INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT
Office of Land Quality
100 North Senate Avenue
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Title: Methyl-Tertiary Butyl Ether (MTBE) Remediation
Identification Number: WASTE-0055-NPD
Date Originally Effective: March 17, 2005
Dates Revised: None
Other Policies Repealed or Amended: None
Brief Description of Subject Matter: This document addresses Remediation and Closure Levels for Methyl-Tertiary Butyl Ether (MTBE), a common additive to gasoline.
Citations Affected: IC 13-23-13; IC 13-24-1; IC 13-25-4; IC 13-25-5

This nonrule policy document is intended solely as guidance and does not have the effect of law or represent formal Indiana Department of Environmental Management (IDEM) decisions or final actions. This nonrule policy document shall be used in conjunction with applicable laws. It does not replace applicable laws, and if it conflicts with these laws, the laws shall control. This nonrule policy document may be put into effect by IDEM thirty days after presentation to the appropriate board. Pursuant to IC 13-14-1-11.5, this policy will be available for public inspection for at least forty-five (45) days prior to presentation to the appropriate board. If the nonrule policy is presented to more than one board, it will be effective thirty days after presentation to the last. IDEM will submit the policy to the Indiana Register for publication. Revisions to the policy will follow the same procedure of presentation to the board and publication.

Background

Methyl-Tertiary Butyl Ether (MTBE) is a common additive to gasoline, particularly in areas where smog and ozone are health concerns. It is an octane enhancing replacement for lead and used as an oxygenate to lower motor vehicle emissions by reducing the need for benzene, a known carcinogen and ozone precursor. MTBE concentrations in enhanced or re-engineered gasoline, generally ranges from 3 to 15 percent by volume. Due to cross mixing of products in storage, distribution and transportation, MTBE can be found in virtually all petroleum products. Releases of gasoline and other petroleum products are common, mainly occurring through leaking underground storage tank releases and spills.

MTBE is considered by the U.S. Environmental Protection Agency (EPA) to be a potential human carcinogen. The EPA is evaluating carcinogenic information on this additive and will be performing additional research on the risk to humans. CERCLA lists MTBE as a hazardous substance. Since MTBE is more soluble than other petroleum hydrocarbons, MTBE is usually out in front or downgradient of the main body of a groundwater plume of gasoline. Therefore areas with drinking water wells present are more susceptible to MTBE impacts than from the other gasoline constituents. While the EPA considers establishing a Maximum Contaminant Level (MCL), they have issued a drinking water advisory of 40 parts per billion (ppb) for MTBE intake. This level is below a taste/odor threshold for a majority of the population. This drinking water advisory concentration will likely protect consumers from potential health effects.

Policy Statement

The Indiana Department of Environmental Management has established default risk-based site cleanup/closure levels for the gasoline additive MTBE. The following default levels apply to sites per their land use determination as Residential or Industrial.

	Soil	**Groundwater**
Residential	0.18 ppm	40 ppb
Industrial	3.9 ppm	870 ppb

ppm = parts per million
ppb = parts per billion

The use of a risk-based approach for the cleanup of MTBE provides environmental and human health benefits for the citizens of Indiana. This policy protects the drinking waters of the state by establishing soil levels that will not allow MTBE to have an adverse effect on groundwater while setting a drinking water level which protects against adverse taste and odor effects. This policy meets the regulatory mandate that IDEM use a risk-based approach to cleanup. This is not a significant departure from the way the Leaking Underground Storage Tank Program and the Excess Liability Fund (ELF) Program currently deal with MTBE issues. The cost of delineating MTBE is an eligible reimbursable expense under the ELF Program. This policy will only affect sites that have a release of gasoline with MTBE present.

Implementation

All sites with gasoline releases should delineate for the constituent MTBE regardless of whether closing using IDEM's RISC (Risk Integrated System of Closure) Program (February 2001) including the RISC Technical Resource Guidance Document, Appendix I, July 2004 updates or the Underground Storage Tank (UST) Guidance Manual (October 1994) criteria. Delineation should be to the RISC Residential levels both on- and off-site.

For sites using the RISC program for closure, in a situation where surrounding properties are a mixture of Residential and Industrial the most protective numbers will apply (Residential) for both soils and groundwater. However, industrial levels may be used if the MTBE is confined to the Industrial property where the release occurred and it can be shown that the plume is stable and/or shrinking. Non-default RISC closure where site specific issues can be addressed is also an option.

For sites using the UST Guidance Manual criteria to close a site, MTBE needs to be delineated in the groundwater only. The RISC Residential groundwater numbers apply. The UST Guidance Manual does not allow for differences between residential and industrial land uses.

For sites where a Corrective Action Plan has already been approved as of the effective date of this policy, the responsible party will not be required to go back and delineate MTBE unless there is potential impact to a receptor (such as a private or public drinking water wells and/or vapors in structures or other impact). Sites that have been issued a No Further Action (NFA) letter for closure of a site will not be reopened unless MTBE contamination is discovered at a receptor (such as a private or public drinking water well and/or vapors in structures or other impact) and the site is the probable cause of that contamination. An exposure issue must be confirmed before IDEM will require the responsible party to provide further delineation for the closed sites.

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Title: Methane Monitoring Program
Identification Number: WASTE-0056-NPD
Date Originally Effective: March 17, 2005
Dates Revised: None
Other Policies Repealed or Amended: Enclosure D1 Guidance
Citations Affected: 329 IAC 10-20-17
Brief Description of Subject Matter: In accordance with the Solid Waste Rule 329 IAC 10-20-17, the owner, operator, or permittee of a municipal solid waste landfill (MSWLF) is required to monitor and control the landfill gas generated by their site to prevent methane concentrations from exceeding 25% of the lower explosive limit for methane in MSWLF structures, and the lower explosive limit for methane at the facility boundary. This document provides guidance for content, design considerations, and specifications that should be included in a Methane Monitoring Program.

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Methane Monitoring Program

In accordance with the Solid Waste Rule 329 IAC 10-20-17, the owner, operator, or permittee of a municipal solid waste landfill (MSWLF) is required to monitor and control the landfill gas generated by their site to prevent methane concentrations from exceeding 25% of the lower explosive limit for methane in MSWLF structures, and the lower explosive limit for methane at the facility boundary. This document provides guidance for content, design considerations, and specifications that will satisfy the commissioner that a Methane Monitoring Program proposal complies with 329 IAC 10-20-17.

This nonrule policy document will be utilized during the commissioner's review of Methane Monitoring Program proposals submitted as required by the Solid Waste Rule for new sites and site expansions. The commissioner shall approve alternatives to the final design as outlined in this guidance if they are demonstrated, to the satisfaction of the commissioner, to provide at least the equivalent protection to human health and the environment. Currently approved Methane Monitoring Programs may continue as approved unless it is determined that the program is ineffective due to physical evidence of gas migration or geological conditions that warrant revision based on 329 IAC 10-20-17(c). Revisions to current Methane Monitoring Programs will follow this guidance only as it is directly supported by the Rule.

Much of the geological information requested in this guidance is available in the site hydrostudy submitted in the permit application under 329 IAC 10-15-4, in subsequent boring information and in the results of the regular ground water sampling.

Policy Standards for Landfill Methane Monitoring Programs

329 IAC 10-20-17(b) requires MSWLFs to prepare, propose for the commissioner's approval, and implement an approved

routine Methane Monitoring Program. The proposal for a facility Methane Monitoring Program should include the following:

1. Facility Conditions

329 IAC 10-20-17(c) requires that the type and frequency of methane monitoring be based on the facility's structural and geological conditions. Conditions applicable to the design of the methane monitoring system should be included in the proposal as follows:

1.1 A narrative describing the following landfill conditions:

a. Maximum depth of landfill and/or waste;

b. Description of the bottom liner design components;

c. Activities and/or practices that might increase or decrease production of landfill gas;

d. The current condition of the facility as it relates to gas and gas-migration related stress including current gas venting spots and leachate seeps on-site and off-site; and

e. A general description and location of any devices currently in-place that are designed to vent landfill gas from the soil or from the waste.

1.2 A narrative with plans and charts describing the following geological conditions:

a. Time versus water level graphs of the uppermost aquifer using all available data collected from the ground water monitoring well system;

b. Determination of stratigraphic target zones for the installation of gas probes;

c. Plans depicting locations where such target zones might provide natural venting of gas (such as cut-banks and borrow-pits); and

d. Geologic cross-sections depicting stratigraphic layers and their predicted role in aiding or preventing gas migration both vertically and laterally. The greatest depth of the liner and waste placement should be indicated on the cross-section.

2. MSWLF Structures

329 IAC 10-20-17(a)(1) requires the facility to measure methane gas in MSWLF structures, excluding gas control, leachate collection manholes, or recovery system components.

The Methane Monitoring Program proposal should include the following information:

2.1 A narrative describing the method of methane measurement including:

a. Equipment used;

b. Procedures of structure monitoring; and

c. A plan including the identification of all applicable structures.

3. Facility Boundary

329 IAC 10-20-17(a)(2) requires the facility to ensure that sub-surface methane gas at the facility boundary does not exceed 100% of the lower explosive limit (LEL) of methane (5%). The facility may make this assurance under one of two systems: Early Warning or Perimeter. A detection in an early warning system allows the facility time to react prior to a violation, while a perimeter system detection automatically triggers a violation. The facility may opt for a mixture of both systems of testing locations within a Methane Monitoring Program. The Methane Monitoring Program should include the following considerations:

3.1 Testing locations under a perimeter system are designed to determine whether gas is migrating across the facility boundary and therefore need to be placed as close as practicable to the facility boundary but not more than fifty (50) feet inside the facility boundary. A detection over the LEL will be considered a transgression of methane across the facility boundary and therefore a violation of 329 IAC 10-20-17(a)(2).

3.2 Testing locations under an early warning system should be as close as possible to the solid waste boundary, however any well between the solid waste boundary and fifty (50) feet from the facility boundary should be considered early warning testing locations.

3.3 All facility boundary testing locations should be spaced on the schedule below. MSWLF structures that are subject to 329 IAC 10-20-17(a)(1) are not intended to be considered in these spacing guidelines.

a. Every 100 feet when occupied buildings, or enclosed non-vented structures, are located at or within 600 feet of the solid waste boundary.

b. Every 300 feet when occupied buildings, or enclosed non-vented structures, are located between 600 and 1,200 feet of the solid waste boundary.

c. Every 1,000 feet when occupied buildings, or enclosed non-vented structures, are located greater than 1,200 feet of the solid waste boundary.

d. The number of permanent probes may be increased or the distance between the probes reduced based on factors such as:

1. Evidence of active gas migration;
2. Absence of bottom liner; or
3. Presence of frequent unconnected or poorly connected conduit zones.

e. The number of permanent probes may be decreased or the distance between the probes expanded based on factors such as:

1. Topographic barriers to methane migration such as ditches and borrow areas that completely expose the target zones

identified in 1.2; or

2. Reducing the circumference of the monitoring boundary by utilizing an early warning system as described in 3.2.

3.4 329 IAC 10-20-17(c) requires the facility to consider the geology of the site to determine gas migration. Generally, this will require a permanent probe at each test location capable of accessing soil gas at depths identified in 1.2.

3.5 329 IAC 10-21-4 should be used as a general guideline for gas probe installation. While this regulation pertains to ground water monitoring wells, the construction and reporting requirements are similar to gas probes. The major exception is 329 IAC 10-21-4(c)(5)(C), which limits screen length. In the case of gas probes, screen lengths should be specified and justified. IDEM prefers probe screen lengths to be as long as possible, though geological conditions may require specific adjustments.

3.6 The installation of permanent probes may be phased to coincide with cell construction provided the facility has interim measures in place and the approval of IDEM.

3.7 The testing location proposal should include landfill topographic plot plans clearly delineating the following on a scaled map as required by 329 IAC 10-11-2.5 and 329 IAC 10-15-2. Items requested below not applicable to the facility should be noted as such in the text or on the plan.

a. Enclosed structures located on-site or within twelve hundred (1,200) feet of the facility's solid waste boundary (As required in 329 IAC 10-11-2.5(a)(9)(B));

b. Solid waste, facility, and property boundaries (As required in 329 IAC 10-15-2(b));

c. Location of proposed gas monitoring probes (As required in 329 IAC 10-15-2(d)(1)(G));

d. Possible methane gas passageways identified such as utility lines, pipes, railroads, mines, field tiles, storm sewers, water lines, electric cables, and sand and/or gravel seams located within one hundred (100) feet of the solid waste boundary of the facility. Such items may be found on the map required in 329 IAC 10-11-2.5(a)(9).

3.8 The Methane Monitoring Program proposal should include a description of the system for measuring the methane gas concentration including:

a. Gas probe installation procedures;

b. Construction materials and methods;

c. Design of probe and/or probe cluster;

d. Gas probe schedule including the total length of the probe, length of the riser, and length and depth range of the screened interval, for all probes.

**Please be aware that, depending on the method chosen for installing permanent probes, the Department of Natural Resources may require borehole drillers to be certified per 312 IAC 13.*

3.9 Testing methods, at each location, should be capable of monitoring methane:

a. At elevations capable of detecting migrating gas at depths across the targeted zones identified in 1.2;

b. In identified natural methane gas migration zones such as sand and/or gravel seams and open karst conduits located within one hundred (100) feet of the solid waste boundary of the facility;

c. Near sensitive methane gas migration zones such as utility lines, and pipes located within one hundred (100) feet of the solid waste boundary of the facility; and

d. At locations where a single screen might provide cross-contamination of perched ground water into an unsaturated zone below, the facility needs to propose a system of dealing with multiple unsaturated zones. Such a proposal should be developed in consultation with the IDEM Geology Section.

3.10 Additional probes might be needed after a Methane Monitoring Program is approved if evidence of gas migration is found through other means. (Ground water indications of gas migration can include volatile organic compounds and select inorganic compounds in ground water analysis results. Gas might also vent from ground water wells partially screened in unsaturated soils. Gas presence within the ground water well risers should be reported to IDEM based on 329 IAC 10-21-1(f). A facility could be put into an unnecessary ground water corrective action when a replacement well is more warranted.)

3.11 The installation of any device designed to vent landfill gas from the soil should be done in consultation with IDEM. Additional, or replacement, probes may be needed after a Methane Monitoring Program is approved if the function of a detection probe is impaired by nearby soil-gas venting.

4. Monitoring

329 IAC 10-20-17(c) requires a determination of type and frequency of methane monitoring. The Methane Monitoring Program should include collection method and quality control of landfill gas monitoring data as follows:

4.1 A description of the methods and equipment used to measure the concentration of methane at the landfill. The description should include procedures to ensure minimal air intrusion, calibration check, and employee and public safety. The equipment must be capable of measuring methane gas. It is preferred that oxygen and carbon dioxide percentages also be measured.

4.2 A sample of the form used to record data that includes the following field information:

a. Analyst name;

b. Gas instrument used;

c. Calibration information;

d. Date of monitoring event;

e. Water level (if applicable);
f. Name of probe and time monitored;
g. Methane concentration (in either percent gas, or percent LEL); and
h. Oxygen and carbon dioxide percentages (if available).

4.3 Methane monitoring should be done:
a. Using permanent probes located around the perimeter of the facility;
b. In all enclosed structures located at or within one hundred (100) feet of the solid waste boundary; and
c. On a quarterly basis unless the site location and the initial methane gas concentration levels dictate a more frequent monitoring schedule.

4.4 Measurements taken within the top few feet of the ground surface have typically proven to be an ineffective measurement of landfill gas migration. Such methods might not take the hydrogeologic conditions into account as is required in 329 IAC 10-20-17(c).

5. <u>Contingency</u>

329 IAC 10-20-17(d) requires an MSWLF facility to follow a schedule of remedial measures if methane gas criteria are exceeded. The Methane Monitoring Program should include a contingency plan, as required in all current permits, that allows the facility to follow pre-developed steps for the initial response to a violation of gas criteria. This general remedial contingency plan should be designed to be performed without acquiring formal approval of a modification to the permit. Performance of any such remedial work should be done in consultation with the Geology Section. Completion of an approved contingency plan should satisfy the implementation portion of 329 IAC 10-20-17(d)(4). The Methane Monitoring Program should include an explanation of how the facility will comply with 329 IAC 10-20-17(d) with a contingency plan including the items in 5.1 and 5.2 below:

5.1 Notification information including:
a. A list of property owners and residences immediately adjacent to the facility boundary;
b. Criteria for notifying residents and owners of property that may be impacted by migrating gas;
c. Location and contact information of the local fire department;
d. Criteria for notifying the local fire department of a potential explosive gas threat;
e. Name, phone number, and e-mail of IDEM contact personnel (either the site-assigned Geologist or the Geology Section Chief) and how they will be contacted in compliance with 329 IAC 10-20-17(d)(2).

5.2 A general narrative including:
a. Immediate actions that might be taken to protect human health from uncontrolled landfill gas as required under 329 IAC 10-20-17(d)(1). This is meant to be a very general discussion, or list, that will be used as a starting point for consultation with the IDEM Geology Section in the event of an exceedance.
b. Methods that will be used to determine the nature and extent of the problem as required under 329 IAC 10-20-17(d)(4). Any delineation of a gas migration plume should be established through supplemental sampling of soil gas from the same zone where the problem was first established.
c. Criteria to be used to determine whether additional investigation is necessary;
d. Criteria to be used to determine whether additional remedial action is necessary;
e. Criteria to be used to determine when a remedial action is deemed finished.
f. A schedule for the development of remedial investigation including:
1. Nature and extent of a problem;
2. The proposed remedy;
3. Historical sampling results for use in comparison; and
4. Methods to measure the effectiveness of the remedial action.

5.3 If the methane limits specified in 329 IAC 10-20-17(a) are exceeded:
a. The contingency plan should be implemented immediately and with consultation with the Geology Section;
b. Work done in compliance with the contingency plan must be compiled and placed in the operating record as per 329 IAC 10-20-17(d)(4) including the nature and extent determination and a proposed remedy within sixty (60) days of the detection;
c. The Geology Section must be notified that the work has been done as per 329 IAC 10-20-17(d)(4) along with the determination whether additional investigation and remediation will be necessary;
d. Completion of the work done in compliance with the approved contingency plan, including 5.1 and 5.2, should satisfy the implementation portion of 329 IAC 10-20-17(d)(4).
e. To comply with the remedy proposal portion of 329 IAC 10-20-17(d)(4), please see Section 6 below.

5.4 Facilities with early warning systems, as described under 3.2, should include contingency plans specific to the system design. Such contingencies may include:
a. The installation of sentinel probes, with the consultation of IDEM Geology Section, at the point nearest to the facility boundary from the well that has detected;
b. A step-out system of probes toward the facility boundary to demonstrate that gas does not migrate to the facility boundary; or

c. Installation of a remedial measure to cease additional gas migration.

6. Remedy Proposal

329 IAC 10-20-17(d)(4) requires a facility to propose a remedy within sixty (60) days of detecting levels of methane that exceed the limits defined in 329 IAC 10-20-17(a). The proposal that is inserted in the facility operating record should include both the work that has already been done, and any additional work that is deemed necessary. In the event that remediation tactics are ineffective and probe concentrations continue to exceed the regulatory limits of 329 IAC 10-20-17 for two quarters of monitoring, a gas venting system or a gas extraction system proposal for the facility should be submitted to IDEM for review. For more information on landfill gas venting systems, refer to the IDEM guidance document entitled "Methane Gas Venting System"

7. Probe Maintenance

329 IAC 10-20-17(b) requires the Methane Monitoring Program to be a long-term routine program. Monitoring devices should be properly protected and maintained to ensure continued compliance with the approved Methane Monitoring Program. Owing to time constraints between monitoring events, submittal of the plans and details of repairs and replacements of monitoring devices in the approved Methane Monitoring Program due to accidental damage may be done after the work is completed as allowed under 329 IAC 10-3-3(b).

7.1 If a probe is damaged, it should be fixed or replaced before the next monitoring event.

7.2 If a gas probe is damaged beyond repair, the probe should be properly abandoned and a replacement probe be installed within ten (10) feet of the original. A description of the work done should be submitted as part of the approved Methane Monitoring Program. A probe will automatically be considered 'replaced' if it is installed within ten (10) feet of the original. If it is installed farther than ten (10) feet from the original, it will be considered a relocation, and a modification under 329 IAC 10-3-3(c), unless the new location is approved as a replacement by the Geology Section.

7.3 Abandonment procedures should follow 329 IAC 10-21-1(i). A description of the abandonment procedure should be submitted as part of the approved Methane Monitoring Program.

8. Modifications

Changes in an approved Methane Monitoring Program are, in effect, a modification to the permit. A change in the program may be prompted by such things as facility activities requiring probes to be relocated or any remedial work required under 329 IAC 10-20-17 (d). Any change to the Methane Monitoring Program, excluding maintenance, repair or replacement, must be submitted to IDEM prior to implementation under 329 IAC 10-3-3.

9. Reporting

9.1 A Methane Monitoring Program is required (329 IAC 10-20-17(b)(1)) to be submitted, per the schedule devised in the facility permit, for approval prior to implementation and should include the information described in this document.

9.2 An As-Built Report will be required, as part of the pre-operational conditions of applicable solid waste permits. An as-Built Report for an approved revision to a Methane Monitoring Program needs to be submitted sixty (60) days after the implementation of the revision. This report should include such information that is gathered during the implementation of the Methane Monitoring Plan such as: probe construction, boring logs and a brief narrative, with geological cross-sections, on the probable interconnection between the screened interval of each probe and the zones targeted for screening in the Plan under 1.2.

