § 6-8.1-10-2.1(a)(1), (a)(3), (d) and (f) (1998) respectively read as follows:

(a) If a person:

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

…

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

…

the person is subject to a penalty.

…

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

…

(f) The department shall adopt rules under IC 4-22-2 [i.e., the Indiana Administrative Orders and Procedures Act] to prescribe the circumstances that constitute *reasonable cause* and *negligence* for purposes of this section.

Id (emphases added). Title 45 IAC § 15-11-2(b) (1996) (2001) defines "negligence." It 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. 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.

Id (emphases added).

The computational errors the taxpayer made appear to be the quintessence of "negligence" as the regulation defines it. Those mistakes indicate one of several possibilities. Either the taxpayer did not know the statutory and regulatory formulae it was applying, did not read (or did not follow, if it did read) the relevant instructions accompanying the Forms IT-20 for fiscal years 2000 and 2002, or was careless in applying the formulae. All of these circumstances are "negligence" as 45 IAC § 15-11-2(b) defines that word.

The taxpayer's generalized allegations of good faith efforts at compliance are not "reasonable cause" for abating negligence penalties. IC § 6-8.1-5-1(b) (1998) states in relevant part that "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Id.* That burden applies to abatement of penalty, as well as substantive tax, assessments. "A person who wishes to avoid the penalty imposed under [IC § 6-8.1-10-2.1(a) and (b) (1998)] must make an affirmative showing of all *facts* alleged as a reasonable cause for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust[.]" IC § 6-8.1-10-2.1(e) (emphasis added). *See also* 45 IAC § 15-11-2(c) (requiring a taxpayer to "affirmatively establish[,]" *id.*, specifying the standard for the existence of, and enumerating the factors that may be considered in determining the presence or absence of, reasonable cause). The taxpayer has made no factual showing of any kind, let alone one that would constitute "reasonable cause."

The taxpayer's further allegation that it has filed all its Indiana tax returns on time is irrelevant. IC § 6-8.1-10-2.1(a) (1998) sets out the circumstances under which a person is subject to a penalty. As quoted above, paragraphs (1) and (3) of this subsection draw a clear distinction between failing to file a return and incurring a deficiency upon examination that is due to negligence, respectively. The penalties the Department has proposed to assess against the taxpayer are of the latter, not the former, type. Thus, any allegation or evidence of timely filing of returns would have no tendency to prove or disprove that the calculations it made in preparing those returns was negligent.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010066.SLOF

SUPPLEMENTAL LETTER OF FINDINGS: 01-0066SLOF
Indiana Corporate Income Tax
For the Years 1993, 1994, and 1995

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

ISSUE

I. Reimbursement of Intracompany Expenses – Gross Income Tax.

Authority: IC 6-2.1-1-2(a); IC 6-2.1-1-11; IC 6-2.1-2-2; IC 6-2.1-2-2(a)(2); 45 IAC 1-1-9; 45 IAC 1-1-10; 45 IAC 1.1-1-5.

Taxpayer argues that the audit review improperly included, as amounts subject to gross income tax, intracompany transfers of expenses.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of developing, manufacturing, and selling items related to automobiles, defense, electronics, and "fluid technologies." Taxpayer has manufacturing facilities located in Indiana. The Department of Revenue (Department) conducted an audit review of taxpayer's business records and tax returns. The Department's review resulted in the assessment of additional corporate income tax for 1993, 1994, and 1995. Taxpayer disagreed with a number of the assessments and submitted a protest to that effect. An administrative hearing was conducted, and a Letter of Findings was issued. Taxpayer challenged the conclusions contained within the Letter of Findings and requested a rehearing. The Department agreed with the taxpayer's request, a rehearing was conducted, and this Supplemental Letter of Findings results.

DISCUSSION

I. Reimbursement of Intracompany Expenses – Gross Income Tax.

Taxpayer argues that the audit review erred when it determined that certain transfers of expenses and reimbursements were subject to gross income tax. Taxpayer maintains that these reimbursements were merely "phantom payments," that no money was received from outside sources, and that the reimbursements were simply an intracompany reallocation of expenses initially incurred by one particular operating group and allocated among its various divisions and subdivisions.