9.3 Quarterly data are required (329 IAC 10-20-8(a)(10)) to be compiled and stored in the facility operating record. The Commissioner may request submittal or inspection of these data at any time (329 IAC 10-20-8(b)). Information in the quarterly data should include the items listed in 4.2.

9.4 Compilation of exceeding data and steps taken to protect human health are required by 329 IAC 10-20-17(d)(3) to be placed in the operating record within seven (7) days of a gas exceedance.

9.5 Within sixty (60) days of a detection of greater than 25% LEL (1.25% methane gas) in MSWLF structures or 100% LEL (5% methane gas) at the facility boundary, 329 IAC 10-20-17(d)(4) requires the following:

a. Implementation of a remediation plan that must include the nature and extent of the problem and the proposed remedy. The remediation plan should include any work done in performance of the contingency plan and a proposal for any additional work that is deemed necessary to prevent additional violations.

b. A copy of the remediation plan must be inserted into the facility operating record.

c. Notification to the Commissioner that the remediation has been implemented. Notification should be in the form of a document outlining the work done, in consultation with IDEM Geology Section, and include a proposal for any additional work deemed necessary

9.6 Implementation of any remediation plan required under 329 IAC 10-20-17(d)(4) is considered a change to, or revision of, the Methane Monitoring Program and therefore a modification to the permit under 329 IAC 10-3-3. Items that require expediency to protect human health and the environment may be approved verbally, and in consultation, with the IDEM Geology Section until a formal revision of the Methane Monitoring Program can be compiled and submitted for approval.

For questions regarding this guidance contact Thomas Brown at 317/233-6540.

INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT
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Title: Sampling and Analysis of Ground Water for Metals at Remediation Sites
Identification Number: WASTE-0057-NPD
Date Originally Effective: March 17, 2005
Dates Revised: None
Other Policies Repealed or Amended: None
Brief Description of Subject Matter: Provides background information for using unfiltered ground water sampling for metals at remediation sites, also, outlines the ground water sampling methods for water supply wells, monitoring wells and boreholes. Guidance applies to those sites being remediated under the following programs in the Remediation Services Branch of the Office of Land Quality: Voluntary Remediation Program, Leaking Underground Storage Tanks, Federal Cleanup Programs, State Cleanup Programs, RCRA Corrective Action, and Site Assessments & Brownfields as well as Environmental Emergency Responses. This guidance does not apply to those sites in the Solid Waste Permits or Hazardous Waste Permits programs.
Citations Affected: 40 CFR 264, Subpart F, as incorporated by reference in 329 IAC 3-1-9

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Sampling and Analysis of Ground Water for Metals at Remediation Sites

INTRODUCTION:

Over the years there has been debate regarding the merits of using filtered vs. non-filtered samples for the analysis of metals in ground water. The primary considerations are: the turbidity of a sample; the type of well (*e.g.* drinking water vs. monitoring well vs. direct push); and whether total or dissolved metals are the parameters of concern, *e.g.* monitoring for health risk vs. leak detection.

This guidance briefly provides background information for using unfiltered ground water sampling for metals at remediation sites. It then outlines the ground water sampling methods for water supply wells, monitoring wells and boreholes. This guidance applies to those sites being remediated under the following programs in the Remediation Services Branch of the Office of Land Quality: Voluntary Remediation Program, Leaking Underground Storage Tanks, Federal Cleanup Programs, State Cleanup Programs, RCRA Corrective Action, and Site Assessments & Brownfields as well as Environmental Emergency Responses. This guidance does not apply to those sites in the Solid Waste Permits or Hazardous Waste Permits programs.

BACKGROUND:

Historically, ground water samples have been filtered as a means of excluding naturally occurring metals and non-mobile organics that were sorbed to aquifer matrix elements (*i.e.* suspended solids, colloids, *etc*.), and to ensure that only site-related inorganic contaminants were evaluated. A growing body of evidence indicates that sample filtration may not achieve this goal, and may instead alter the characteristics of site-related hazardous constituents in a ground water sample.

Sample agitation, aeration, and rapid purge and sample rates, which exceed 1.0 liter/minute or cause a drawdown of more than 0.3 feet, may induce physical and chemical changes in a sample. These changes may include induced turbidity, exposure of fresh suspended sorptive surfaces (capable of adsorbing dissolved contaminants), mixing (may cause dilution), oxidation, and other changes in metal speciation. Any of these could affect sample analysis in the laboratory (Luftig, 2003).

Proper sampling techniques minimizes induced turbidity and the need for filtering and, thus, does not alter the sample. Filtration may cause a number of unintended changes (oxidation, aeration, etc.) to occur by introducing artifacts to the analytical results, which may be misleading (Puls and Barcelona, 1996). Filtering a ground water sample may remove contaminants that exist in the dissolved and mobile phase or remove colloidal particles that are known to be mobile in certain ground water conditions and may be important to the transport of hydrophobic contaminants and metals. The resulting sample analysis will produce false negatives and not accurately reflect the true concentrations for these contaminants. In comparison, proper sampling techniques that minimize stress to the well/aquifer interface should achieve acceptably low levels of induced turbidity without the risk of altering the sample by filtering (Luftig, 2003). USEPA and several states recommend testing unfiltered ground water samples for metals (USEPA, 1992). The analysis of filtered samples for ground water without also including the analysis of unfiltered (totals) samples is rarely considered acceptable (USEPA, 1998).

Filtration cannot correct improper sampling technique nor is it a “cure” for improperly built/developed wells that produce turbid samples (O’Toole, 1988). As a result, sample filtration is an unacceptable alternative to proper sampling methods.

GROUND WATER SAMPLING AT REMEDIATION SITES:
Sampling Considerations

The following minimum conditions should be met to ensure that ground water samples are representative and of sufficient quality for the intended data use.

1. The sample location is in the appropriate area;
2. The sample comes from the appropriate depth;
3. If taken from a well, the well is properly constructed according to 312 IAC 13;
4. If taken from a well, the is well properly developed according to 312 IAC 13; and
5. The sampling method will yield a representative sample.

Water Supply Well Sampling Methodology (Metals)

Conditions 1 through 4 may be unknown or uncertain when sampling an existing water supply well. One certainty, though, is people, plants, and/or animals are in contact with or drinking the water from that well. To obtain a representative ground water sample in this situation:

1. If there is an aerator at the sampling point, remove it.
2. Either shut down or bypass treatment systems (*e.g.* softener, reverse osmosis, carbon filtration, *etc)*.
3. Completely purge the storage tank until fresh ground water comes from the tap. This may take several minutes, depending on the volume of the storage tank and flow rate. Typically a fifteen-minute purge time is utilized.
4. Collect the sample and preserve (acidify) it without filtration.

Monitoring Well Sampling Methodology (Metals)

If conditions 1 through 4 can be met, then sampling may proceed. If one or more of the conditions is not met, then the well probably should not be used for ground water sampling, (however, the well may be suitable for other purposes, such as determining ground water elevation). Proper sampling technique involves gathering samples that more accurately represent the mobile composition of ground waters (Matanoski, and Murarka, 1997). Bailers increase turbidity while purging and sampling and should be avoided when sampling for metals (Yeskis and Zavala, 2002). Low-flow, low-stress purging and sampling (micro-purge sampling) has been shown to significantly reduce induced turbidity problems. This method may prove particularly valuable with low permeability sediments and highly turbid ground water (OLQ Geological Services, 2003). For example, micro-purge sampling was approved for a landfill in Indiana, with very high turbidity. The turbidity dropped from over 40,000 NTUs (nephelometric turbidity units) to 6 or less (OLQ Geological Services, 1998). A review of micro-purge sampling, listing advantages and disadvantages of the technique is on the web at: http://www.in.gov/idem/land/geology/pdf/micropurgereview.pdf

The complete text for using Micro-Purge Sampling for Monitoring Wells is on the web at: http://www.in.gov/idem/land/geology/pdf/micropurgesampling.pdf

Sometimes, a well may be properly installed, developed and sampled; yet turbidity is high. In this situation field-filtered samples may be taken but only in conjunction with unfiltered samples to determine if particle size and mobility affect the results. A large difference between unfiltered and filtered samples does not preclude the use of unfiltered data for risk assessment decisions (Puls and Barcelona, 1989).

Sample filtration may be used if the OLQ determines that conditions 1 through 4 are met and that micro-purge sampling does not reduce turbidity to <10 NTU (Yeskis and Zavala, 2002). (The project chemist should be consulted to determine if proper water quality screening and sampling techniques have been conducted. Also, the project geologist should be consulted to determine if proper well construction and development occurred). When filtration is necessary, a 10 mm in-line filter should be used to minimize contact with air and avoid metals precipitation (Yeskis and Zavala, 2002). This recommendation is similar to what other states suggest. Also, a filter pore size of 10 mm approximates the efficiency of a common household filter. The filter should be allowed to acclimate before a sample is collected. Approximately 500 to 1000 ml of water should pass through the filter (depending on manufacturer's recommendation) before a sample is collected and preserved. If volatile organic compounds are also to be collected, they should be collected first and metals last.

Other filter sizes may be appropriate but their usage should be predetermined based on several factors such as, grain-size distribution, ground water flow and velocity, mineralogy, and the project Data Quality Objectives (DQO). The changing of filter media pore size may limit the comparability of the data obtained with other data sets from a site, region, or aquifer and the DQOs should be taken into consideration (Yeskis and Zavala, 2002).

Borehole Sampling Methodology (Metals)

Boreholes should meet the first two conditions, (appropriate sample location and sample depth); however, they will probably not meet the conditions of proper construction and development. Nevertheless, the same considerations and procedures for monitoring well sampling and sample treatment should be followed. When sampling boreholes, particular care needs to be taken to ensure that samples do not include:

1. Drilling fluids;
2. Soil materials sloughed from upper horizons; and
3. Water or other fluids encountered in other zones during drilling (cross contamination).

Following these steps for micro-purge sampling should reduce the turbidity and, thus, the need for field filtration.

REFERENCES CITED

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INDIANA DEPARTMENT OF INSURANCE
March 3, 2005
Bulletin 128
NOTICE TO POLICYHOLDERS REGARDING
FILING COMPLAINTS WITH THE DEPARTMENT OF INSURANCE

This Bulletin is directed to all insurers issuing life, health, or personal lines property and casualty products, health maintenance organizations, and limited service health maintenance organizations doing business in the state of Indiana. Bulletin 63, issued on May 7, 1990, required a standardized notice to all existing policyholders about their right to file a complaint with the Indiana Department of Insurance. Thereafter insurers were required to provide the notice on all newly issued policies. The Department of Insurance has determined that the notice contained in Bulletin 63 is ambiguous and has resulted in confusion to policyholders as to when they should contact the insurance company and when they should contact the Department of Insurance. Therefore, the Department is revising the standard language to be as follows:

[in bold] Questions regarding your policy or coverage should be directed to:

[Company Name]
Contact number

[not in bold] If you (a) need the assistance of the governmental agency that regulates insurance; or (b) have a complaint you have been unable to resolve with your insurer you may contact the Department of Insurance by mail, telephone or email:

State of Indiana Department of Insurance
Consumer Services Division
311 West Washington Street, Suite 300
Indianapolis, Indiana 46204

Consumer Hotline: (800) 622-4461; (317) 232-2395

Complaints can be filed electronically at www.in.gov/idoi.

Bulletin 63 applied to insurance companies. This Bulletin specifically applies to all insurers, health maintenance organizations, and limited service health maintenance organizations.

This standardized language is required for policies issued or renewed 180 days after the issuance of this Bulletin. In order to fully comply with the bulletin each entity shall maintain a contact number for consumer inquiries.

INDIANA DEPARTMENT OF INSURANCE
James Atterholt

INDIANA DEPARTMENT OF INSURANCE
March 3, 2005
Bulletin 129
PATIENT'S COMPENSATION FUND
FILING AND PROCESSING FEES

This Bulletin is directed to all persons that file a Proposed Complaint for Damages under Indiana's Medical Malpractice Act, IC 34-18. IC 34-18-8-2 requires that each Proposed Complaint for Damages be accompanied by a filing fee in the amount of five dollars ($5) and a processing fee in the amount of two dollars ($2) for each defendant after the first named defendant. IC 34-18-9-1 requires the Commissioner to forward a copy of the Complaint by registered or certified mail to each health care provider named as a defendant. The filing and processing fees are intended to cover the Department's costs in accomplishing these tasks. While the statute does not specifically require the Department to serve all Amended Proposed Complaints on all health care providers, the Department has determined that it is appropriate to do so and has historically processed all Amended Proposed Complaints the same as the initial filing. The Department receives a significant number of Amended Proposed Complaints. In addition, there is often more than one defendant required to be served. In order to support the cost of serving these Amended Proposed Complaints the Department has determined that the filing and processing fees should be collected at the time of filing any amendment to a Proposed Complaint.

Therefore, effective May 1, 2005, all persons filing an amendment to a Proposed Complaint for Damages shall submit a filing fee in the amount of five dollars ($5) and a processing fee in the amount of two dollars ($2) for each defendant after the first named defendant. An Amended Proposed Complaint, as with the initial Proposed Complaint, shall not be considered filed with the Department until the filing and processing fees are received by the Department.

INDIANA DEPARTMENT OF INSURANCE
James Atterholt, Commissioner

DEPARTMENT OF STATE REVENUE

01980577.LOF

LETTER OF FINDINGS: 98-0577
Indiana Adjusted Gross Income Tax
For 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. Net Operating Losses – Adjusted Gross Income Tax.

Authority: IC 6-3-2-2.6; IC 6-8.1-5-1(b); 45 IAC 3.1-1-6; I.R.C. § 172(b)(1)(A)(ii); I.R.C. § 172(b)(3); I.R.C. § 172(c), (d); Treas. Reg. § 1.172-2; Treas. Reg. § 1.172-3.

Taxpayer argues that it was entitled to carry forward a net operating loss and that – as a result – taxpayer did not owe Indiana adjusted gross income tax for 1995.

STATEMENT OF FACTS

The Department of Revenue (Department) determined that taxpayer owed a delinquent state income tax liability for 1995, offset a year 2000 refund otherwise owed taxpayer, and sent taxpayer a notice to that effect. Taxpayer challenged the decision. Taxpayer did so on the ground that a net operating loss – carried forward from 1987 – more than compensated for any 1995 tax liability.

Taxpayer and the Department exchanged correspondence without resolving the matter. The unresolved issue was treated as a protest. Because taxpayer's representative declined the opportunity to take part in an administrative hearing, this Letter of Findings was written based upon the information contained within the Department's file and the correspondence furnished by taxpayer's representative.

DISCUSSION

I. Net Operating Losses – Adjusted Gross Income Tax.

According to taxpayer, her farm business incurred a net operating loss of approximately $200,000 in 1987. Taxpayer then carried forward the 1987 loss to 1988 entirely offsetting taxpayer's income received during that year. Taxpayer carried forward the "unused" portion of the loss to 1989 thereby offsetting the 1989 income. Because the original loss was substantial and the personal income received during each following year was comparatively small, the original net operating loss was carried forward again and again offsetting each subsequent year's income. Taxpayer repeated this process through 1995 after which nothing remained of the original $200,000 loss.

The Department's only challenge was to taxpayer's 1995 calculation. The Department requested documentation substantiating the source and nature of the 1987 loss. Taxpayer's representative supplied copies of the underlying federal return and copies of the taxpayer's state returns. The Department remained unsatisfied with the documentation supplied and the explanations offered.

Taxpayer's contention is that the 1987 net operating loss offset any potential 1995 tax liability. The rule governing net operating losses for individuals is found at 45 IAC 3.1-1-6 which states in part as follows:

> The following provisions pertain to the use of a Federal net operating loss deduction as it applies to an individual subject to the Indiana Adjusted Gross Income Tax Act. The amount of the net operating loss that may be carried back and forward for Indiana income tax purposes shall be that portion of the Federal net operating loss allocated to Indiana for the taxable year the operating loss is sustained.

Indiana treatment of individual net operating losses is governed by the provisions of the federal law concerning corporate net operating losses. IC 6-3-2-2.6. I.R.C. § 172(c), (d), defines a net operating loss as the excess in allowable deductions over gross income computer under the law in effect during the loss year. Treas. Reg. §§ 1.172-2; 1.172-3. This net operating loss (NOL) can be carried back and used as a deduction for the two years preceding the loss year. If some of the NOL has not been used up by the carryback, it is carried forward into the 20 years after the loss year and used as a deduction. I.R.C. § 172(b)(1)(A)(ii). Alternatively, taxpayer may elect to forgo the entire carryback period. I.R.C. § 172(b)(3). If this election is made, the loss will then be carried forward only.

Taxpayer has the responsibility to show that the 1995 income was offset by the serial carry forward of the 1987 NOL. IC 6-8.1-5-1(b) states that, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

The Department has no quarrel with taxpayer's calculations because the serial carry forward calculations appear to be correct. However, what is missing is any sort of explanation as to the manner in which the $200,000 was originally incurred or how that loss was calculated. The Department is left to speculate as to the nature and source of this loss. (What did taxpayer lose? How did taxpayer figure that it was worth $200,000?) The Department has no reason to doubt taxpayer's veracity or good intentions, but with nothing more to go on than taxpayer's repeated assurance that there *was* a $200,000 loss in 1987, the Department is unable to conclude that taxpayer has met her burden of demonstrating that the proposed assessment is incorrect.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04990511.LOF

LETTER OF FINDINGS NUMBER: 99-0511
Sales and Use Tax
For The Tax Period 1989-1998

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

ISSUES

I. Sales and Use Tax - Imposition

Authority: IC 6-2.5-2-1, IC 6-2.5-3-2 (a), IC 6-2.5-2 (c)(1), IC 6-8.1-5-1 (b), IC 6-8.1-5-4.

The taxpayer protests the assessment of sales and use tax.

II. Tax Administration – Fraud Penalty

Authority: IC 6-8.1-10-4 (a), 45 IAC 15-11-4.

The taxpayer protests the imposition of the fraud penalty.

STATEMENT OF FACTS

The taxpayer is the sole proprietor and operator of a body repair shop. In addition to revenue from repairing cars, taxpayer also purchases wrecked vehicles to repair and repaint. He then sells the repaired cars on a consignment basis from a local car lot. 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 sales tax assessment and the penalty. A hearing was held and this Letter of Findings results.

I. Sales and Use Tax -Imposition

DISCUSSION

Indiana imposes a sales tax on the transfer of tangible personal property in a retail transaction. IC 6-2.5-2-1. Indiana imposes a complementary excise tax, the use tax, on tangible personal property purchased in a retail transaction and stored, used, or consumed in Indiana. IC 6-2.5-3-2 (a). Payment of sales tax at the time of purchase exempts the use of tangible personal property from the use tax. IC 6-2.5-2(c)(1).

Pursuant to IC 6-8.1-5-1(b), all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. Taxpayers have a statutory duty to keep records as set out at IC 6-8.1-5-4 as follows:

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

The taxpayer did not submit any documentation to substantiate his claim that the department's assessment was inaccurate. Therefore, the taxpayer did not sustain his burden of proof.

FINDING

The taxpayer's protests to the assessments of sales and use tax are denied.

II. Tax Administration – Fraud Penalty

DISCUSSION

The department assessed the one hundred percent (100%) fraud penalty pursuant to the provisions of IC 6-8.1-10-4 (a) as follows:

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

This penalty is further explained at 45 IAC 15-11-4 as follows:

The penalty for failure to file a return or to make full payment with that return with the fraudulent intent of evading the tax is one hundred percent (100%) of the tax owing. Fraudulent intent encompasses the making of a misrepresentation of a material fact which is known to be false, or believed not to be true in order to evade taxes. Negligence, whether slight or great, is not equivalent to the intent required. An act is fraudulent if it is an actual, intentional wrongdoing, and the intent required is the specific purpose of evading tax believed to be owing.

The taxpayer was registered to collect sales tax and collected it from most customers. He never, however, filed sales tax returns with the department or voluntarily remitted collected sales taxes. The taxpayer admitted that he "borrows" other dealers' identification numbers. He also deals in "cash only" sales and purchases without recording any transactions. The taxpayer acknowledged that he destroyed purchase invoices. The business records were poorly kept and minimal. The taxpayer clearly knew that he was required to collect and remit sales taxes but failed to do so. The taxpayer intentionally misrepresented to the state the amount of sales taxes that he was required to remit to the state. These actions constitute fraud.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20020087.LOF

LETTER OF FINDINGS NUMBER: 02-0087
Adjusted Gross Income Tax
For Tax Years 1998 through 1999

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

ISSUE

I. Adjusted Gross Income—Nexus

Authority: Quill Corporation v. North Dakota, 504 U.S. 298 (U.S. 1992); in Miles, Inc. v. Indiana Department of State Revenue, 659 N.E.2d 1158, 1164 (Ind. Tax 1995); Chief Industries, Inc. v. Indiana Department of State Revenue, 792 N.E.2d 972 (Ind. Tax 2000); Subaru-Isuzu Automotive, Inc., Company v. Indiana Department of State Revenue, 782 N.E.2d 1071 (Ind. Tax 2003); IC 6-3-2-2; IC 6-3-4-14; IC 6-8.1-3-3; 45 IAC 3.1-1-50; 45 IAC 3.1-1-55; 45 IAC 15-3-2; Geoffry, Inc. v. South Carolina Tax Commission, 437 S.E. 2d 13 (S.C. 1993)

Taxpayer protests the imposition of adjusted gross income tax on activity it believes has no nexus with Indiana.

II. Tax Administration—Negligence Penalty and Interest

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

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

STATEMENT OF FACTS

Taxpayer is a member of a consolidated group which operates several chains of retail clothing stores in multiple states and affiliated companies which hold the rights to trademarks and trade brands associated with each particular retail chain. For example, a retail chain named "Retail Clothing Store" would have an affiliated company with a similar name such as "Retail Clothing Store Holdings" which held the rights to the trademarks and trade brand of "Retail Clothing Store". The retailer would pay the affiliated company royalties for the use of the trademarks and trade brands. Also, the affiliated company made loans to the retail company, upon which the retail company paid interest to the trademark holding company. All of these companies are listed together on the Federal consolidated returns, while only the retail stores are listed on the Indiana consolidated returns. As the result of an audit conducted for the tax years at issue, the Indiana Department of Revenue ("Department") issued proposed assessments for additional adjusted gross income tax on the income the trademark holding companies received in the form of royalty payments and interest payments. Taxpayer protests these proposed assessments on the grounds that it has insufficient nexus with the state for Indiana to tax the activities at issue. Further facts will be supplied as necessary.

I. Adjusted Gross Income—Nexus

DISCUSSION

Taxpayer is a member of a group which consists of several related chains of retail clothing stores and affiliated companies which file a consolidated Indiana adjusted gross income tax return. Taxpayer paid royalty income from a retail company to another affiliated company, which the audit refers to as a "royalty-receiving company" (hereinafter "RRC") and which taxpayer refers to in its protest as a "Trademark Protection Company", for the use of trademarks and trade names owned by the RRC. The retail company also paid interest to the RRC on loans from the RRC. The audit report notes that the RRCs in the group had no payroll or employees and that the tangible property such as is used to compute the property factor of the apportionment computation was so small as to be negligible. Also, the RRCs in the group each had total depreciable assets everywhere of less than ten thousand dollars ($10,000).

The Department conducted an audit for the tax years at issue and determined that the royalty income paid to the RRC and interest paid to the RRC on loans made by the RRC to the retail company should have been included in the consolidated return. Accordingly, the Department issued proposed assessments for adjusted gross income tax on the newly included income. Taxpayer protests that the income should not be included and that the proposed assessments are incorrect.

Taxpayer presents several arguments supporting its position. Taxpayer's first argument is that the amounts of taxes assessed and the methods used to compute such amounts are unexplained by and inconsistent with the audit report, are based on an overstatement of corporate income tax liability for the period at issue, and fail to allow taxpayer appropriate credit for corporate income tax paid for the period at issue. Taxpayer refers to IC 6-3-4-14(a), which provides in part:

> An affiliated group of corporations shall have the privilege of making a consolidated return with respect to the taxes imposed by IC 6-3.

Next, taxpayer refers to IC 6-3-4-14(b), which states:

> For purposes of this section the term "affiliated group" shall mean an "affiliated group" as defined in Section 1504 of the Internal Revenue Code with the exception that the affiliated group shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana.

Taxpayer does not believe that the RRCs should be included in a consolidated return due to the provision of IC 6-3-4-14(b) excluding corporations which do not have adjusted gross income derived from sources within the state of Indiana.

In support of its position that the RRCs do not have adjusted gross income derived from sources within the state of Indiana, taxpayer refers to IC 6-3-2-2(a), which states in part:

> With regard to corporations and nonresident persons, "adjusted gross income derived from sources within the state of Indiana", for the purposes of this article, shall mean and include:
> (1) income from real or tangible personal property located in this state;
> (2) income from doing business in this state;
> (3) income from a trade or profession conducted in this state;
> (4) compensation for labor or services rendered within this state; and
> (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.
> …

Taxpayer believes that the modifier,"…if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter" applies to all income sources listed in IC 6-3-2-2(a)(5). Since IC 6-3-2-2.2 deals primarily with interest income and income from loans, and does not mention income from trademarks or trade brands, taxpayer does not believe that the income received by the royalty receiving corporations for trademark and trade brand use qualifies as adjusted gross income derived from sources within the state of Indiana.

In its protest, taxpayer refers to the Indiana Tax Court case, Chief Industries, Inc. v. Indiana Department of State Revenue (which was issued in 2000 and ruled "For Publication" in 2004) for support in its assertion that the Department's regulations are out of date, but Chief also provides guidance in determining if the modifier found in IC 6-3-2-2(a)(5) applies to all categories listed therein. Chief Industries, Inc. v. Indiana Department of State Revenue, 792 N.E.2d 972 (Ind. Tax 2000). In that case, the Tax Court examined IC 6-3-2-2(a)(5) as it was written in 1986, which was the time Chief Industries stock sales took place. At that time, the modifier in IC 6-3-2-2(a)(5) read, "…and other intangible personal property having a situs in this state." The Tax Court explained that modifiers in the first four subsections clearly modify each item referenced within each subsection, and added:

To be consistent throughout section 6-3-2-2, the pattern must be read to extend to subsection (5). It would be absurd to read subsection (5) differently than the immediately preceding four subsections.

Id., at 977.

However, as the Tax Court explained in footnote 10 of Chief Industries:

The current version of section 6-3-2-2(a)(5) omits the phrase "having a situs in this state" and replaces it with "if the receipt from the intangible is attributable under section 2.2 of this chapter. *INDIANA CODE ANN. §6-3-2-2.2* (West 2000), effective January 1, 1990, discusses when income from, among other things, certain loans, sales contracts and dividends is attributable to Indiana.

Id., at 976.

The Tax Court decided that the pre-January 1, 1990 version of IC 6-3-2-2(a)(5) required all items listed therein to have a situs in Indiana, and proceeded to provide a three-part test to determine whether income is derived from an Indiana source or tax situs.

With the language change in the modifier of IC 6-3-2-2(a)(5) came a significant change in the effect the modifier had on the subsection. IC 6-3-2-2.2 contains no reference to eleven (11) of the twelve (12) categories listed in IC 6-3-2-2(a)(5). If all twelve categories were subject to the modification of being attributable to Indiana under IC 6-3-2-2.2, which only discusses one of the twelve categories, it would render eleven of the twelve items not applicable to Indiana under any circumstances.

As the Indiana Tax Court explained in Miles, Inc. v. Indiana Department of State Revenue, 659 N.E.2d 1158, 1164 (Ind. Tax 1995), "The Court cannot presume the legislature intended to enact a nullity." To read the reference to IC 6-3-2-2.2 as modifying all twelve items in IC 6-3-2-2(a)(5) would render the eleven excluded items nullified. Also, more direct evidence that the legislature did not intend to nullify the eleven items in IC 6-3-2-2(a)(5) is the fact that the modification to the subsection was enacted by P.L.347-1989(ss), Sec. 6, while IC 6-3-2-2.2 was enacted by P.L.347-1989(ss), Sec. 7. If the legislature intended to eliminate the eleven items in question from taxation under IC 6-3-2-2(a)(5), it could have simply modified the subsection to incorporate the language of IC 6-3-2-2.2 rather than go to the effort of leaving eleven meaningless categories and creating an entire separate statute to describe the sole remaining relevant category. That the legislature did not do this indicates that it did not intend to nullify the eleven categories, including trademarks and trade names.

Therefore, since IC 6-3-2-2(a)(5) was altered to include the eleven categories not related to IC 6-3-2-2.2 in 1990, and since the eleven categories can not be presumed to be nullified by the language of IC 6-3-2-2.2, the decisions in Chief Industries and in Miles leads to the conclusion that taxpayer's reliance on the descriptive language in IC 6-3-2-2.2 is misplaced. The legislature altered IC 6-3-2-2(a)(5) so that the modifier can not be logically applied to all twelve categories listed therein. The Chief Industries decision that the entire subsection is modified can only be applied to the pre-January 1, 1990 version of IC 6-3-2-2(a)(5), and taxpayer's belief that IC 6-3-2-2.2 must be satisfied for the eleven non-related categories is incorrect.

In the course of its argument, taxpayer refers to two Revenue Rulings in support of its argument. These two Revenue Rulings deal with Financial Institutions Tax (FIT). Since this protest deals with Adjusted Gross Income tax, and these Revenue Rulings are based on FIT statutes, they are not relevant to this protest and will receive no further discussion.

Taxpayer's next argument that the proposed assessments are invalid is that taxpayer believes that the Department relied on invalid regulations in its audit report. In the audit report the Department referred to several regulations to support its position. 45 IAC 3.1-1-50, in describing sales to be included in the sales factor of the apportionment formula, states in relevant part:

Sales Made in General Business Operations. "Sales" means all gross receipts of the taxpayer which are not subject to allocation as nonbusiness income. The following are examples of "sales" in various situations:

…

(5) If the taxpayer is in the business of selling, assigning, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.

…

Also, the Department referred to 45 IAC 3.1-1-55, which states in relevant part:

When Sales Other Than Sales of Tangible Personal Property Are in This State. Gross receipts from transactions other than sales of tangible personal property shall be included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within this state. Except as provided below if the income producing activity is performed within and without this state such receipts are attributed to this state if the greater portion of the income producing activity is performed here, based on costs of performance.

The term "income producing activity" means the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit. Such activity does not include activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, "income producing activity" includes but is not limited to the following: (1) The rendering of personal services by employees or the utilization of tangible and intangible personal property by the taxpayer in performing a service. (2) The sale, rental, leasing, or licensing the use of other use of tangible personal property. (3) The sale, licensing the use of or other use of intangible personal property.

Income producing activity is deemed performed at the situs of real, tangible and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that the substantial use or value attaches to the property….

Taxpayer believes that since these regulations were promulgated in 1979, prior to the changes to IC 6-3-2-2 which became effective on January 1, 1990, these regulations are invalid. Taxpayer states that since the regulations use the phrase "business situs" they are no longer applicable to determining adjusted gross income tax derived from intangible personal property. The Indiana Tax Court has addressed the impact a change in the underlying statute will have on a regulation. In Subaru-Isuzu Automotive, the legislature had repealed a two-sentence provision dealing with apportionment of Net Operating Losses and replaced it with a lengthy and complex four-step process for calculating Net Operating Losses. Subaru-Isuzu Automotive, Inc., Company v. Indiana Department of State Revenue, 782 N.E.2d 1071 (Ind. Tax 2003). The Department did not promulgate a new regulation in accordance with the new four-step process, and the Court explained:

An administrative rule is a nullity where the provision upon which the rule is based has been repealed.

Id., at 1076

The Court decided that the regulations relied upon by the Department no longer adequately reflected apportionment process they were designed to enhance, and therefore were no longer valid. Taxpayer's position in the instant case is that the administrative rules (regulations) referred to in the audit report are invalid under the same reasoning used by the Tax Court to describe a nullity in Subaru-Isuzu Automotive.

There is a fundamental difference between a nullified regulation, as described in Subaru-Isuzu Automotive, and the instant case. In Subaru-Isuzu Automotive, the underlying statute had been repealed and wholly replaced while the related regulation did not reflect this change. Here, the underlying statute has merely been simplified, with more complex analysis of one of twelve categories listed being relegated to a separate statute, while the regulation remains applicable to the remaining, unaffected eleven categories in IC 6-3-2-2(a)(5). The underlying statute was not repealed, but rather was modified, and the regulations are therefore not nullities as explained in Subaru-Isuzu Automotive.

Taxpayer's next argument is that the Department erroneously relied on the authority of a South Carolina case, Geoffry, Inc. v. South Carolina Tax Commission, 437 S.E. 2d 13 (S.C. 1993), for its assessments. Taxpayer states that the decision in Geoffrey does not address Indiana adjusted gross income tax, which is of relevance here, but instead addresses Federal constitutional issues. Taxpayer also states that the court in Geoffrey made the wrong decision in that case, and offers a New Jersey case in its place.

A review of the audit report reveals that the Department did not rely on the authority of Geoffrey to reach its assessments. Rather, the Department relied on the regulations previously discussed, and merely used Geoffrey as an example of how a court decided that state taxation of royalty income to a non-resident business was not prohibited by the Due Process Clause or Commerce Clause of the United States Constitution. In any event, a case decided in another state's courts has no authority in Indiana, which means that both South Carolina's Geoffrey and New Jersey's case are useful only for example purposes, do not form the basis of the assessments, and will not be discussed further.

Taxpayer's next argument is that the Due Process Clause and Commerce Clause of the United States Constitution both bar Indiana from taxing the royalty income. Taxpayer refers to Quill Corporation v. North Dakota, 504 U.S. 298 (U.S. 1992), to support its contention that physical presence is required for a state to impose tax. Quill deals with sales tax, as the Court explains when it discusses the Commerce Clause requirements, "In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar, bright-line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule in *Bellas Hess* established in the area of sales and use taxes." Id., at 317. Also, in its discussion of the Due Process Clause, the Court explains that physical presence is not required for a state to impose sales tax. Id., at 308. Therefore, since the instant case deals with income tax rather than sales and use taxes, and the Court specifically states that the physical presence requirement has not been adopted for taxes other than sales and use, Quill provides no support for taxpayer.

Taxpayer's next argument is that the Department changed its interpretation of a listed tax without properly promulgating new regulations. Taxpayer refers to IC 6-8.1-3-3(b), which states:

No change in the department's interpretation of a listed tax may take effect before the date the change is:

(1) adopted in a rule under this section; or

(2) published in the Indiana Register under IC 4-22-7-7(a)(5), if IC 4-22-2 does not require the interpretation to be adopted as a rule;

if the change would increase a taxpayer's liability for a listed tax.

Taxpayer also refers to 45 IAC 15-3-2(d)(3), which states:

In respect to rulings issued by the department, based on a particular fact situation which may affect the tax liability of the taxpayer, only the taxpayer to whom the ruling was issued is entitled to rely on it. Since the department publicizes summaries of rulings which it makes, other taxpayers with substantially identical factual situations may rely on the publicized rulings for informational purposes in preparing returns and making tax decisions. Generally, department publications may be relied on by any taxpayer if their fact situation does not vary substantially from those facts upon which the department based its publication. If a taxpayer relies on a publicized ruling and the department discovers, upon examination, that the fact situation of the particular taxpayer is different in any material respect from that situation on which the original ruling was issued, the ruling will afford the taxpayer no protection and the examination will apply to all open years under the statutes. Letters of findings that are issued by the department, as a result of protested assessments, are to be considered rulings of the department as applied to the particular facts protested.

Taxpayer believes that the Department is changing its interpretation in the instant case from its interpretation found in two revenue rulings issued in April, 1982. The text of a summary of one of the rulings states in its entirety:

Advice was requested as to the taxability of an Indiana-based corporation engaged in receiving copyright royalties from various sources worldwide. All of the property and employees are located in Indiana.

The Department ruled that the taxpayer was subject to gross income tax on its entire gross receipts. IC 6-2.1-1-2(e)(6) provides an exclusion for amounts received at an out-of-state business situs, but this taxpayer has no such situs. Likewise, its entire adjusted gross income is taxable in Indiana because no other state has jurisdiction to impose a net income tax.

Taxpayer states that the rulings could not be clearer or more on point, and that their interpretation of the tax statutes can not be changed prior to the promulgation of a rule or publication in the Indiana Register as required under IC 6-8.1-3-3. Taxpayer states that the audit report's attempt to do so is plainly impermissible under IC 6-8.1-3-3 and would violate taxpayer's rights under 45 IAC 15-3-2 to rely on rulings issued to other taxpayers. Taxpayer is incorrect.

The summary taxpayer refers to is a short summary and provides little information. One obvious difference is that the summary discusses a taxpayer with no activities outside Indiana, while the instant case deals with taxpayers who have activities in several states. Taxpayer emphasizes the last sentence of the summary, which mentions adjusted gross income and is also the tax at issue in this protest. In the summary, the Department explained that the taxpayer's entire royalty income was taxable in Indiana since there was no other taxing jurisdiction to apportion the income with. In the instant case, the Department has apportioned the royalty income according to the apportionment formula explained in IC 6-3-2-2. In other words, there was no reason to apportion in the 1982 instance and there is a reason to apportion in this instance. Taxpayer fails to explain why the last sentence of the summary means that the instant audit represents an attempt to change the Department's interpretation of adjusted gross income tax statutes in this case.

In its protest, taxpayer cites only the first two sentences of 45 IAC 15-3-2(d)(3). It is clear that the two situations are materially different from one another, and as explained in the fourth sentence of 45 IAC 15-3-2(d)(3), "If a taxpayer relies on a publicized ruling and the department discovers, upon examination, that the fact situation of the particular taxpayer is different in any material respect from that situation on which the original ruling was issued, the ruling will afford the taxpayer no protection and the examination will apply to all open years under the statutes." The fact situation of this particular taxpayer is different in at least one material respect from the situation on which the original ruling was issued. Therefore, the 1982 rulings afford no protection to taxpayer.

Next, taxpayer argues that the Department erred in its calculation of the apportionment factors it used to determine the proposed assessments. Taxpayer refers to 45 IAC 3.1-1-55(e), which states:

Gross receipts from intangible personal property shall, if classified as business income, be attributed to this state based upon the ratio which the total property and payroll factors in this state bears to the total of the property and payroll factors everywhere for the tax period as determined in Regulations 6-3-2-2(c)(010) *[45 IAC 3.1-1-40]* et seq. and 6-3-2-2(d)(010) *[45 IAC 3.1-1-47]* et seq.

Taxpayer states that the audit report does not attribute the royalty-receiving corporation's intangible income to Indiana based on their Indiana property and payroll factors, but rather by multiplying the royalty-receiving corporation's total royalty and interest income by the sales factor of the retailers to whom the royalty-receiving corporations licensed intangibles or lent money. Taxpayer believes that to do so is not only unsupportable under the Adjusted Gross Income act, but is contrary to the regulations. Taxpayer's interpretation of 45 IAC 3.1-1-55(e) is that with zero tangible personal property and zero payroll in Indiana, the apportionment factor should be zero. Taxpayer is incorrect.

The Department refers to IC 6-3-2-2(l), which states:

If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting;

(2) the exclusion of any one (1) or more of the factors;

(3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

In this case, taxpayer is correct that the royalty-receiving corporations have no Indiana payroll or real or tangible personal property. As previously explained, they do not have payroll or real or tangible personal property anywhere else either. Yet they clearly have income, and if the Department were to follow taxpayer's suggestion that the apportionment be calculated at zero, the result would not fairly represent taxpayer's income derived from sources within the state of Indiana. This situation is resolved by IC 6-3-2-2(l) which allows the exclusion of one or more of the three factors and the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. The Department included the total receipts of the royalty-receiving corporations in the denominator of the sales apportionment factor. The Department multiplied the total receipts for the royalty-receiving corporations by the sales factors of the related retail corporation since royalty revenues are directly based on sales revenues. As explained in the audit report, this results in an accurate and equitable Indiana sales factor numerator.

Taxpayer's next argument deals with the interest payments made by the retailer to the RRC. The Department referred to 45 IAC 3.1-1-59, which explains when interest is treated as business or nonbusiness income, while describing the adjustments in the audit report. Taxpayer states that it is irrelevant if the interest is business or nonbusiness income and refers to IC 6-3-2-2.2 to raise the point that the type of interest income in question is not included in the various descriptions therein and concludes that the interest payment income is therefore not to be included in Indiana income. IC 6-3-2-2.2 states:

> (a) Interest income and other receipts from assets in the nature of loans or installment contracts that are primarily secured by or deal with real or tangible personal property are attributable to this state if the security or sale property is located in Indiana.
> (b) Interest income and other receipts from consumer loans not secured by real or tangible personal property are attributable to this state if the loan in made to a resident of Indiana, whether at a place of business, by a traveling loan officer, by mail, by telephone, or by other electronic means.
> (c) Interest income and other receipts from commercial loans and installment obligations not secured by real or tangible personal property are attributable to this state if the proceeds of the loan are to be applied in Indiana. (b) If it cannot be determined where the funds are to be applied, the income and receipts are attributable to the state in which the business applied for the loan. As used in this section, "applied for" means the initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application, whichever occurs first.
> (d) Interest income, merchant discount, and other receipts including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders' fees are attributable to the state to which the card charges and fees are regularly billed.
> (e) Receipts from the performance of fiduciary and other services are attributable to the state in which the benefits of the services are consumed. If the benefits are consumed in more than one (1) state, the receipts from those benefits are attributable to this state on a pro rata basis according to the portion of the benefits consumed in Indiana.
> (f) Receipts from the issuance of traveler's checks, money orders, or United States savings bonds are attributable to the state in which the traveler's checks, money orders, or bonds are purchased.
> (g) Receipts in the form of dividends from investments are attributable to this state if the taxpayer's commercial domicile is in Indiana.

Taxpayer states that it is not possible to determine where the proceeds of the loan were applied, therefore IC 6-3-2-2.2(c) requires the income and receipts to be attributed to the state where the loan was applied for. Since the loan was applied for wholly outside of Indiana, taxpayer believes that the income and receipts can not be attributed to Indiana. Taxpayer also reiterates its argument that the regulation relied upon by the Department is invalid due to new statutory language.