Taxpayer describes these particular transactions as follows: In operating its business, taxpayer incurs a particular expense. For example, taxpayer incurs $100 in legal costs. Taxpayer then determines which of its three major divisions is responsible for the $100 expense. Taxpayer may decide that the $100 expense is attributable to major division one, two, or three. After making the decision, taxpayer charges that particular major division for the $100. Shortly thereafter, that major division will make a $100 book-entry reimbursement to taxpayer. As taxpayer describes this process, no money ever changes hands. The charges and reimbursements do not represent money received from outside parties. According to taxpayer, the system is simply an accounting procedure by which each of the major divisions is held responsible for the cost of performing some service. In the example cited, one of the major divisions was the particular entity which was "charged" with the $100 legal expense.

Similarly, the charge and reimbursement system functions at the major division / subdivision level. One of the major divisions incurs a certain expense. For example, major division one incurs a $200 advertising expense. Major division one then determines that this particular expense is attributable to two of the sub-divisions operating within that major division; it determines that subdivision "A" is responsible for $50 of the advertising expense, and subdivision "B" is responsible for the remaining $150. Major division one "charges" these two subdivisions the apportioned costs, the two subdivisions make a book-entry "reimbursement" for the cost, and – according to taxpayer's description – the original $200 expense is properly apportioned between the two subdivisions actually responsible for the advertising cost.

It is taxpayer's contention that all of these reimbursements are merely "phantom payments" and do not represent the receipt of actual money. Because, according to taxpayer, all of these phantom book entries are merely accounting fictions, the audit's decision to find that the "reimbursements" are subject to gross income tax is erroneous.

Under the provisions of IC 6-2.1-2-2, the state's gross income tax is imposed 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 a domiciliary of Indiana." IC 6-2.1-2-2(a)(2).

"Gross income" is defined at IC 6-2.1-1-2(a) which states, in part, that "Except as expressly provided in this article, 'gross income" means all the gross receipts a taxpayer receives: (1) from trades, businesses, or commerce... and (10) from any other source not specifically defined in this subsection." "Receives" is defined at IC 6-2.1-1-11 which states that "'Receives', as applied to a taxpayer, means (1) the actual coming into possession of, or the crediting to, the taxpayer, of gross income; or (2) the payment of the taxpayer's expenses, debts, or other obligations by a third party for the taxpayer's direct benefit." Id.

The Department's regulation defines those instances in which a taxpayer receives income subject to the gross income tax. 45

IAC 1-1-9 (1979) states that, "'[R]eceived' means either the actual coming into possession of gross income by the taxpayer or the crediting to him of gross income." *See* 45 IAC 1.1-1-5 (1999). The regulation further states that, "It is not necessary for gross income to actually come into the taxpayer's possession to be his gross income. Whenever gross income is 'received' in any manner other than by actual possession, gross income is considered to be 'constructively received.'" Id. The regulation defines " 'Constructive receipts' [as] those items of gross income which are not actually received by the taxpayer but which are credited to him, available for his withdrawal, paid to another for his benefit, or represent income to which he is entitled." 45 IAC 1-1-10 (1978); *See* 45 IAC 1.1-1-5 (1999).

If taxpayer were simply moving money from one corporate pocket into another, taxpayer's argument would merit consideration because such strictly intra-company transactions would be entirely transparent for gross income tax purposes. However, on taxpayer's corresponding federal tax returns these purportedly intra-company reimbursements were reflected on line 26 of the federal form for "Other Deductions." These identical reimbursements were shown on the federal form as a credit labeled "Rent, Services, and Other Overhead Items" on the schedule of "Other Deductions" attached to the original federal return supporting the line 26 "Other Deductions." With all due respect to taxpayer's internal accounting procedures, taxpayer's argument appears to be at odds with how these amounts were treated for federal tax purposes; taxpayer's treatment of these particular amounts on its federal return is inconsistent with its contention that the transfer of these amounts has no state gross income tax effect. If these amounts were in fact merely intra-company reallocations of expenses, the expense reallocations would not be reported on the corresponding federal tax return as a credit to "Other Deductions."

FINDING

Taxpayer's protest is respectfully denied.