Regarding the loan interest payments, the Department referred to 45 IAC 3.1-1-59 which states in relevant part:

> Interest income is nonbusiness income if the intangible with respect to which the interest was received did not arise out of or was not created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible was not related to or incidental to such trade or business operations. The term "interest" as used in this regulation *[45 IAC 3.1-1-59]* includes service charges, time-price differentials, and all other charges for the use of money.
> …

The Department determined that the interest in question did arise out of the regular course of the taxpayer's business operations and was therefore business income and therefore should be included in the apportionment calculations.

Regarding taxpayer's argument that the regulation is invalid because it has not been updated since the enactment of IC 6-3-2-2.2, IC 6-3-2-2.2 does provide a new statutory-level method for how to determine if loan interest is attributable to Indiana which is not referred to by 45 IAC 3.1-1-59. However, the two are not discussing the same thing. IC 6-3-2-2.2 is designed to determine the attribution of business income while 45 IAC 3.1-1-59 is designed to determine if interest income is business or nonbusiness income, not where it should be attributed.

It appears that the loans are generally applied to the retail company. Therefore, a portion of the loans are applied to the retail company's Indiana operations. The Department apportioned the amount of interest applied to Indiana with the same formula as it used to apportion royalty income, as provided in IC 6-3-2-2(m), which states:

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

In this case, the loans are made by one business to another which is controlled directly or indirectly by the same interests. The Department apportioned the income from the interest payments with the same formula as it used to apportion the royalty income which fairly reflects the income derived from sources within the state of Indiana by the various taxpayers.

Additional support for the proposed assessments is found in the Department's treatment of companies that claim deductions for royalty income paid to related companies, such as the companies in the instant case. The Department has consistently determined that such a company cannot deduct such royalty payments, using virtually identical language and referring to the same statutes and regulations to reach those conclusions. Since this taxpayer is sufficiently close to the other companies to qualify as a consolidated group, the Department could have denied a deduction taken by the clothing companies for the royalty payments to the RRCs. This would have had the same effect on the consolidated group's income.

In conclusion, taxpayer availed itself of Indiana's markets by licensing its trademarks and trade brands to an affiliated company doing business in Indiana. IC 6-3-2-2(a)(5) provides that this activity creates adjusted gross income derived from sources in Indiana and is therefore taxable here. The Department did not rely on a South Carolina case as its authority to tax the income. The regulations the Department did rely on are not invalid, even taking into account the 1990 revision to IC 6-3-2-2. The Due Process Clause and Commerce Clause of the Federal Constitution do not prevent Indiana from taxing the income. It can be determined that the proceeds of the loans are partially applied to Indiana, and IC 6-3-2-2.2(c) provides that the interest on those loans are partially applicable to Indiana. The Department properly included and apportioned the royalty and interest income.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty and interest, and states that the imposition of a negligence penalty is contrary to IC 6-8.1-10-2.1, which deals with the negligence penalty and its imposition. The Department refers to IC 6-8.1-10-1(e), which states, "Except as provided by IC 6-8.1-5-2(e)(2), the department may not waive the interest imposed under this section." Therefore, the Department may not waive interest.

Taxpayer states that the audit report states no factual basis for the imposition of penalties and that no factual basis exists. Taxpayer reiterates its position from Issue I that the proposed assessments are attributable to the treatment of the royalty-receiving company as subject to the adjusted gross income tax and includable in the consolidated returns, which taxpayer disagreed with. As explained in Issue I, the royalty-receiving company is subject to adjusted gross income tax and includable in the consolidated returns. At hearing, taxpayer was adamant that it had diligently attempted to comply with Indiana's tax methods and that it should not be subject to the negligence penalty.

IC 6-8.1-10-2.1(f) explains:

The department shall adopt rules under IC 4-22-2 to prescribe the circumstances that constitute reasonable cause and negligence for purposes of this section.

The relevant regulation is 45 IAC 15-11-2(b), which states:

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

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

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

In this case, taxpayer has not affirmatively established that its failure to pay the full amount of tax due was due to reasonable cause and not due to negligence. In its protest in Issue I, taxpayer's arguments include relying on Financial Institutions Tax statutes to determine its actions regarding Adjusted Gross Income Tax, relying on an Indiana Tax court case which was not published until after the audit period, and relying on revenue rulings with materially different fact situations from its own. These are not reasonable causes to not pay the full amount of adjusted gross income tax due.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

18-20020120.LOF

LETTER OF FINDINGS NUMBER: 02-0120
Financial Institutions Tax
For Tax Years 1994-1996

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

ISSUE

I. Financial Institutions Tax—Credit Card Operations

Authority: Quill Corporation v. North Dakota, 504 U.S. 298 (U.S. 1992); IC 6-5.5-3-1; IC 6-5.5-3-8; IC 6-5.5-4-4; IC 6-5.5-4-5; IC 6-5.5-4-6; IC 6-5.5-4-8; 45 IAC 17-2-8

Taxpayer protests imposition of Financial Institutions Tax on income from credit card-related activities.

II. Tax Administration—Negligence Penalty and Interest

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

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

STATEMENT OF FACTS

Taxpayer was a member of a group of companies which included several retail clothing store chains. Taxpayer ran the group's credit card operations from an out-of-state location. The Indiana Department of Revenue ("Department") conducted an audit for the tax years in question and issued proposed assessments along with a ten percent (10%) negligence penalty and interest for those years. Taxpayer protests that the proposed assessments are incorrect as are the imposition of the negligence penalty and interest. Further facts will be provided as necessary.

I. Financial Institutions Tax—Credit Card Operations

DISCUSSION

Taxpayer protests the imposition of the Financial Institutions Tax (FIT) for the tax years in question. The Department conducted an audit and concluded that taxpayer was subject to the FIT and issued proposed assessments. Taxpayer protests that it is not subject to the FIT and argues that it has not conducted business in Indiana as defined in FIT statutes. Taxpayer refers to IC 6-5.5-3-8(5), and states that its only activity associated with Indiana falls within subsections (C) or (D).

IC 6-5.5-3-8 states:

Notwithstanding any other provision of this chapter, a taxpayer, except for a trust company formed under IC 28-1-4, is not considered to be transacting business in Indiana if the only activities of the taxpayer in Indiana are or are in connection with any of the following:

(1) Maintaining or defending an action or suit.

(2) Filing, modifying, renewing, extending, or transferring a mortgage, deed of trust, or security interest.

(3) Acquiring, foreclosing, or otherwise conveying property in Indiana as a result of a default under the terms of a mortgage, deed of trust or other security instrument relating to the property.

(4) Selling tangible personal property, if taxation under this article is precluded by 15 U.S.C. 381 through 384.

(5) Owning an interest in the following types of property, including those activities within Indiana that are reasonably required to evaluate and complete the acquisition or disposition of the property, the servicing of the property, or the acquisition or liquidation of collateral relating to the property:

(A) An interest in a real estate mortgage investment conduit, a real estate investment trust, or a regulated investment company (as those terms are defined in the Internal Revenue Code).

(B) An interest in a loan backed security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments in relation to payments or reasonable projections of payments on the notes or certificates.

(C) An interest in a loan or other asset from which the interest is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5, and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.

(D) An interest in the right to service or collect income from a loan or other asset from which interest on the loan or other asset is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5, and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.

(E) An amount held in an escrow or a trust account with respect to property described in this subdivision.

(6) Acting:

(A) as an executor of an estate;

(B) as a trustee of a benefit plan;

(C) as a trustee of an employee's pension, profit sharing, or other retirement plan;

(D) as a trustee of a testamentary or inter vivos trust or corporate indenture; or

(E) in any other fiduciary capacity, including holding title to real property in Indiana.

Since taxpayer states that its only activity relating to Indiana is described in IC 6-5.5-3-8(5)(C) and IC 6-5.5-3-8(5)(D), it is important to review the statutes listed therein. IC 6-5.5-4-4 states:

Interest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property must be attributed to Indiana if the security or sale property is located in Indiana.

IC 6-5.5-4-5 states:

Interest income and other receipts from consumer loans not secured by real or tangible property must be attributed to Indiana if the loan is made to a resident of Indiana, whether at a place of business, by a traveling loan officer, by mail, by telephone, or by other electronic means.

IC 6-5.5-4-6 states:

Interest income and other receipts from commercial loans and installment obligations not secured by real or tangible personal property must be attributed to Indiana if the proceeds of the loan are to be applied in Indiana. If it cannot be determined where the funds are to be applied, the income and receipts are attributed to the states in which the business applied for the loan. As used in this section, "applied for" means initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application.

None of these activities describe taxpayer's business of issuing and servicing credit cards, and if these were the only statutes available, taxpayer might have a point. However, IC 6-5.5-4-8 explains:

Interest income, merchant discount, and other receipts including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders' fees must be attributed to the state to which the card charges and fees are regularly billed.

Therefore, the portion of income taxpayer received from its Indiana customers must be attributed to Indiana since Indiana is the state to which the card charges and fees were regularly billed.

Taxpayer protests that it was not transacting business within Indiana. Taxpayer states that the employees of the retailers were not agents, employees or representatives of taxpayer and that agreements between taxpayer and retailers and their factoring companies disclaimed any agency relationship among those parties. Taxpayer has not provided documentation establishing the nature of this relationship.

Also, IC 6-5.5-3-8 deals with "Events not considered transacting business in state". Equally valuable is a review of IC 6-5.5-3-1, which deals with "Transacting business within state". IC 6-5.5-3-1 states:

For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year only if the taxpayer:

(1) maintains an office in Indiana;
(2) has an employee, representative, or independent contractor conducting business in Indiana;
(3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
(4) regularly solicits business from potential customers in Indiana;
(5) regularly performs services outside Indiana that are consumed within Indiana;
(6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;
(7) owns or leases tangible personal property or real property located in Indiana; or
(8) regularly solicits and receives deposits from customers in Indiana.

45 IAC 17-2-8 explains:

A taxpayer is not required to be physically present within Indiana to be soliciting business. Soliciting business includes, but is not limited to, the following:

(1) The distribution, by mail or otherwise, of catalogs, periodicals, advertising flyers, or other written solicitation of business to potential customers in Indiana, without regard to the state from where the distribution originated or where the materials were prepared.
(2) Display of advertisements on billboards or other outdoor advertising in this state.
(3) Advertisements in newspapers published in this state.
(4) Advertisements in trade journals or other periodicals, the circulation of which is primarily within this state.
(5) Advertisements in an Indiana edition of a national or regional publication or a limited regional edition of which this state is included as part of a broader regional or national publication, and which are not placed in other geographically defined editions of the same issue of the same publication.
(6) Advertisements in regional or national publications in an edition which is not by its contents geographically targeted to Indiana, but which is sold over the counter in Indiana or by subscription to Indiana residents.
(7) Advertisements broadcast on a radio or television station which are received by Indiana residents.
(8) Any other solicitation by telegraph, telephone, computer data base, cable, optic, microwave, or other communication system.

Taxpayer states that the retailer's employees were not agents. While it has not been definitely established that the retailers and retailer's employees were not acting in an agency capacity, it remains that Indiana customers were acquiring taxpayer's credit cards. Therefore, either the retailers and their employees were acting as agents for taxpayer or taxpayer must have been distributing, by mail or otherwise, catalogs, periodicals, advertising flyers, or other written solicitation of business to potential customers in Indiana. One way or another, Indiana business was being solicited.

Since 45 IAC 17-2-8(1) establishes that taxpayer's activities constituted soliciting business in Indiana, IC 6-5.5-3-1(4) establishes that taxpayer was transacting business within Indiana for FIT purposes. Also, taxpayer regularly performed services outside Indiana that were consumed within Indiana which qualifies as transacting business within Indiana under IC 6-5.5-3-1(5).

Therefore, taxpayer was transacting business within Indiana as explained by IC 6-5.5-3-1.

Next, taxpayer states that Indiana is prohibited from imposing FIT on taxpayer by the Commerce Clause of the United States Constitution. Taxpayer states that it has no substantial nexus with Indiana and a substantial nexus is required. Taxpayer refers to Quill Corporation v. North Dakota, 504 U.S. 298 (U.S. 1992), to support its contention that physical presence is required for a state to impose tax. Quill deals with use tax, as the Court explains when it discusses the Commerce Clause requirements, "In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar, bright-line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule in *Bellas Hess* established in the area of sales and use taxes." Id., at 317. Therefore, since the instant case deals with financial institutions tax rather than sales and use taxes, and the Court specifically states that the physical presence requirement has not been adopted for taxes other than sales and use, Quill provides no support for taxpayer.

In conclusion, 45 IAC 17-2-8(1) establishes that taxpayer's activities constituted soliciting business within Indiana. IC 6-5.5-3-1(4) establishes that taxpayer was transacting business within Indiana for FIT purposes. The Federal Commerce Clause does not prohibit Indiana from imposing FIT on a nonresident taxpayer.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty and Interest

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty and interest, and states that the imposition of a negligence penalty is contrary to IC 6-8.1-10-2.1, which deals with the negligence penalty and its imposition. The Department refers to IC 6-8.1-10-1(e), which states, "Except as provided by IC 6-8.1-5-2(e)(2), the department may not waive the interest imposed under this section." Therefore, the Department may not waive interest.

Taxpayer states that the audit provides no indication of any wrongdoing on taxpayer's part to justify the imposition of penalties and that no factual basis exists. At hearing, taxpayer was adamant that it had diligently attempted to comply with Indiana's tax methods and that it should not be subject to the negligence penalty.

IC 6-8.1-10-2.1(f) explains:

The department shall adopt rules under IC 4-22-2 to prescribe the circumstances that constitute reasonable cause and negligence for purposes of this section.

The relevant regulation is 45 IAC 15-11-2(b), which states:

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

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

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

In this case, taxpayer has not affirmatively established that its failure to pay the full amount of tax due was due to reasonable cause and not due to negligence. As explained in Issue I, taxpayer was clearly soliciting business from with Indiana, which clearly qualified as transacting business within Indiana for FIT purposes. Taxpayer has not affirmatively established a reason why it did not pay the full amount of adjusted gross income tax due.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20020310.LOF

LETTER OF FINDINGS NUMBER: 02-0310
Adjusted Gross Income Tax
For Tax Years 1998 through 1999

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ISSUE

I. Adjusted Gross Income—Nexus

Authority: Quill Corporation v. North Dakota, 504 U.S. 298 (U.S. 1992); Miles, Inc. v. Indiana Department of State Revenue, 659 N.E.2d 1158, 1164 (Ind. Tax 1995); Chief Industries, Inc. v. Indiana Department of State Revenue, 792 N.E.2d 972 (Ind. Tax 2000); Subaru-Isuzu Automotive, Inc., Company v. Indiana Department of State Revenue, 782 N.E.2d 1071 (Ind. Tax 2003); IC 6-3-2-2; IC 6-3-4-14; IC 6-8.1-3-3; 45 IAC 3.1-1-50; 45 IAC 3.1-1-55; 45 IAC 15-3-2; Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E. 2d 13 (S.C. 1993); Lanco, Inc. v. Director, Division of Taxation, 21 N.J. Tax 200

Taxpayer protests the imposition of adjusted gross income tax on activity it believes has no nexus with Indiana.

II. Tax Administration—Negligence Penalty and Interest

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

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

STATEMENT OF FACTS

Taxpayer is a member of a consolidated group which operates several chains of retail clothing stores in multiple states and affiliated companies which hold the rights to trademarks and trade brands associated with each particular retail chain. For example, a retail chain named “Retail Clothing Store” would have an affiliated company with a similar name such as “Retail Clothing Store Holdings” which held the rights to the trademarks and trade brand of “Retail Clothing Store”. The retailer would pay the affiliated company royalties for the use of the trademarks and trade brands. Also, the affiliated company made loans to the retail company, upon which the retail company paid interest to the trademark holding company. All of these companies are listed together on the Federal consolidated returns, while only the retail stores are listed on the Indiana consolidated returns. As the result of an audit conducted for the tax years at issue, the Indiana Department of Revenue (“Department”) issued proposed assessments for additional adjusted gross income tax on the income the trademark holding companies received in the form of royalty payments and interest payments. Taxpayer protests these proposed assessments on the grounds that it has insufficient nexus with the state for Indiana to tax the activities at issue. Further facts will be supplied as necessary.

I. Adjusted Gross Income—Nexus

DISCUSSION

Taxpayer is a member of a group which consists of several related chains of retail clothing stores and affiliated companies which file a consolidated Indiana adjusted gross income tax return. Royalty income was paid from a retail company to an affiliated company, which the audit refers to as a “royalty-receiving company” (hereinafter “RRC”) and which taxpayer refers to in its protest as a “Trademark Protection Company”, for the use of trademarks and trade names owned by the RRC. The retail company also paid interest to the RRC on loans from the RRC. The audit report notes that the RRCs in the group had no payroll or employees and that the tangible property used to compute the property factor of the apportionment computation was so small as to be negligible. Also, the RRCs in the group each had total depreciable assets of less than ten thousand dollars ($10,000).

The Department conducted an audit for the tax years at issue and determined that the royalty income paid to the RRC and interest paid to the RRC on loans made by the RRC to the retail company should have been included in the consolidated return. Accordingly, the Department issued proposed assessments for adjusted gross income tax on the newly included income. Taxpayer protests that the income should not be included and that the proposed assessments are incorrect.

Taxpayer presents several arguments supporting its position. Taxpayer’s first argument is that the amounts of taxes assessed and the methods used to compute such amounts are unexplained by and inconsistent with the audit report, are based on an overstatement of corporate income tax liability for the period at issue, and fail to allow taxpayer appropriate credit for corporate income tax paid for the period at issue. Taxpayer refers to IC 6-3-4-14(a), which provides in part:

> An affiliated group of corporations shall have the privilege of making a consolidated return with respect to the taxes imposed by IC 6-3.

Next, taxpayer refers to IC 6-3-4-14(b), which states:

> For purposes of this section the term “affiliated group” shall mean an “affiliated group” as defined in Section 1504 of the Internal Revenue Code with the exception that the affiliated group shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana.

Taxpayer does not believe that the RRCs should be included in a consolidated return due to the provision of IC 6-3-4-14(b) excluding corporations which do not have adjusted gross income derived from sources within the state of Indiana.

In support of its position that the RRCs do not have adjusted gross income derived from sources within the state of Indiana, taxpayer refers to IC 6-3-2-2(a), which states in part:

> With regard to corporations and nonresident persons, “adjusted gross income derived from sources within the state of Indiana”, for the purposes of this article, shall mean and include:
>
> (1) income from real or tangible personal property located in this state;
> (2) income from doing business in this state;
> (3) income from a trade or profession conducted in this state;
> (4) compensation for labor or services rendered within this state; and

(5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

…

Taxpayer believes that the modifier,"…if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter" applies to all income sources listed in IC 6-3-2-2(a)(5). Since IC 6-3-2-2.2 deals primarily with interest income and income from loans, and does not mention income from trademarks or trade brands, taxpayer does not believe that the income received by the royalty receiving corporations for trademark and trade brand use qualifies as adjusted gross income derived from sources within the state of Indiana.

In its protest, taxpayer refers to the Indiana Tax Court case, Chief Industries, Inc. v. Indiana Department of State Revenue (which was issued in 2000 and ruled "For Publication" in 2004) for support in its assertion that the Department's regulations are out of date, but Chief also provides guidance in determining if the modifier found in IC 6-3-2-2(a)(5) applies to all categories listed therein. Chief Industries, Inc. v. Indiana Department of State Revenue, 792 N.E.2d 972 (Ind. Tax 2000). In that case, the Tax Court examined IC 6-3-2-2(a)(5) as it was written in 1986, which was the time Chief Industries stock sales took place. At that time, the modifier in IC 6-3-2-2(a)(5) read, "…and other intangible personal property having a situs in this state." The Tax Court explained that modifiers in the first four subsections clearly modify each item referenced within each subsection, and added:

To be consistent throughout section 6-3-2-2, the pattern must be read to extend to subsection (5). It would be absurd to read subsection (5) differently than the immediately preceding four subsections.

Id., at 977.

However, as the Tax Court explained in footnote 10 of Chief Industries:

The current version of section 6-3-2-2(a)(5) omits the phrase "having a situs in this state" and replaces it with "if the receipt from the intangible is attributable under section 2.2 of this chapter. *INDIANA CODE ANN. §6-3-2-2.2* (West 2000), effective January 1, 1990, discusses when income from, among other things, certain loans, sales contracts and dividends is attributable to Indiana.

Id., at 976.

The Tax Court decided that the pre-January 1, 1990 version of IC 6-3-2-2(a)(5) required all items listed therein to have a situs in Indiana, and proceeded to provide a three-part test to determine whether income is derived from an Indiana source or tax situs.

With the language change in the modifier of IC 6-3-2-2(a)(5) came a significant change in the effect the modifier had on the subsection. IC 6-3-2-2.2 contains no reference to eleven (11) of the twelve (12) categories listed in IC 6-3-2-2(a)(5). If all twelve categories were subject to the modification of being attributable to Indiana under IC 6-3-2-2.2, which only discusses one of the twelve categories, it would render eleven of the twelve items not applicable to Indiana under any circumstances.

As the Indiana Tax Court explained in Miles, Inc. v. Indiana Department of State Revenue, 659 N.E.2d 1158, 1164 (Ind. Tax 1995), "The Court cannot presume the legislature intended to enact a nullity." To read the reference to IC 6-3-2-2.2 as modifying all twelve items in IC 6-3-2-2(a)(5) would render the eleven excluded items nullified. Also, more direct evidence that the legislature did not intend to nullify the eleven items in IC 6-3-2-2(a)(5) is the fact that the modification to the subsection was enacted by P.L.347-1989(ss), Sec. 6, while IC 6-3-2-2.2 was enacted by P.L.347-1989(ss), Sec. 7. If the legislature intended to eliminate the eleven items in question from taxation under IC 6-3-2-2(a)(5), it could have simply modified the subsection to incorporate the language of IC 6-3-2-2.2 rather than go to the effort of leaving eleven meaningless categories and creating an entire separate statute to describe the sole remaining relevant category. That the legislature did not do this indicates that it did not intend to nullify the eleven categories, including trademarks and trade names.

Therefore, since IC 6-3-2-2(a)(5) was altered to include the eleven categories not related to IC 6-3-2-2.2 in 1990, and since the eleven categories can not be presumed to be nullified by the language of IC 6-3-2-2.2, the decisions in Chief Industries and in Miles leads to the conclusion that taxpayer's reliance on the descriptive language in IC 6-3-2-2.2 is misplaced. The legislature altered IC 6-3-2-2(a)(5) so that the modifier can not be logically applied to all twelve categories listed therein. The Chief Industries decision that the entire subsection is modified can only be applied to the pre-January 1, 1990 version of IC 6-3-2-2(a)(5), and taxpayer's belief that IC 6-3-2-2.2 must be satisfied for the eleven non-related categories is incorrect.

In the course of its argument, taxpayer refers to two Revenue Rulings, 2000-01 FIT and 2000-02 FIT in support of its argument. These two Revenue Rulings deal with Financial Institutions Tax (FIT). Since this protest deals with Adjusted Gross Income tax, and these Revenue Rulings are based on FIT statutes, they are not relevant to this protest and will receive no further discussion.

Taxpayer's next argument that the proposed assessments are invalid is that taxpayer believes that the Department relied on invalid regulations in its audit report. In the audit report the Department referred to several regulations to support its position. 45 IAC 3.1-1-50, in describing sales to be included in the sales factor of the apportionment formula, states in relevant part:

Sales Made in General Business Operations. "Sales" means all gross receipts of the taxpayer which are not subject to allocation as nonbusiness income. The following are examples of "sales" in various situations:

…

(5) If the taxpayer is in the business of selling, assigning, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.

…

Also, the Department referred to 45 IAC 3.1-1-55, which states in relevant part:

When Sales Other Than Sales of Tangible Personal Property Are in This State. Gross receipts from transactions other than sales of tangible personal property shall be included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within this state. Except as provided below if the income producing activity is performed within and without this state such receipts are attributed to this state if the greater portion of the income producing activity is performed here, based on costs of performance.

The term "income producing activity" means the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit. Such activity does not include activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, "income producing activity" includes but is not limited to the following: (1) The rendering of personal services by employees or the utilization of tangible and intangible personal property by the taxpayer in performing a service. (2) The sale, rental, leasing, or licensing the use of other use of tangible personal property. (3) The sale, licensing the use of or other use of intangible personal property.

Income producing activity is deemed performed at the situs of real, tangible and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that the substantial use or value attaches to the property….

Taxpayer believes that since these regulations were promulgated in 1979, prior to the changes to IC 6-3-2-2 which became effective on January 1, 1990, these regulations are invalid. Taxpayer states that since the regulations use the phrase "business situs" they are no longer applicable to determining adjusted gross income tax derived from intangible personal property. The Indiana Tax Court has addressed the impact a change in the underlying statute will have on a regulation. In Subaru-Isuzu Automotive, the legislature had repealed a two-sentence provision dealing with apportionment of Net Operating Losses and replaced it with a lengthy and complex four-step process for calculating Net Operating Losses. Subaru-Isuzu Automotive, Inc., Company v. Indiana Department of State Revenue, 782 N.E.2d 1071 (Ind. Tax 2003). The Department did not promulgate a new regulation in accordance with the new four-step process, and the Court explained:

An administrative rule is a nullity where the provision upon which the rule is based has been repealed.

Id., at 1076

The Court decided that the regulations relied upon by the Department no longer adequately reflected apportionment process they were designed to enhance, and therefore were no longer valid. Taxpayer's position in the instant case is that the administrative rules (regulations) referred to in the audit report are invalid under the same reasoning used by the Tax Court to describe a nullity in Subaru-Isuzu Automotive.

There is a fundamental difference between a nullified regulation, as described in Subaru-Isuzu Automotive, and the instant case. In Subaru-Isuzu Automotive, the underlying statute had been repealed and wholly replaced while the related regulation did not reflect this change. Here, the underlying statute has merely been simplified, with more complex analysis of one of twelve categories listed being relegated to a separate statute, while the regulation remains applicable to the remaining, unaffected eleven categories in IC 6-3-2-2(a)(5). The underlying statute was not repealed, but rather was modified, and the regulations are therefore not nullities as explained in Subaru-Isuzu Automotive.

Taxpayer's next argument is that the Department erroneously relied on the authority of a South Carolina case, Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E. 2d 13 (S.C. 1993), for its assessments. Taxpayer states that the decision in Geoffrey does not address Indiana adjusted gross income tax, which is of relevance here, but instead addresses Federal constitutional issues. Taxpayer also states that the court in Geoffrey made the wrong decision in that case, and offers the New Jersey case Lanco, Inc. v. Director, Division of Taxation, 21 N.J. Tax 200, in its place.

A review of the audit report reveals that the Department did not rely on the authority of Geoffrey to reach its assessments. Rather, the Department relied on the regulations previously discussed, and merely used Geoffrey as an example of how a court decided that state taxation of royalty income to a non-resident business was not prohibited by the Due Process Clause or Commerce Clause of the United States Constitution. In any event, a case decided in another state's courts has no authority in Indiana, which means that both South Carolina's Geoffrey and New Jersey's Lanco decision are useful only for illustrative purposes only and do not form the basis of these assessments.

Taxpayer's next argument is that the Due Process Clause and Commerce Clause of the United States Constitution both bar Indiana from taxing the royalty income. Taxpayer refers to Quill Corporation v. North Dakota, 504 U.S. 298 (U.S. 1992), to support its contention that physical presence is required for a state to impose tax. Quill deals with use tax, as the Court explains when it discusses the Commerce Clause requirements, "In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar, bright-line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule in *Bellas Hess* established in the area of sales and use taxes." Id., at 317. Also, in its discussion of the Due Process Clause, the Court explains that physical presence is not required for a state to impose sales tax. Id., at 308. Therefore, since the instant case deals with income tax rather than sales and use taxes, and the Court specifically states that the physical presence requirement has not been adopted for taxes other than sales and use, Quill provides no support for taxpayer.

Taxpayer's next argument is that the Department changed its interpretation of a listed tax without properly promulgating new regulations. Taxpayer refers to IC 6-8.1-3-3(b), which states:

> No change in the department's interpretation of a listed tax may take effect before the date the change is:
> (1) adopted in a rule under this section; or
> (2) published in the Indiana Register under IC 4-22-7-7(a)(5), if IC 4-22-2 does not require the interpretation to be adopted as a rule;
> if the change would increase a taxpayer's liability for a listed tax.

Taxpayer also refers to 45 IAC 15-3-2(d)(3), which states:

> In respect to rulings issued by the department, based on a particular fact situation which may affect the tax liability of the taxpayer, only the taxpayer to whom the ruling was issued is entitled to rely on it. Since the department publicizes summaries of rulings which it makes, other taxpayers with substantially identical factual situations may rely on the publicized rulings for informational purposes in preparing returns and making tax decisions. Generally, department publications may be relied on by any taxpayer if their fact situation does not vary substantially from those facts upon which the department based its publication. If a taxpayer relies on a publicized ruling and the department discovers, upon examination, that the fact situation of the particular taxpayer is different in any material respect from that situation on which the original ruling was issued, the ruling will afford the taxpayer no protection and the examination will apply to all open years under the statutes. Letters of findings that are issued by the department, as a result of protested assessments, are to be considered rulings of the department as applied to the particular facts protested.

Taxpayer believes that the Department is changing its interpretation in the instant case from its interpretation found in two revenue rulings issued in April, 1982. Taxpayer refers to DRG 82-1 and DRG 82-2, which are summaries of revenue rulings issued to a non-related taxpayer. The text of DRG 82-2 states in its entirety:

> Advice was requested as to the taxability of an Indiana-based corporation engaged in receiving copyright royalties from various sources worldwide. All of the property and employees are located in Indiana.
> The Department ruled that the taxpayer was subject to gross income tax on its entire gross receipts. IC 6-2.1-1-2(e)(6) provides an exclusion for amounts received at an out-of-state business situs, but this taxpayer has no such situs. Likewise, its entire adjusted gross income is taxable in Indiana because no other state has jurisdiction to impose a net income tax.

DRG 82-1 merely states, "See DRG 82-2, supra.".

Taxpayer states that the rulings could not be clearer or more on point, and that their interpretation of the tax statutes can not be changed prior to the promulgation of a rule or publication in the Indiana Register as required under IC 6-8.1-3-3. Taxpayer states that the audit report's attempt to do so is plainly impermissible under IC 6-8.1-3-3 and would violate taxpayer's rights under 45 IAC 15-3-2 to rely on rulings issued to other taxpayers. Taxpayer is incorrect.

DRG 82-2 is a short summary and provides little information. One obvious difference is that DRG 82-2 discusses a taxpayer with no activities outside Indiana, while the instant case deals with taxpayers who have activities in several states. Taxpayer emphasizes the last sentence of DRG 82-2, which mentions adjusted gross income and is also the tax at issue in this protest. In DRG 82-2, the Department explained that the taxpayer's entire royalty income was taxable in Indiana since there was no other taxing jurisdiction with whom to apportion the income. In the instant case, the Department has apportioned the royalty income according to the apportionment formula explained in IC 6-3-2-2. In other words, there was no reason to apportion in the 1982 instance and there is a reason to apportion in this instance. Taxpayer fails to explain why the last sentence of DRG 82-2 means that the instant audit represents an attempt to change the Department's interpretation of adjusted gross income tax statutes in this case.

In its protest, taxpayer cites only the first two sentences of 45 IAC 15-3-2(d)(3). It is clear that the two situations are materially different from one another, and as explained in the fourth sentence of 45 IAC 15-3-2(d)(3), "If a taxpayer relies on a publicized ruling and the department discovers, upon examination, that the fact situation of the particular taxpayer is different in any material respect from that situation on which the original ruling was issued, the ruling will afford the taxpayer no protection and the examination will apply to all open years under the statutes." The fact situation of this particular taxpayer is different in at least one material respect from the situation on which the original ruling was issued. Therefore, the 1982 rulings afford no protection to taxpayer.

Next, taxpayer argues that the Department erred in its calculation of the apportionment factors it used to determine the proposed assessments. Taxpayer refers to 45 IAC 3.1-1-55(e), which states:

> Gross receipts from intangible personal property shall, if classified as business income, be attributed to this state based upon the ratio which the total property and payroll factors in this state bears to the total of the property and payroll factors everywhere for the tax period as determined in Regulations 6-3-2-2(c)(010) *[45 IAC 3.1-1-40]* et seq. and 6-3-2-2(d)(010) *[45 IAC 3.1-1-47]* et seq.

Taxpayer states that the audit report does not attribute the royalty-receiving corporation's intangible income to Indiana based on their Indiana property and payroll factors, but rather by multiplying the royalty-receiving corporation's total royalty and interest income by the sales factor of the retailers to whom the royalty-receiving corporations licensed intangibles or lent money. Taxpayer believes that to do so is not only unsupportable under the Adjusted Gross Income act, but is contrary to the regulations. Taxpayer's interpretation of 45 IAC 3.1-1-55(e) is that with zero tangible personal property and zero payroll in Indiana, the apportionment factor should be zero. Taxpayer is incorrect.

The Department refers to IC 6-3-2-2(l), which states:

If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting;

(2) the exclusion of any one (1) or more of the factors;

(3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

In this case, taxpayer is correct that the royalty-receiving corporations have no Indiana payroll or real or tangible personal property. As previously explained, they do not have payroll or real or tangible personal property anywhere else either. Yet they clearly have income, and if the Department were to follow taxpayer's suggestion that the apportionment be calculated at zero, the result would not fairly represent taxpayer's income derived from sources within the state of Indiana. This situation is resolved by IC 6-3-2-2(l) which allows the exclusion of one or more of the three factors and the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. The Department included the total receipts of the royalty-receiving corporations in the denominator of the sales apportionment factor. The Department multiplied the total receipts for the royalty-receiving corporations by the sales factors of the related retail corporation since royalty revenues are directly based on sales revenues. As explained in the audit report, this results in an accurate and equitable Indiana sales factor numerator.

Taxpayer's next argument deals with the interest payments made by the retailer to the RRC. The Department referred to 45 IAC 3.1-1-59, which explains when interest is treated as business or nonbusiness income. Taxpayer states that it is irrelevant if the interest is business or nonbusiness income and refers to IC 6-3-2-2.2 to raise the point that the type of interest income in question is not included in the various descriptions therein and concludes that the interest payment income is therefore not to be included in Indiana income. IC 6-3-2-2.2 states:

(a) Interest income and other receipts from assets in the nature of loans or installment contracts that are primarily secured by or deal with real or tangible personal property are attributable to this state if the security or sale property is located in Indiana.

(b) Interest income and other receipts from consumer loans not secured by real or tangible personal property are attributable to this state if the loan in made to a resident of Indiana, whether at a place of business, by a traveling loan officer, by mail, by telephone, or by other electronic means.

(c) Interest income and other receipts from commercial loans and installment obligations not secured by real or tangible personal property are attributable to this state if the proceeds of the loan are to be applied in Indiana. If it cannot be determined where the funds are to be applied, the income and receipts are attributable to the state in which the business applied for the loan. As used in this section, "applied for" means the initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application, whichever occurs first.

(d) Interest income, merchant discount, and other receipts including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders' fees are attributable to the state to which the card charges and fees are regularly billed.

(e) Receipts from the performance of fiduciary and other services are attributable to the state in which the benefits of the services are consumed. If the benefits are consumed in more than one (1) state, the receipts from those benefits are attributable to this state on a pro rata basis according to the portion of the benefits consumed in Indiana.

(f) Receipts from the issuance of traveler's checks, money orders, or United States savings bonds are attributable to the state in which the traveler's checks, money orders, or bonds are purchased.

(g) Receipts in the form of dividends from investments are attributable to this state if the taxpayer's commercial domicile is in Indiana.

Taxpayer states that it is not possible to determine where the proceeds of the loan were applied, therefore IC 6-3-2-2.2(c) requires the income and receipts to be attributed to the state where the loan was applied for. Since the loan was applied for wholly outside of Indiana, taxpayer believes that the income and receipts can not be attributed to Indiana. Taxpayer also reiterates its argument that the regulation relied upon by the Department is invalid due to new statutory language.

Regarding the loan interest payments, the Department referred to 45 IAC 3.1-1-59 which states in relevant part:

Interest income is nonbusiness income if the intangible with respect to which the interest was received did not arise out of or was not created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible was not related to or incidental to such trade or business operations. The term "interest" as used in this regulation *[45 IAC 3.1-1-59]* includes service charges, time-price differentials, and all other charges for the use of money.

…

The Department determined that the interest in question did arise out of the regular course of the taxpayer's business operations and was therefore business income and therefore should be included in the apportionment calculations.

Regarding taxpayer's argument that the regulation is invalid because it has not been updated since the enactment of IC 6-3-2-2.2, IC 6-3-2-2.2 does provide a new statutory-level method for how to determine if loan interest is attributable to Indiana which is not referred to by 45 IAC 3.1-1-59. However, the two are not discussing the same thing. IC 6-3-2-2.2 is designed to determine the attribution of business income while 45 IAC 3.1-1-59 is designed to determine if interest income is business or nonbusiness income, not where it should be attributed.

It appears that the loans are generally applied to the retail company. Therefore, a portion of the loans are applied to the retail company's Indiana operations. The Department apportioned the amount of interest applied to Indiana with the same formula as it used to apportion royalty income, as provided in IC 6-3-2-2(m), which states:

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

In this case, the loans are made by one business to another which is controlled directly or indirectly by the same interests. The Department apportioned the income from the interest payments with the same formula as it used to apportion the royalty income which fairly reflects the income derived from sources within the state of Indiana by the various taxpayers.

In conclusion, taxpayer availed itself of Indiana's markets by licensing its trademarks and trade brands to an affiliated company doing business in Indiana. IC 6-3-2-2(a)(5) provides that this activity creates adjusted gross income derived from sources in Indiana and is therefore taxable here. The Department did not rely on a South Carolina case as its authority to tax the income. The regulations the Department did rely on are not invalid, even taking into account the 1990 revision to IC 6-3-2-2. The Due Process Clause and Commerce Clause of the Federal Constitution do not prevent Indiana from taxing the income. It can be determined that the proceeds of the loans are partially applied to Indiana, and IC 6-3-2-2.2(c) provides that the interest on those loans are partially applicable to Indiana. The Department properly included and apportioned the royalty and interest income.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty and interest, and states that the imposition of a negligence penalty is contrary to IC 6-8.1-10-2.1, which deals with the negligence penalty and its imposition. The Department refers to IC 6-8.1-10-1(e), which states, "Except as provided by IC 6-8.1-5-2(e)(2), the department may not waive the interest imposed under this section." Therefore, the Department may not waive interest.

Taxpayer states that the audit report states no factual basis for the imposition of penalties and that no factual basis exists. Taxpayer reiterates its position from Issue I that the proposed assessments are attributable to the treatment of the royalty-receiving company as subject to the adjusted gross income tax and includable in the consolidated returns, which taxpayer disagreed with. As explained in Issue I, the royalty-receiving company is subject to adjusted gross income tax and includable in the consolidated returns. At hearing, taxpayer was adamant that it had diligently attempted to comply with Indiana's tax methods and that it should not be subject to the negligence penalty.

IC 6-8.1-10-2.1(f) explains:

> The department shall adopt rules under IC 4-22-2 to prescribe the circumstances that constitute reasonable cause and negligence for purposes of this section.

The relevant regulation is 45 IAC 15-11-2(b), which states:

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

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

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

In this case, taxpayer has not affirmatively established that its failure to pay the full amount of tax due was due to reasonable cause and not due to negligence. In its protest in Issue I, taxpayer's arguments include relying on Financial Institutions Tax statutes to determine its actions regarding Adjusted Gross Income Tax, relying on an Indiana Tax court case which was not published until after the audit period, and relying on revenue rulings with materially different fact situations from its own. These are not reasonable causes to not pay the full amount of adjusted gross income tax due.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420020507.LOF

LETTER OF FINDINGS NUMBER: 02-0507
Sales and Use Tax
For the Years 1998-2000

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

ISSUES

I. Sales and Use Tax-Exemption Certificates

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-2-1, IC 6-2.5-8-8, IC 6-2.5-5-25, 45 IAC 2.2-8-8, 45 IAC 2.2-8-12, Indiana Department of Revenue Information Bulletin #10, dated February 10, 1986.

The taxpayer protests the disallowance of certain exemption certificates.

II. Sales and Use Tax-Brochures and Prizes

Authority: IC 6-2.5-3-2(a), IC 6-2.5-5-6, Maurer v. Indiana Department of State Revenue, 607 N.E.2d985 (Ind. Tax 1993).

The taxpayer protests the imposition of use tax on brochures and prizes.

III. Tax Administration-Penalty

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

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

STATEMENT OF FACTS

The taxpayer is an Indiana corporation operating as a wholesaler of fundraising materials such as candy and novelty items. The taxpayer's customers are typically not-for-profit organizations such as schools, youth sports leagues, and churches who use the taxpayer's services to raise money for their organizations. Occasionally there is a for-profit business as a customer. The taxpayer supplies their customers' members with brochures and selling tools for the members to show to family and friends. Orders are compiled and a total order of items is placed with the taxpayer. The taxpayer's customers pay for the orders at a wholesale price and collect the marked up price from their own customers. Therefore the not-for-profits collect and keep the difference for their fundraising efforts. As part of the sales agreement, the taxpayer will offer to add funds to the prize accounts or they may agree to supply prizes for sales persons selling at a certain level. The taxpayer also supplies the order forms, specialty bags, and explanation letters for the fundraising members. 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. A hearing was held and this Letter of Findings results.

I. Sales and Use Tax-Exemption Certificates

DISCUSSION

The taxpayer protested assessments of sales tax on certain sales to two youth organizations where the exemption certificates provided by the taxpayers did not include registered retail merchant certificate numbers. The taxpayer also protested the sales tax on a third youth organization that is referred to in the audit report as having given an incomplete exemption certificate but the certificate is not currently available. The taxpayer contended that these sales qualified for a statutory exemption in that they were sales to qualified not-for-profit organizations to raise money for their exempt activities. Further, the taxpayer argued that the exemption certificates were completed in accordance with the law. The first issue to be determined is whether or not the exemption certificates were properly completed.

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

Indiana sales of tangible personal property are subject to the Indiana sales tax unless they qualify for a statutory exemption. The sellers of the property are required to collect the sales tax from the purchasers and remit that tax to the state. IC 6-2.5-2-1.

IC 6-2.5-8-8 provides for exemption certificates from sales tax in pertinent part as follows:

(a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

(b) The following are the only persons authorized to issue exemption certificates:

(1) retail merchants, wholesalers, and manufacturers, who are registered with the department under this chapter;

(2) organizations which are exempt from the state gross retail tax under IC 6-2.5-5-21, IC 6-2.5-5-25, or IC 6-2.5-5-26 and which are registered with the department under this chapter; and...

45 IAC 2.2-8-8 clarifies the law pertaining to exemption certificates of not-for-profit organizations such as the taxpayer's customers as follows:

(a) Organizations exempt from gross retail tax under IC 6-2.5-5-21, IC 6-2.5-5-25, or IC 6-2.5-5-26 may register with the Not-

For-Profit Section, Income tax Division, in order to issue proper exemption certificates for exempt transactions.
(b) An exempt organization making taxable sales must register with the Central Registration Section and obtain a registered retail merchants' certificate.
45 IAC 2.2-8-12 clarifies the law concerning exemption certificates in pertinent part as follows:
(a) Exemption certificates may be issed [sic.]only by purchasers authorized to issue such certificates by the Department of Revenue. Retail merchants, manufacturers, wholesalers and others who must register with the Department of Revenue and who qualify to purchase exempt from tax under this Act [IC 6-2.5] may issue exemption certificates with respect to exempt transactions. All persons or entities not required to register with the Department as retail merchants, manufacturers, or wholesalers, and who are exempt under this [Act IC 6-2.5] with respect to all or a portion of their purchases are authorized to issue exemption certificates with respect to exempt transaction provided an exemption number has been assigned by the Department of Revenue, or provided that the Department of Revenue has specifically provided a form and manner for issuing exemption certificates without the need for assigning an exemption number...

Indiana Department of Revenue Sales Tax Information Bulletin #10 dated February 10, 1986 provides directions for the application of sales and use tax to not-for-profit corporations in pertinent part as follows:
Not-for-profit organizations (except governmental entities) are no longer required to obtain retail merchant certificates unless they conduct retail sales on which tax must be collected.
Such organizations must register with the Income Tax division of the Indiana Department of Revenue and receive a Not-For-Profit Registration Number... The Not-For-Profit Registration Number may be used on sales tax exemption certificates (form ST-105) when making qualified purchases, unless the organization has been classified as a social organization and issued a number in the 800,000 series.

The law provides for two categories of organizations that can issue exemption certificates. The first is registered retail merchants. None of the three disputed exemption certificates were issued by an organization with a valid registered retail certificate number.

The second category is organizations that qualify for exemption from the payment of sales tax pursuant to certain provisions of the Indiana Code. One of those categories is not-for-profit organizations exempted at IC 6-2.5-5-25. The taxpayer contends that the exemption certificates submitted, although improperly completed, are adequate to extinguish its responsibility to collect and remit the protested sales taxes. Since the three exemption certificates under consideration did not meet the stated standards to be valid, they cannot relieve the taxpayer of its duty to collect and remit sales taxes on items sold to these not-for-profit organizations.

Pursuant to the statute and explanatory regulation, the production of a valid exemption certificate exempts the merchant from the duty of collecting and remitting sales tax. Without a valid exemption certificate, the burden shifts back to the merchant to prove that the sales were not actually subject to sales tax as provided in 45 IAC 2.2-8-12 as follows:
(d) Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the necessity for such proof...

Although the exemption certificates presented were not adequate to exempt the taxpayer from the collecting and remitting of sales tax, the taxpayer could demonstrate that the taxpayer's customers actually used the purchased products for an exempt purpose. The taxpayer provided documentation that the soccer club and youth basketball association actually used the items for an exempt purpose.

FINDING

The taxpayer's protest is sustained as to the sales made to the soccer club and the youth basketball association. The remainder of the protest is denied.

II. Sales and Use Tax-Brochures and Prizes

DISCUSSION

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

The taxpayer purchased brochures which describe the items being sold by the fundraising customers. The brochures were included in the sales kits. The customers' members used these brochures to illustrate what they were selling to their families and friends and procure orders. The department assessed use tax on the taxpayer's use of these brochures. The taxpayer protested the assessments on the brochures based on the contention that the brochures were an integral part of the sales kit and therefore qualified for exemption pursuant to IC 6-2.5-5-6. The brochures act as both advertising for the products being sold and a means by which customers choose the products they will buy. They are clearly an essential part of the sales price. As a major cost, the cost of the brochures is factored into the cost of the candy and novelties sold and the percentage of profits going to the selling organizations. There is, however, no indication in the audit or materials provided by the taxpayer that the brochures were ever sold to the taxpayer's customers. Rather, the taxpayer provides the brochures free of charge. The taxpayer had the option of either selling the brochures or providing them free of charge. It chose the second option. Presumably that choice offered advantages to the taxpayer. It also offered the disadvantage of subjecting the taxpayer's use of the brochures to Indiana use tax.

The taxpayer also provided prizes such as pens, radios, stuffed animals, and bicycles to serve as motivators for the customers' members making the sales. The department assessed use tax on these items. The taxpayer protested the assessment contending that the prizes were exempt from gross retail and use tax based upon the Indiana Tax Court's finding in Maurer v. Indiana Department of State Revenue, 607 N.E.2d985 (Ind. Tax 1993). That case concerned a not-for-profit organization that held a fundraising raffle for a car. The not-for-profit organization purchased a car from a dealer and then sold chances to win the car. Mr. Maurer won the raffle and was charged sales tax on the transaction transferring the car. He paid the tax and claimed a refund. The Court held that Mr. Maurer had purchased the "right to claim a prize upon the happening of a contingency." Id. at 987. Since he had not purchased tangible personal property, there was no sales tax due. Further, the Court held that the not-for-profit organization had purchased the car to be used to further its exempt not-for-profit purpose. Therefore it did not owe use tax on the use of the car.

The cited Tax Court case concerned the sale of a car to an exempt not-for-profit organization and the sale of a chance to win the car. The taxpayer's situation is different. The use tax in this instance is imposed on the taxpayer. Although the taxpayer could have chosen to do so, the taxpayer did not sell the prizes to its customers. Rather the taxpayer provided the prizes free of charge. The taxpayer was the user of the prizes. The taxpayer is like the car dealer in the cited case. Had the car dealer given the car away, the car dealer would have been liable for use tax on its use of the car.

FINDING

The taxpayer's protest to the assessments of use tax on brochures and prizes is denied.

III. Tax Administration-Penalty

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

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

During the period of the audit, the taxpayer ignored the law and departmental instructions for the payment of Indiana sales tax. The taxpayer did not pay sales tax on office supplies and computer and other equipment used in the office as clearly required by the law. This breach of the taxpayer's duty constitutes negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01-20020555.LOF

LETTER OF FINDINGS NUMBER: 02-0555
ADJUSTED GROSS INCOME TAX
For 1997

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

ISSUES

I. Adjusted Gross Income Tax —Exemption for taxes paid to another state

Authority: IC § 6-8.1-5-4; 1997 IT-40

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

STATEMENT OF FACTS

The Department was contacted by taxpayer regarding a warrant for a 1997 tax assessment. Review of his records indicated that the warrant may have been issued improperly and was consequently expunged by the department, but also indicated that while earning income in Indiana, taxpayer was reporting his residence as South Carolina and indicated on his return that he was claiming credit for the taxes paid to South Carolina. Taxpayer protested that despite a residence and office in Indiana, he earned the income for the year at issue in South Carolina and had filed and paid taxes in South Carolina on the income in question. A hearing was held on January 29th, 2003 and taxpayer made these assertions and offered to provide documentation to support them. Taxpayer failed to provide documentation on this matter, and an inquiry with the South Carolina Department of Revenue- as well as a criminal investigation conducted by the Indiana Department of Revenue concurrent to this protest- found no evidence to support taxpayer's contention.

I. Adjusted Gross Income Tax—Exemption for taxes paid to another state

DISCUSSION

Taxpayer asserted that due to his payment of taxes to South Carolina, he did not owe taxes to the state of Indiana. The income in question was originally sourced to Indiana by the Department of Revenue based on information in the taxpayer's Federal returns. Taxpayer failed to respond to notices as to this assessment until after a warrant was issued. Since the Department could not confirm that the issuance of the warrant was procedurally correct, it was expunged and a protest was granted. An inquiry to the South Carolina Department of Revenue indicates that taxpayer did not file a 1997 South Carolina individual income tax return, nor did he file an extension. His Indiana IT-40 filed in 1997 stated that he had paid $2,307 as taxes paid outside of Indiana. Taxpayer reported this on Line 1 of Schedule 2, Indiana Credits, which states "Credit for Local Taxes Paid Outside Indiana (see page 19)." The page 19 reference states in relevant part:

> **Line 1 - Credit for Local Taxes Paid Outside of Indiana**
> If you figured county tax on Form IT-40, line 14, **and** had to pay a local income tax outside Indiana, you may be able to take a credit. This credit applies only if the tax you paid outside Indiana was to another city, county, town, or other local government, and they did not refund the tax or give you a credit for Indiana county tax. The credit can be used against the Indiana county tax figured if the tax is the County Adjusted Gross Income Tax (CAGIT) or County Option Income Tax (COIT). This credit **cannot** be claimed against the County Economic Development Income Tax (CEDIT). The *County Income Tax Chart* found on page 17 of this booklet lists the counties with their combined tax rates, if applicable.

The taxpayer did not mark the appropriate line on Schedule 2, Indiana Credits, under the scenario the taxpayer asserts. The line indicated by the taxpayer was explicitly for an offset of county taxes, not for the state liability. Line 4 of Schedule 2, Indiana Credits, states, "Credit for Taxes Paid to Other States: Attach other state's return (see page 21)." This issue revolves around the burden of proof, which IC § 6-8.1-5-4 defines as:

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

Taxpayer does not cite any statute, regulation, or case law for the proposition that the Department was required to accept taxpayer's assertions as to the nature of the transactions without any of the required supporting documentation. Under the facts that have been established, i.e., no return filed in South Carolina and an inaccurate and misleading completion of the Indiana return, the Department denies taxpayer's protest.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20030206.LOF

LETTER OF FINDINGS NUMBER: 03-0206
Gross Income Tax and 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.

ISSUES

I. Adjusted Gross Income Tax- Net operating loss elections

Authority: Ind. Code § 6-3-2-2.6; 45 IAC 3.1-1-9; I.R.C. § 172

Taxpayer protests the Department's disallowance of an election by taxpayer to forgo net operating loss carrybacks.

II. Gross Income Tax-Applicability

Authority: Ind. Code § 6-2.1-1-2.

Taxpayer protests the imposition of gross income tax with respect to the proceeds from the sale of a parcel of real estate.

STATEMENT OF FACTS

Taxpayer is a corporation engaged in managing several businesses in Indiana and other states. For fiscal year 1997, taxpayer had incurred a net operating loss for those businesses subject to Indiana taxation, but not for its entire consolidated group for federal purposes. However, the federal pro forma return submitted by taxpayer did not indicate that taxpayer had elected to forego carryback of its losses. Taxpayer then used the net operating loss on its returns for 1998, 1999 and 2000.

During 2000, taxpayer also sold a piece of real estate located in Indiana for a substantial sum of money. However, taxpayer listed the piece of property as being sold for a considerably lower sum of money. The difference, according to taxpayer, was that expenses for depreciation and losses were booked against the real estate for accounting purposes.

As a result of the audit, the Department found that taxpayer should have carried its net operating loss back to 1994, 1995 and 1996 prior to any application for years after 1997. The Department further found that the taxpayer should have used the gross proceeds from the sale of its real estate as opposed to the net proceeds. Taxpayer protested these issues, and accordingly this letter of findings results.

I. Adjusted Gross Income Tax- Net operating loss elections

DISCUSSION

Taxpayer argues that its net operating losses should be carried forward. In particular, taxpayer argues that its failure to check the relevant box on its federal pro forma return was inadvertent, and therefore the election should be permitted to be made.

However, taxpayer's failure to elect was greater than merely this oversight. Ordinarily, the federal election controls the state election. 45 IAC 3.1-1-9. On the corporate tax return, Schedule IT-20NOL, is a box that can be checked if a taxpayer has a net operating loss for a given tax year for state purposes but not for federal purposes. However, the box for making the election with respect to the net operating loss was not checked. The act of checking the relevant box constitutes the election in question. Conversely, failure to check the box is not an election. Taxpayer, by failing to comply with the requirements to make a timely election to waive the carryback of its losses, is subject to carryback of its losses.

Taxpayer also cites to a Department letter of findings for the proposition that the Department is willing to overlook innocent mistakes by a taxpayer. In that letter of findings, the taxpayer had a net operating loss carryover that was not shown on a federal pro forma return after the taxpayer had merged with another company. The auditor treated the net operating loss as being eliminated by the merger, which would have ended any net operating loss carryover for Indiana. However, it was determined that the successor corporation was entitled to continue using its net operating loss carryovers for federal purposes, and accordingly the taxpayer's return was proper in that respect.

Unlike the corporation in the letter of findings cited by taxpayer, where the corporation was compliant with state and federal law, the failure to make an election to not carry back its net operating losses was non-compliance with state and federal law. Such non-compliance denies the election. Further, permitting the election to waive carrybacks in this case where the taxpayer does not properly make the election on the initial return would be a license to permit future taxpayers to not make the election, and then allow them to make (or not make) the election if circumstances permitted at a later time, renders the phrase "irrevocable for such taxable year" meaningless. I.R.C. § 172(b)(3).

Taxpayer further maintains that the years prior to fiscal year 1997 were loss years, and thus a carryback would have been superfluous. First, taxpayer's returns actually show a net profit for Indiana purposes during the first two of those prior years. Second, if taxpayer had net operating losses from years prior to 1994 that were not utilized in those three years, then an election to waive a carryback would have been a functional nullity – the loss could realistically only be carried forward, regardless of any election. As a result, taxpayer's net operating losses are to be carried back in accordance with Ind. Code § 6-3-2-2.6.

FINDING

Taxpayer's protest is denied.

II. Gross income tax- Applicability

DISCUSSION

Taxpayer has also protested the imposition of gross income tax with respect to the sale of a parcel of real estate. In particular, taxpayer protested the imposition of tax with respect to the full sale price as opposed to the net sale price. Under Ind. Code § 6-2.1-1-2(a)(3), all proceeds from the sale of real property in Indiana are subject to tax, subject to certain deductions and exemptions not at issue here. Accordingly, taxpayer's protest must be denied.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030216.LOF

LETTER OF FINDINGS: 03-0216
Indiana Corporate Income Tax
For 1999, 2000, and 2001

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

ISSUES

I. Rent Expense Computational Error.

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

Taxpayer argues that the audit erred by understating the amount of its rent expenses.

II. Royalty Income Received from the Licensing Trademarks to Foreign Subsidiaries – Adjusted Gross Income Tax.

Authority: IC 6-3-1-20; IC 6-3-2-2(a); IC 6-3-2-2(a)(5); IC 6-3-2-2(b); IC 6-3-2-2(g) to (k); IC 6-3-2-2.2; Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983); May Department Store Co. v. Indiana Dept. of State Revenue, 746 N.E.2d 651

(Ind. Tax Ct. 2001); Chief Industries v. Dep't of Revenue, 792 N.E.2d 972 (Ind. Tax Ct. 2000); Hunt Corp. v. Dep't of State Revenue, 709 N.E.2d 766 (Ind. Tax Ct. 1999); 45 IAC 3.1-1-29; 45 IAC 3.1-1-30.

Taxpayer claims that the audit incorrectly classified its royalty income as "business" income and that the income should be classified as "non-business."

STATEMENT OF FACTS

Taxpayer is an out-of-state air carrier in the business of transporting and delivering packages. Taxpayer operates both within and without the United States.

The Department of Revenue (Department) conducted an audit review of taxpayer's returns and business records. The audit made a number of adjustments. Taxpayer challenged two of these adjustments and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for the protest. This Letter of Findings results.

DISCUSSION

I. Rent Expense Computational Error.

In preparing its federal income tax return for the fiscal year ending May 31, 2001, taxpayer erroneously listed certain royalty payments as "other deductions." Before taxpayer filed the return, the error was discovered and corrected. When taxpayer's general ledger was incorporated into its tax software, the royalty payments were "mapped" to the rents expense line of its pro forma income tax return. An "adjusting entry" was made in the software program to move these royalty payments from the return's expense line to the gross royalties' income line. However, while the income portion of the adjusting entry was credited correctly, the wrong expense line was debited. This posting error resulted in an offsetting debit and credit being reported on two separate expense lines on the federal return.

In reviewing taxpayer's records, the audit made an adjustment to taxpayer's rent expense. According to taxpayer – and in apparent reliance upon the taxpayer's own records – the audit substantially understated the amount of taxpayer's rent expense.

Taxpayer now asks that this error be corrected.

The audit's original determination is presumed correct. IC 6-8.1-5-1(b) states in part that, "The notice of proposed assessment is prima facie evidence that the department's claim for unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with person against whom the proposed assessment is made."

Taxpayer has provided detailed financial records purporting to establish that the amount of rent expense as indicated on the audit report was erroneous and attempting to explain the basis for that error.

A letter of findings is not the appropriate means by which to correct mathematical or accounting errors. However, taxpayer has met its burden of demonstrating that its argument is neither wholly unsubstantiated nor entirely frivolous. The audit review is requested to review the original audit report, taxpayer's newly provided information, taxpayer's narrative, and to make whatever adjustment may be appropriate.

FINDING

Subject to audit's review, taxpayer's protest is sustained.

II. Royalty Income Received from the Licensing Trademarks to Foreign Subsidiaries – Adjusted Gross Income Tax.

Taxpayer has foreign subsidiaries. The subsidiaries are also in the business of transporting and delivering packages. Taxpayer entered into agreements which permit these subsidiaries to use taxpayer's trademarks. These agreements are called "Service Mark Agreements." In return for the right to use these trademarks, the foreign subsidiaries pay taxpayer royalties.

The taxpayer originally classified this income as "non-business income" and reported it on Schedule F of taxpayer's Indiana corporate income tax returns. During the audit review, the income was reclassified from "non-business income" to "business income." The audit did so citing as authority 45 IAC 3.1-1-29. In part, that regulation reads as follows:

> "Business Income" defined. "Business Income" is defined in the Act as income from transactions and activity in the regular course of the taxpayer's trade or business including income from tangible and intangible property if the acquisition, management, or disposition of the property are integral parts of the taxpayer's regular trade or business.
>
> Nonbusiness income means all income other than business income.
>
> The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, non-operating income, etc., is of no aid in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business.

Whether taxpayer's income is classified as "business" or "non-business" makes a difference because of the way in which a corporate taxpayer's adjusted gross income is calculated. For purpose of determining a taxpayer's adjusted gross income tax liability, business income is apportioned between Indiana and other states using a three-factor formula. IC 6-3-2-2(b). In contrast, non-business income is either allocated to Indiana or is allocated to another state. IC 6-3-2-2(g) to (k). Therefore, "whether income is deemed business income or non-business income determines whether it is allocated to a specific state or whether it is apportioned between Indiana and other states [in which] the taxpayer is conducting its trade or business." May Department Store Co. v. Indiana Dept. of State Revenue, 746 N.E.2d 651, 656 (Ind. Tax Ct. 2001).

If – as taxpayer contends – these royalty payments constitute "non-business" income, then the income is allocated outside of Indiana. In addition, taxpayer raises alternative threshold issues.

A. Royalty Income as Derived From Sources Within Indiana.

Taxpayer states the royalty payments are not taxable under Indiana law because the royalty payments are not "derived from sources within Indiana." Taxpayer contends that it is not necessary to reach the "business" / "non-business" distinction because the income should be "sourced" to the out-of-state location where the royalty income was generated. In support of that argument, taxpayer cites to Chief Industries v. Dep't of Revenue, 792 N.E.2d 972 (Ind. Tax Ct. 2000).

Taxpayer seeks to turn the adjusted gross income tax scheme on its head by setting out a threshold sourcing test. It is difficult to accept taxpayer's argument in the face of the generally accepted statutory scheme under IC 6-3-2-2(a) to (k). The scheme asks whether the royalties are business or non-business income and whether the sales, payroll, and property of the taxpayer are apportionable to Indiana in the case of business income or the income is allocable to Indiana in the case of non-business income.

"[S]tates do not have to evaluate each income generating activity of the corporate enterprise in order to determine whether the income gained from that activity is properly taxable by the state. Instead the state may look at all of the income gained by the corporate enterprise's business activity and determine the state's fair share of that total." Hunt Corp. v. Dep't of State Revenue, 709 N.E.2d 766, 769 (Ind. Tax Ct. 1999). Taxpayer's effort to interpose a threshold sourcing test for royalty income does not survive close scrutiny. "In order to determine what income is attributable to Indiana, it must *first* be determined whether the income sought to be attributed is business or non-business income." Id. at 771 (*Emphasis added*).

Taxpayer's argument that out-of-state royalty income – by definition – falls outside Indiana's adjusted gross income tax scheme is not well founded. The Indiana legislature has defined "adjusted gross income" as including "(1) income from real or tangible personal property in this state; (2) income from doing business in this state; (3) income from a trade or profession conducted in this state; (4) compensation for labor or services rendered within this state; and (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter." IC 6-3-2-2(a). IC 6-3-2-2(a)(5) includes an internal reference to IC 6-3-2-2.2 but IC 6-3-2-2.2 is limited in its effect acting only to describe the manner in which interest and dividend is attributed to the state.

B. Royalties as Business / Non-business Income.

The audit found that the royalty income received from taxpayer's foreign subsidiaries constituted "business" income. Taxpayer disagrees arguing that it is in the package transportation business and not in the business of licensing intangibles.

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

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

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

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

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

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

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

The audit correctly decided that the money received in the form of royalty payments constituted "business income." Taxpayer's core business involves the transportation and delivery of packages; however, taxpayer has also entered into agreements whereby it licenses its trademarks – developed during and associated with the package delivery and transport business – to its foreign subsidiaries. These agreements are ongoing arrangements by which taxpayer receives royalty payments acknowledging taxpayer's primary ownership of the trademarks, acknowledging the value of the trademarks to the foreign subsidiaries' business, and acknowledging the value of the trademarks developed through taxpayer's business acumen, experience, and reputation. The royalty proceeds are properly classified as "business income" pursuant to the transactional test.

In addition, the income is properly classified as "business income" under the functional test because the trademark properties are an integral part of taxpayer's package transportation and delivery business. Although taxpayer may be correct in stating that it is not in the business of licensing trademarks, that distinction is irrelevant. The issue is not whether taxpayer is or is not in the business of licensing trademarks. The issue is whether the royalties are classified as "business" or non-business" income. During the regular course of its business, taxpayer decided to license its valuable trademarks to its subsidiaries, to exploit the value of the trademarks it had nurtured, and thereafter to allow – in return for valuable consideration – its own subsidiaries to employ those trademarks in developing and promoting the subsidiaries' package transportation and delivery business. The royalty income is properly classified as "business income" pursuant to the functional test.

C. Royalty Expense Deductions.

Taxpayer argues that if the Department classifies the royalties as "business income," it is being inconsistent because – in addressing issues related to royalty payments – the Department "has repeatedly held that the licensee should not be entitled to a deduction for [royalty] payments, holding in essence that the payments should be disregarded for Indiana adjusted gross income tax purposes." Taxpayer refers to instances in which a trademark licensee has been refused permission to claim, as legitimate business expenses, royalty payments made to a licensor with which the licensee has a symbiotic business relationship. Taxpayer refers to instances in which a claimed business expense has been disallowed because the royalty payments were based upon a sham transaction without any rational or justifiable business purpose. Taxpayer cites to instances in which the claimed business expenses were disallowed because the royalty payments were simply a charade to avoid state income tax liability. Nonetheless, taxpayer argues that because – in certain instances – the Department has disallowed royalty business expenses, the Department cannot now classify royalty receipts as "business income."

Taxpayer is mixing apples and oranges. Taxpayer is correct in pointing out that the Department has disallowed claimed business expenses because the royalty payments upon which the expenses were claimed were simply an elaborate accounting ruse. However, the allowance or disallowance of business expenses is an issue entirely separate from the issue of whether royalty income is or is not "business income."

D. Constitutionality.

Taxpayer argues that "any attempt to impose tax would in fact violate the Commerce Clause and Due Process Clause of the United States Constitution." Taxpayer cites to Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) in support of its argument that because "All aspects of the licensing transactions occurred outside Indiana... [a]ny efforts to impose tax under these facts would violate the constitutional prerequisites for apportionment of income." Taxpayer somewhat overstates the constitutional constraints imposed on Indiana. The Constitution does indeed restrict an individual state's right to "tax value earned outside its borders." Id. at 164. However, Indiana does not seek to levy an income tax on taxpayer's royalty payments; Indiana seeks to tax taxpayer's unitary business – which necessarily includes the royalty payments – based upon well-founded, long-established, apportionment principles which observe the distinction between "business" and "non-business" income. "[I]t is constitutionally permissible for a State to tax an apportioned share of a corporate enterprise's multi-state income." Hunt, 709 N.E.2d at 769. Having determined that the royalty income should be included within the formulary tax calculation, taxpayer then "has the burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed." Container Corp. at 164. (Punctuation omitted). Taxpayer has failed to do so, and the Department is unable to agree that apportionment of taxpayer's royalty income is constitutionally offensive.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220030223.LOF

LETTER OF FINDINGS: 03-0223
Indiana Corporate Income Tax
For 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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

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

Authority: Public Law 86-272; IC 6-3-2-1(b); IC 6-3-2-2; IC 6-3-2-2(e); IC 6-3-2-2(n); IC 6-3-2-2(n)(1); First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999); 45 IAC 3.1-1-64; Mich. Comp. Laws § 208.31(3); Jerome R. Hellerstein and Walter Hellerstein, State and Local Taxation: Cases and Materials (7th ed. 2001); Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue erred when it required that taxpayer – in calculating its adjusted gross income – add back the income obtained from selling goods to Michigan customers.

STATEMENT OF FACTS

Taxpayer is a holding company for several businesses which sell packaging materials. The Department of Revenue (Department) conducted an audit review of taxpayer's tax returns and business records. The audit found that – in arriving at its adjusted gross income – taxpayer had deducted sales made to Michigan customers by two of taxpayer's businesses. The Department concluded that this specific deduction was unwarranted and that the sales should have been "thrown back" to Indiana. The consequent adjustment resulted in the assessment of additional Indiana corporate income tax.

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

DISCUSSION

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

For purposes of calculating taxpayer's adjusted gross income, the money that two of taxpayer's businesses received from selling goods to Michigan customers was "thrown back" to Indiana. The audit did so on the ground that the two businesses were not subject to Michigan's taxing jurisdiction pursuant to Public Law 86-272.

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

Taxpayer argues that it is subject to the Michigan Single Business Tax (MSBT) which states that, "[T]he tax levied under this section and imposed is upon the privilege of doing business and not upon income...." Mich. Comp. Laws § 208.31(3). Taxpayer maintains that it has a taxable nexus with Michigan based upon the number of days its sales persons worked in that state. Taxpayer asserts that it did not file the MSBT returns simply as a ploy to eliminate sales to Indiana. According to taxpayer, the MBST falls squarely within IC 6-3-2-2(n) because it is a "franchise tax for the privilege of doing business...." Id.

The Department has interpreted IC 6-3-2-2(n) to mean, "A corporation is 'taxable in another state' under the Act when such state has jurisdiction to subject it to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of Public Law 86-272...." 45 IAC 3.1-1-64.

Nonetheless, taxpayer maintains that 45 IAC 3.1-1-64 "certainly does not conform to the Indiana statute 6-3-2-2 Section 2n." However, resolution of the question presented by taxpayer does not turn on the finer points of statutory or regulatory interpretation. Under a fair reading of IC 6-3-2-2(n), the issue is whether or not taxpayer's activities within Michigan provided that state with the authority to tax the income received from those activities. Conversely, were taxpayer's activities such that federal law (Public Law 86-272) precluded Michigan from imposing a net income tax on those receipts. Taxpayer chooses to sidestep this standard and focuses entirely on the fact that it paid the MSBT. Taxpayer's rationale is that because it paid the MSBT, it does not have to pay the Indiana tax.

The Department must respectfully disagree with taxpayer's conclusion that imposition of the MSBT automatically precludes Indiana from throwing back taxpayer's Michigan sourced sales receipts. The Indiana Tax Court has stated, "The MSBT is a type of value added tax. VAT" First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631, 632 (Ind. Tax Ct. 1999). "Although taxable income is one portion of the tax base formula, *the MSBT is not measured by or based on income.*" Id. at 634 (*Emphasis* *added*). “The law [Public Law 86-272] applies only to net income taxes... and does not apply to the general business of taxes of states that do not employ a net income measure, such as Michigan’s Single Business Tax, which is a form of value-added tax.” Jerome R. Hellerstein and Walter Hellerstein, State and Local Taxation: Cases and Materials 389 (7th ed. 2001).

In every sales transaction, at least one state has the power to impose a net income tax on the money derived from the sale of tangible personal property; if the state in which the sale occurred is forbidden to do so by Public Law 86-272, then the income is “thrown-back” to the originating state. In this case, taxpayer sold goods to Michigan customers, but Indiana was the originating state. Michigan is not constrained by Public Law 86-272 from imposing the MSBT because the MSBT is not a net income tax. Therefore, the issue is whether taxpayer’s activities within Michigan were such that Michigan has “jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, [Michigan] does or does not.” However, taxpayer has declined the opportunity to do so because it” [does] not believe it is necessary to provide any additional information related to Michigan activities.” Instead, taxpayer concludes that imposition of the MSBT is entirely dispositive of the question of whether Indiana may throw back these sales; taxpayer errs because the MSBT is not “a *franchise* tax for the privilege of doing business....” IC 6-3-2-2(n). The MSBT is not “based on or measured by income.” First Chicago NBD, 708 N.E.2d at 634. (*Emphasis* added). As a VAT, the MSBT is one of the costs of doing business in Michigan; however, the MSBT itself is akin to a sales tax, it is plainly not a tax based on or measured by income.

Based upon the information taxpayer chose to provide, it is not known whether taxpayer’s activities within Michigan gave that state the authority to impose a tax based on taxpayer’s Michigan income. Based upon the information taxpayer chose to provide, it is not known whether taxpayer’s activities within Michigan were such that Public Law 86-272 *precluded* Michigan from imposing a tax based upon on taxpayer’s Michigan income. Therefore, the sales proceeds were properly thrown back to Indiana.

FINDING

Taxpayer’s protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420030293.LOF

LETTER OF FINDINGS NUMBER: 03-0293
Responsible Officer Liability—Duty to Remit Sales and Withholding Taxes
For Tax Year 2001

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

ISSUES

I. Responsible Officer Liability—Duty to Remit Sales and Withholding Taxes

Authority: IC § 6-2.5-2-1; IC § 6-2.5-9-3; IC § 6-3-4-8; 45 IAC 2.2-9-4; *Indiana Department of Revenue v. Safayan,* 654 N.E.2d 270, 273 (Ind. 1995)

Taxpayer protests the Department’s determination of responsible officer liability for sales and withholding taxes not paid during the assessment period.

STATEMENT OF FACTS

At all times relevant to the protest of the Department’s determination of responsibility officer liability, taxpayer was an employee of the corporation. Taxpayer’s job title was vice-president of engineering. The corporation manufactures and installs large-scale commercial skylights. Taxpayer’s duties and responsibilities as an employee for the corporation were exclusively in the areas of engineering and, to a more limited extent, sales. Taxpayer’s primary function was to design, develop, and test the skylights the corporation manufactured. Additional facts will be supplied as necessary.

I. Responsible Officer Liability—Duty to Remit Sales and Withholding Taxes

A gross retail (sales) tax is imposed on retail transactions made in Indiana. While this sales tax is levied on the purchaser of retail goods, it is the retail merchant who must “collect the tax as agent for the state.” *See*, IC § 6-2.5-2-1.

Individuals may be held personally responsible for failing to remit any sales tax. In determining who may acquire personal liability, IC § 6-2.5-9-3 is applicable:

An individual who:

(1) is an individual retail merchant or is an employee, officer, or member of a corporate or partnership retail merchant; and

(2) has a duty to remit state gross retail or use taxes (as described in IC § 6-2.5-3-2) to the department;

holds those taxes in trust for the state and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes to the state.

An income tax is assessed on wages that employers pay to their employees. The employer is responsible, and liable, for deducting, retaining, and paying “the amount prescribed in [the] withholding instructions. *See*, IC § 6-3-4-8(a). Like the sales tax, employers hold the withholding tax in trust for the state.

IC § 6-3-4-8(f) provides in pertinent part:

> All money deducted and withheld by an employer shall immediately upon such deduction be the money of the state, and every employer who deducts and retains any amount of money under the provisions of IC § 6-3 shall hold the same in trust for the state of Indiana.

In order to determine which persons are personally liable for the payment of these "trust" taxes, the Department must initially determine which parties had a duty to remit the taxes to the Department. *Indiana Department of Revenue v. Safayan*, 654 N.E.2d 270, 273 (Ind. 1995) is instructive:

> The method of determining whether a given individual is a responsible person is the same under the gross retail and the withholding tax…. An individual is personally liable for unpaid sales and withholding taxes if she is an officer, employee, or member of the employer who has a duty to remit the taxes to the Department…. The statutory duty to remit trust taxes falls on any officer or employee who has the authority to see that the taxes are paid.

The Indiana Supreme Court in *Safayan* identified three relevant factors:

(1) the person's position within the power structure of the corporation;

(2) the authority of the officer or employee as established by the articles of incorporation, bylaws, or the person's employment contract; and

(3) whether the person actually exercised control over the finances of the business.

The Supreme Court also stated in *Safayan* that "where the individual was a high ranking officer, we presume that he or she had sufficient control over the company's finances to give rise to a duty to remit the trust taxes." Id. at 273. The Department further notes that *Safayan* specifically rejects the defense of failure by an officer to exercise oversight.

In addition to the duties set forth *supra*, taxpayer also had other responsibilities, such as designing equipment for bending, extrusions, and break metal used in the skylight manufacturing process. Taxpayer also designed tanks for pretreatment, a part baking oven and overhead conveyor system for the painting system the corporation used. In addition, taxpayer also called upon architects and contractors in a sales capacity and assumed the duties of a project manager in connection with the corporation's larger installation projects.

Previous to and/or during the relevant time period, the corporation decided to expand its plant on six occasions, taxpayer was consulted regarding the engineering and production capacity issues involved with the plant expansions and designed the building expansions. However, taxpayer did not participate in the basic decisions whether to expand or not, nor did he participate in any financial matters relating to the financing of the plant. Taxpayer's duties did not include any office functions. He had no duties relating to the corporation's accounting functions or the corporation's financial management. Taxpayer did not participate in decisions regarding which creditors were to be paid. Taxpayer did not have access to the corporation's books or accounting records and was not otherwise consulted regarding financial matters, nor did he attend meetings at which accounting or financial matters were discussed. Taxpayer did not participate in, prepare, or review the corporation's tax returns, and was unaware the corporation had failed to pay its withholding and sales tax liabilities.

To the best of taxpayer's knowledge, he was not a member of the corporation's board of directors, and to the extent any corporate filings may have listed him as, such, the filings were made without his knowledge or consent. Taxpayer does not know, and did not know at the time, who was on the board; he assumes the owner was. Taxpayer did not sign checks on behalf of the corporation nor to his knowledge was he an authorized signatory on any corporate checking account. Taxpayer was compensated on a salary basis, and received 10% of the corporation's stock as a bonus.

All major decisions of the corporation were made by its founder, president, and majority stockholder, Mr. X. Taxpayer's receipt of the stock bonus had no effect on how Mr. X operated the corporation and stock ownership did not, as a practical matter, entitle taxpayer to any say in how the corporation was operated, or in any of its financial decisions. According to taxpayer, what Mr. X decided controlled, and his decisions were final. Mr. X relied on taxpayer's expertise in engineering matters. Taxpayer's role in the corporation did not extend beyond engineering matters and taxpayer had no role in the financial management of the corporation and was unaware of any tax problems.

Taxpayer had authority over design engineering matters, but Mr. X ran the company, founded it, and was the majority owner. Things were either done his way, or an employee who disagreed could "hit the highway." There are no documents in existence showing taxpayer had the duty or authority to pay trust taxes. Taxpayer exercised no control whatsoever over the corporation's business and finances; again, Mr. X had total control in those areas.

FINDING

Based on all the above, taxpayer's protest of the Department's determination of responsible officer liability is sustained.

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS: 03-0472
Indiana Gross Retail Tax
For 2001

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

ISSUE

I. Contract for the Purchase and Installation of HVAC Equipment – Gross Retail Tax.

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2(a); 45 IAC 2.2-4-22(e); 45 IAC 2.2-4-25(a); 45 IAC 2.2-4-26(a); Sales Tax Information Bulletin 60 (Dec. 2002).

Taxpayer argues that that it is not required to pay use tax on the cost of purchasing and installing air conditioning and heating equipment at taxpayer's business location.

STATEMENT OF FACTS

Taxpayer operates an Indiana service business. During 2003, the Department of Revenue (Department) conducted an audit review of taxpayer's business records and concluded that taxpayer had failed to pay sales tax on a contract for the purchase and installation of heating and air conditioning equipment. The Department concluded that the sales tax should have been collected by the contractor at the time taxpayer paid for the equipment and installation. Accordingly, the Department assessed use tax and sent a notice of proposed assessment dated November 2003.

Taxpayer challenged the assessment and sent a protest to that effect during November 2003. Taxpayer declined the opportunity take part in an administrative hearing on the challenged assessment. Instead, taxpayer instructed the Department to prepare a Letter of Findings based upon the contents of taxpayer's initial protest letter, the information contained within the Department's audit report, and on other correspondence sent by the taxpayer. This Letter of Findings results.

DISCUSSION

I. Contract for the Purchase and Installation of HVAC Equipment – Gross Retail Tax.

In 2001, taxpayer hired a contractor to install new air conditioning and heating equipment. After the equipment was installed, the contractor submitted a bill for $5,060. The bill stated charges of $3,100 for a "new 90% gas furnace" and $1,960 for a "5 ton condensing unit." The bill was apparently for both labor and materials although the bill did not differentiate between those costs. The bill had a space listed for "tax," but there was nothing written in that space.

The audit found that, "The taxpayer entered into a time and material contract for building improvements, i.e. furnace and air conditioning system." The audit stated that the contractor was acting as a retail merchant with respect to the materials furnished and should have collected sales tax with respect to those materials. Because the contractor failed to do so, the audit concluded that taxpayer was required to pay the corresponding use tax.

Taxpayer protested this decision and sent the Department a letter from the contractor in which the contractor stated that "sales tax was included in our quote... for the [] HVAC work that was completed in November of 2001 in the amount of $5,060." The contractor's letter also stated that, "The exact amount of sales tax paid was $108.34 on the materials involved in this job."

The Department requested that taxpayer provide a copy of the contractor's original quote which purportedly included the sales tax charge. Taxpayer did so but the contractor's original quote did not state that sales tax would be charged. Instead the quote provided that the contractor would "supply all labor, equipment, and supplies necessary to replace the existing furnace...." The quote stated that it would charge $3,100 for the new furnace and $1,960 for the new air conditioner.

It is taxpayer's contention that "sales tax was paid on the materials...." Taxpayer stated that the furnace and air conditioning equipment were "a permanent attachment to real estate and... are not subject to sales tax." Taxpayer concludes that it is not its responsibility to "determine how [contractor] computes and pays sales tax to the state of Indiana."

Indiana imposes a sales tax on retail sales of tangible personal property. IC 6-2.5-2-1. Indiana also imposes a complementary use tax on tangible personal property stored used, or consumed in Indiana when the sales tax was not paid at the time of the purchase. IC 6-2.5-3-2(a). The audit found that because the contractor's bill did not include a listing for sales tax, taxpayer should have paid use tax when it bought the air conditioning and heating units.

From the information provided by taxpayer and the contractor, it becomes apparent that the parties entered into a lump sum contract for improvements to taxpayer's business location. Sales Tax Information Bulletin 60 (Dec. 2002) states that, "'Lump sum contract' means a contract to incorporate construction materials into real estate with the charge for labor and materials being quoted as one price." *See also* Sales Tax Information Bulletin 60 (Nov. 2000). The fact that the parties entered into a lump sum contract is significant because taxpayer is not subject to use tax liability for those transactions – entered into for the purpose of improving the taxpayer's realty – in which the agreement is couched in terms of a lump sum contract. Under 45 IAC 2.2-4-22(e), "With respect to construction material a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner... He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price." Accordingly, the contractor will either pay the gross retail tax "up-front" when he initially purchases the construction materials or at the point where the materials are incorporated into the taxpayer's realty. Either "up-front" or at the point where the materials are incorporated into the taxpayer's realty, in lump sum contracts between the taxpayer and its contractors, it is the contractors which are ultimately responsible for paying the gross retail tax on the construction materials. 45 IAC 2.2-4-26(a) provides that "[a] person making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used." 45 IAC 2.2-4-25(a) states that, "For purposes of [45 IAC 2.2], 'contractor' means any person engaged in converting construction material into realty." The regulation defines the term "contractor" to include "persons engaged in building, cement work, carpentry, plumbing, *heating*, electrical work, roofing, wrecking, excavating, plastering, tile and road construction." Id. (*Emphasis added*).

Taxpayer entered into an agreement with its contractor for the purchase and installation of new heating and air conditioning equipment. The agreement was framed in terms of a lump sum contract. The contractor was responsible for paying sales tax when it initially purchased the equipment or use tax when it installed the equipment at taxpayer's business location. The contractor's responsibility for doing so is not the taxpayer's concern.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 04-0097
Sales/Use Tax
For the Year 2001

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

ISSUE

I. Sales/Use Tax—Assessment on Purchase of Aircraft

Authority: IC 6-2.5-5-27; IC 6-8.1-5-1; 45 IAC 2.2-5-61; Title 14 CFR, (Part) section 21, 43, 91, 121, 125, 135; Panhandle Eastern Pipeline Company v. Dept. of Revenue, 741 N.E.2d 816 (Ind. Tax 2001); Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 55 N.E. 745 (1899); *Indiana Register*, Volume 25, Number 7, April 1, 2002; FAA AC 120-12A (4/24/86).

Taxpayer protests the assessment of sales tax on the purchase of an aircraft Taxpayer asserts is used in Public Transportation.

II. Sales/Use Tax—Trade in value of an aircraft

Authority: IC 6-8.1-5-1; IC 6-2.5-1-1; 45 IAC 2.2-3-6

Taxpayer protests the disallowance of the trade in value of an aircraft against the purchase cost of a new aircraft in determining the amount subject to sale/use tax.

STATEMENT OF FACTS

Taxpayer is a single member LLC disregarded for federal and state income tax purposes—consolidated with its owner, Parent. In March 2001, Taxpayer purchased an aircraft—a Raytheon Beechcraft King Air 350. Taxpayer was established with the intent to transport the employees, property, customers, and suppliers of Parent and Parent's affiliates. Taxpayer seeks the Public Transportation exemption to sales/use tax permitted in IC 6-2.5-5-27, which states:

Public transportation; acquisitions

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

The Department has promulgated a regulation addressing and defining Public Transportation, as it relates to the exemption. 45 IAC 2.2-5-61(b) states:

Definition: Public Transportation.

Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation unless it is in fact engaged in the transportation of persons or property for consideration as defined above.

Taxpayer owns the aircraft, and contracts with third parties for operation services and accounting services. Since the purchase of the aircraft, Third-party Operations has provided to Taxpayer travel related services—including pilots, maintenance, training, and assistance with certifications and warranties. Third-party Operations maintains Taxpayer's authority to operate under a Part 91 certification by the FAA. Third-party Operations initially provided to Taxpayer accounting services—including billing, check writing, and bookkeeping. In 2002, Third-party Accounting took over the accounting services previously provided to Taxpayer by Third-party

Operations. Taxpayer, initially through Third-party Operations, and now through Third-party Accounting, bills Parent for the use of Taxpayer's aircraft by Parent's affiliates.

I. Sales/Use Tax—Assessment on Purchase of Aircraft

DISCUSSION

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). Tax exemption statutes are construed strictly in favor of taxation. Panhandle Eastern Pipeline Company v. Dept. of Revenue, 741 N.E.2d 816, 818 (Ind. Tax 2001). To prevail, a taxpayer must prove that it meets the requirements of IC 6-2.5-5-27. *See id*. Taxpayer asserts that it meets the statutory requirements of IC 6-2.5-5-27 for entitlement to the Public Transportation exemption. Taxpayer asserts it meets the regulatory requirements of 45 IAC 2.2-5-61(b) to be defined as a Public Transportation company. Taxpayer asserts it operates under 45 IAC 2.2-5-61(b) as a contract carrier.

Having received the evidence presented by Taxpayer and having considered the testimony given at hearing, the Department must apply the elements of the Public Transportation statute and regulation.

The Tax Court has stated that the public transportation exemption provided by IC 6-2.5-5-27 is an all-or-nothing exemption; if a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption, but if a taxpayer is not predominately engaged in transporting [third-parties or] the property of another, it is not entitled to the exemption. Panhandle, 741 N.E.2d at 819.

Public transportation of others is a serious matter—a high duty of care is imposed. Air travel is highly regulated. The Indiana Supreme Court—as well as courts across the land—have stated that a party cannot have the benefits without the burdens. *See* Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 301-02; 55 N.E. 745, 749 (1899). Taxpayer is seeking the benefits of the Public Transportation exemption—without assuming the burdens of being a Public Transportation entity. 45 IAC 2.2-5-61(b) states that public transportation carriers are required to operate under an authority—unless specifically exempted.

The aircraft is registered with the FAA to operate under Part 91 and is registered with the State of Indiana. Under the Department's Public Transportation regulation, an entity seeking the Public Transportation exemption is required to demonstrate that it is a public transportation entity by operating under the authority of—in this case—the U.S. Department of Transportation, specifically the FAA. While the regulation also mentions the Aeronautics Commission of Indiana, the agency has been subsumed into the Indiana Department of Transportation. Its primary function is the regulation and administration of airports. The *Indiana Register*, Volume 25, Number 7, April 1, 2002, p. 2206, states that the Aeronautics Commission of Indiana's rules are entirely repealed, transferred, or otherwise voided. The regulation also names the U.S. Civil Aeronautics Board. Taxpayer has not stated it operates as a Public Transportation entity under the authority of the Aeronautics Commissions of Indiana or the U.S. Civil Aeronautics Board. The Department mentions these two agencies so as to address those potential agencies that could possibly be invoked for qualifying for the Public Transportation exemption by operating under their authority. Taxpayer has stated that it operates as a Public Transportation entity only under the authority of the FAA. While Taxpayer is authorized to operate its aircraft—Taxpayer has not registered to operate its aircraft under FAA regulations as a Public Transportation entity. Taxpayer has not sought a Part 135, 121, or 125 registration with the FAA. These are public transportation registrations; they will be discussed further below.

The FAA has issued an Advisory Circular discussing private carriage versus common carriage of persons or property. FAA AC 120-12A (4/24/86). The FAA states that the advisory circular furnishes general guidelines for determining whether transportation operations constitute private or common carriage. *Id*. at 1. Operations that constitute common carriage are required to be conducted under Federal Aviation Regulations (FAR) Parts 121 or 135. Private carriage may be conducted under FAR Parts 125 or 91, Subpart D. Of note, the Department only permits the Public Transportation exemption for those operating under Part 125 if there exists a bona fide third party carriage operation. In Indiana, those operating under Part 125 in private carriage are not entitled to the Public Transportation exemption. An example of a bona fide Public Transportation exemption under Part 125 is where a professional sports team has a contract with an air carrier to transport the team. This is a contract carrier. An aircraft is dedicated to transporting the team; the general public cannot obtain a ticket. But the aircraft is owned and operated by a bona fide third party. The professional sports team has secured exclusive rights to use that aircraft. Lest Taxpayer attempt to argue that it is structured similarly to this, it needs to be noted that these professional sports teams have secured the exclusive right to fly on an airliner aircraft. Airliner aircraft are held to stricter safety and operation standards. An airliner aircraft cannot be operated under Part 91; they must operate under the safety and operation requirements of an airliner; they are held to the requirements of transporting the public. It is this combination of heightened regulatory standards and a bona fide contract to carry a third party that qualifies a taxpayer in Indiana to secure the Public Transportation exemption under Part 125.

Concerning operating as a Public Transportation Company under the authority of the FAA—Taxpayer is registered with the FAA under Part 91 instead of Part 135. The significance of this difference requires an explanation of FAA registration regulations. All aircraft are required to possess an airworthiness certificate—an FAA document which grants authorization to operate an aircraft in flight. There are two different classifications of FAA airworthiness certificates: FAA Form 8100-2, **Standard Airworthiness Certificate**, and FAA Form 8130-7, **Special Airworthiness Certificate**. Title 14 CFR, section 21.175 (FAR Part 21.175) defines the two different classifications of airworthiness certificates. Standard Airworthiness Certificates are airworthiness certificates issued for aircraft types certificated in the normal, utility, acrobatic, commuter, or transport category, and for manned free balloons, and for aircraft designated by the FAA Administrator as special classes of aircraft. Taxpayer's aircraft qualifies under this. Special

Airworthiness Certificates are restricted, limited, and provisional airworthiness certificates, special flight permits, and experimental certificates. A Special Airworthiness Certificate is issued to aircraft not meeting the requirements for a standard airworthiness certificate. This LOF only will address Standard Airworthiness Certificates—because the Special Airworthiness Certificates are beyond the scope of concern for this LOF. An airworthiness certificate is transferred with the aircraft. FAR Part 21.179. Standard airworthiness certificates are effective as long as the aircraft is registered in the United States and the maintenance, preventive maintenance, and alterations are performed in accordance with FAR Part 43 and FAR Part 91. FAR Part 21.181.

Under Standard Airworthiness Certificates, a registered owner or an owner's agent of an aircraft applies for particular operation certificates. These commonly are referred to as (FAR) Part Registrations. There are four Part Registrations:

Part 91—**Private Carriers**

General Operating and Flight Rules

Part 121—**Airline Operators**

Air Carriers and Commercial Operators

Part 125—**Business and Commercial Airlines**

Airplanes having a Seating Capacity of 20 or more passengers or a maximum payload capacity of 6,000 pounds or more

Part 135—**Air Taxi Operators**

Commuter and On-Demand Operations

As can be seen, Parts 121, 125, and 135 are operation certificates for airlines, commercial operators, commuter, and on-demand (charter) services. These are Public Transportation operations—the systematic transportation of others (persons and property). Parts 121, 125, and 135 are classified under Subchapter G of Title 14. Subchapter G is entitled, **Air Carriers and Operators for Compensation or Hire: Certification and Operations**. Those operating under these Parts need to acquire a Part 119 Air Carriers and Commercial Operations Certification. Part 91 is classified under Subchapter F, entitled, **Air Traffic and General Operating Rules**.

The baseline registration is a Part 91 registration. All owners and aircraft are required to adhere to these general operating and flight rules—as well as the basic pilot and maintenance requirements. Specific types of aircraft and business operations are required to obtain more stringent Part Registrations and to operate under more demanding regulations. For example, under a Part 91 registration, any qualified pilot may fly an aircraft—regardless of age. But under a Part 121 registration, a pilot may no longer fly an airline aircraft after age 60—because of safety and operation concerns. There are five pilot certificates (licenses) granted by the FAA:

1. A **student pilot certificate** (license) is designed for the initial training period of flying. The student pilot must have a flight instructor present. He or she can solo after appropriate instructor endorsements.
2. A **recreational pilot certificate** limits the holder to: specific categories and classes of aircraft, the number of passengers which may be carried, the distance that may be flown from the departure point, flight into controlled airports, and other limitations.
3. A **private pilot certificate** lets the pilot carry passengers and provides for limited business use of an airplane.
4. A **commercial pilot certificate** lets the pilot conduct some operations for compensation and hire.
5. An **airline transport pilot certificate** is required to fly as captain by some air transport operations.

The FAA regulations require that a pilot operating under a Part 135 air carrier certificate hold a commercial pilot license—with a minimum of 1200 hours of experience as a pilot-in-command. FAR Part 135.243(c)(2). Some operations are required to have a flight crew of at-least two pilots. FAR Part 135.4. This LOF focuses on the requirements for a Part 135 because Taxpayer owns and operates a Raytheon Beechcraft King Air 350 with the potential to seat from nine to fifteen passengers. Taxpayer has configured its aircraft to accommodate eleven passengers, plus a pilot and co-pilot seat. Such an aircraft best qualifies to operate commercial and public transportation services under a Part 135—instead of a Part 121 or Part 125—since the aircraft is not a commercial airliner. Operations under Part 135 are designed for smaller commercially operated aircraft.

Under a Part 135, those engaged in commuter or air-taxi operations are held to higher safety and operation standards than Part 91. FAR Part 135.141 prescribes the additional aircraft and equipment requirements for operations as an air carrier. Some of the heightened requirements apply only to certain aircraft or passenger numbers, but all demonstrate heightened regulation of those being carried in public transportation.

Taxpayer stated at the protest hearing that Third-party Operations maintains Taxpayer's aircraft according to Part 135 requirements. There is no requirement under Part 91 that the aircraft be maintained and operated according to Part 135 requirements. Taxpayer voluntarily chooses to do so. Taxpayer could choose in the future to maintain the aircraft merely to Part 91 requirements. Certification to operate under Part 135 as an air carrier would ensure that Taxpayer—consistently and without waiver—is mandated to the standards of a Public Transportation entity. With a Part 135 Registration, Taxpayer would be operating under FAA authority as a Public Transportation entity—as required under 45 IAC 2.2-5-61(b). Also note that Taxpayer stated only the aircraft is maintained to Part 135 standards; Taxpayer did not state that the aircraft is operated according to Part 135 requirements. Because Taxpayer has configured the plane to seat eleven passengers, certain heightened safety and operations regulations are triggered under Part 135. There are additional requirements for air carriers when they transport nine or more passengers. Because Taxpayer's aircraft is registered under Part 91, these additional measures are not triggered as mandatory requirements; Taxpayer voluntarily can choose to adopt and adhere to them, but it is not held to the mandatory requirements by any authority to which it has submitted itself.

Taxpayer seeks the benefits of the Public Transportation exemption without the burdens of public transportation regulations. The Department requires those seeking the Public Transportation exemption to act as a public transportation entity—subject to the stringent regulations of Part 135 (or Part 121, Part 125). Taxpayer operates under Part 91—a less stringent set of regulations. If Taxpayer seeks the Public Transportation exemption—then Taxpayer is required to seek authority to do so and must submit and operate as required by that authority. That means Taxpayer be registered and operate under Part 135, not Part 91.

Taxpayer asserts it purchased the aircraft for the purpose of engaging in Public Transportation. Concerning Taxpayer's assertion that it is a Public Transportation entity, this introduces evidence of Taxpayer's intentions when it registered the aircraft with the State of Indiana. In March 2001, Taxpayer filed a Form 7695, **Application for Aircraft registration or Exemption**. The registration process is similar to the registration of a motor vehicle—legal registration occurs and a concurrent assessment of sales/use tax is made. On the form, Taxpayer in Section D, **Sales/Use Tax Information**, checked the box to claim a tax exemption, choosing **Rental or Lease to others**. A cross check of the merchant number shows a filed Form ST-105, **General Sales Tax Exemption Certificate**, in which Taxpayer has checked off to indicate a **Single Purchase** for the aircraft as a **Sale to Retailer, Wholesaler or Manufacturer for Resale Only**. Taxpayer held out at the time of registration that it was purchasing the aircraft for rental or leasing to others. Taxpayer now seeks the Public Transportation exemption. The Department is confused by Taxpayer's assertion that Taxpayer purchased the aircraft for the purpose of engaging in Public Transportation—since it originally filed an exemption for rental and leasing. Accepting the premise that Taxpayer decided to reclassify the exemption to which it is entitled, if Taxpayer genuinely seeks to hold itself out as a public transportation entity, it would have filed with the Department to amend Form 7695.

Two years later in September 2003, the Department requested that Taxpayer provide documentation to substantiate the Purchase for Resale exemption. The Department asked to be provided flight schedules and logs, the entities leasing the aircraft, and a copy of the rental and lease agreements. Taxpayer indicates that it received the letter in the wrong department and because of this unintentional failure to provide information, the use tax assessment was triggered. The fact exists that Taxpayer now is arguing it is entitled to the Public Transportation exemption—not purchase for resale for rental and leasing—but the registration has not been amended to indicate this intention. Form 7695 requires that a taxpayer seeking the Public Transportation exemption indicate under what FAA Part the taxpayer is operating the aircraft. The taxpayer also is required to submit a copy of the FAA Certificate for Public Transportation. This would be evidence of an authority to be classified and operate as a public transportation entity. The FAA Certificate for Public Transportation is a document issued by the FAA permitting an aircraft to be operated in the public transportation of others. Taxpayer has not submitted a Part 121, Part 125, or Part 135 Certificate for Public Transportation. Common sense indicates that it is a Part 135 Public Transportation Certificate that is due to the Department—given that Taxpayer's aircraft is not a large airliner, but a small aircraft with a maximum passenger capacity of fifteen. Taxpayer may submit an FAA Certificate for Public Transportation under Part 121, Part 125, or Part 135. The Department merely is exercising common sense as to which Part Certificate it likely should expect from Taxpayer.

Taxpayer is entitled to amend Form 7695, **Application for Aircraft Registration or Exemption**. However, the September 2003 letter sent by the Department seeking documentation to substantiate Taxpayer's claim for exemption is the focal point at this time. Evidence was presented at the hearing in an attempt to substantiate an exemption under Public Transportation. But Taxpayer has not submitted any evidence of an attempt to amend Form 7695 to indicate its change in the basis of its exemption status. An attempt to amend Form 7695 would be strong evidence to indicate the intentions of Taxpayer's exempt claim. That and the submission of an Air Carrier Certificate. As it currently stands, Taxpayer is arguing the Public Transportation exemption without having amended Form 7695 and submitting the requisite documentation to accompany the registration. Based on Form 7695, Taxpayer still is seeking a tax exemption for Rental or Lease. Since no evidence has been submitted to substantiate renting or leasing to others, and since Taxpayer did not present this argument at the hearing, the exemption is denied on this basis. Taxpayer has based its tax protest on seeking the Public Transportation exemption. The Department wishes to foreclose Taxpayer from coming back later to try a second time under another exemption provision. The Department will not be caught between conflicting positions. Taxpayer brought forward its protest under Public Transportation—so this is the one to which Taxpayer is held.

Directly addressing the Public Transportation exemption, Taxpayer has not provided the requisite documentation to indicate that it operates as a Public Transportation entity. To have done, so Taxpayer would have needed to have amended Form 7695. Overlooking this—for the sake of discussion—Taxpayer still would need to submit documentation that it is operating as a Public Transportation entity. That requires submitting to the Department a copy of an FAA Certificate for Public Transportation. Taxpayer argues that the statutes and regulations permit it to operate under Part 91. This is unconvincing. As discussed in length and detail above, the FAA has stringent requirements regarding the registration and operation of aircraft for hire. Taxpayer cannot glean the benefits of the Public Transportation tax exemption without also assuming the regulatory burdens of being a Public Transportation entity. Taxpayer is not operating under the authority of the FAA as a Public Transportation entity.

I. Sales/Use Tax—Assessment on Purchase of Aircraft

FINDING

For the reasons named above, Taxpayer's claim for the Public Transportation exemption is denied. Additionally, a future attempt to claim under the Rental and Sales exemption is denied.

II. Sales/Use Tax—Trade in value of an aircraft

DISCUSSION

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). Taxpayer purchased its aircraft from an Indiana dealer. Every aircraft dealer making a sale of an aircraft required to be licensed in the State of Indiana must complete a Form ST-108AC and must send the original to the Department. Form ST-108AC is a summary of the transaction and requires that a description of the aircraft purchased and any aircraft traded in. Then there is a computation for the amount subject to sales or use tax.

The dealer entered the selling price of the aircraft purchased as $5,138,292.00. Where the trade-in allowance should be entered, the area has been stricken with a stripe of correction fluid. This means that no trade-in allowance has been entered. Taxpayer seeks to be able to subtract $825,000 for the trade-in allowance. IC 6-2.5-1-1 permits a like kind exchange of personal property. However, the persons exchanging the property must own the property prior to the exchange. Implicit in the meaning of the word **exchange** is a contemporaneous transfer to each other. *Webster's Third New International Dictionary* includes in the definition of exchange, "the process of reciprocal transfer of ownership." For a sale to have occurred, a contract must exist. That means that all bargaining has been completed. Because all bargaining has been completed, it is understood that each party understands what has been offered and accepted. For this reason, at the time of the sale, the dealer would have known the agreed trade-in value of the aircraft being exchanged. That agreed price would be listed on Form ST-108AC. The trade-in allowance amount listed is blank, but more importantly—whatever had been placed in the space for the trade-in allowance amount has been stricken with a stripe of correction fluid.

45 IAC 2.2-3-6 states that only the trade-in value of an aircraft for another aircraft may be deducted from the selling price for sales [and use] tax purposes. The Department will grant the trade-in allowance amount listed on the original ST-108AC. That amount is blank. An attempt to amend the trade-in allowance amount after the fact does not comport with the intention of the like kind exchange—which is a contemporaneous transfer. Form 7695, **Application for Aircraft Registration or Exemption**, also has a stripe of correction fluid in Section D where the trade-in allowance is to be placed—which would reduce the amount subject to sales and use tax. Taxpayer's attempt to seek $825,000 as the trade-in allowance is disallowed because the indicia of reliability as to that amount is suspect. Without speculating as to why the amount of the trade-in allowance has been stricken and left blank, the Department looks to the amount listed by the dealer on Form ST-108AC. That amount is blank.

II. Sales/Use Tax—Trade in value of an aircraft

FINDING

The taxpayer is sustained on the amount listed on the ST-108AC and denied the $825,000 trade-in allowance sought.

DEPARTMENT OF STATE REVENUE

0220040295.LOF

LETTER OF FINDINGS: 04-0295
Indiana Corporate Income Tax
For 1999, 2000, and 2001

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

ISSUES

I. Exclusion of Taxpayer's Telemarketing Subsidiary from Taxpayer's Consolidated Indiana Income Tax Returns.

Authority: IC 6-3-2-2(l), (m); 45 IAC 3.1-1-38; 45 IAC 3.1-1-111.

Taxpayer maintains that the Department of Revenue (Department) erred when it determined that taxpayer's telemarketing subsidiary should have been included in the taxpayer's 1999, 2000, and 2001 consolidated adjusted gross income tax returns.

II. Ten-Percent Negligence Penalty.

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

Taxpayer asks that the Department exercise its discretion to abate the ten-percent negligence penalty on the ground that any errors taxpayer made were not attributable to negligence.

STATEMENT OF FACTS

Taxpayer is an affiliated group of companies engaged in the funeral and cemetery business. Taxpayer submitted consolidated Indiana tax returns reporting its state income tax liability for 1999, 2000, and 2001. During an audit review of those returns, it was determined that taxpayer's telemarketing subsidiary should not have been included in the consolidated returns. That determination mirrored a similar decision made at the time taxpayer's 1998 return was reviewed. For each of the returns, the audit concluded that the telemarketing subsidiary did not have an Indiana nexus.

Taxpayer first protested the decision as it related to the 1998 audit. An administrative hearing was held, a Letter of Findings (LOF) was issued, taxpayer – being dissatisfied with that initial decision – asked for a rehearing, the request was granted, and a Supplemental Letter of Findings (SLOF) was issued. In that SLOF, the Department concluded that the telemarketing subsidiary was – by virtue of its part-time employees and a small amount of personal property – doing business within the state. Nevertheless, the

SLOF concluded that the telemarketing subsidiary was correctly excluded from the 1998 consolidated return. The Department found that including the telemarketing subsidiary would have the result of distorting the taxpayer's overall adjusted gross income.

Taxpayer now raises the identical issue in regards to the 1999, 2000, and 2001 returns. Taxpayer protests the audit's decision to exclude the telemarketing subsidiary from these consolidated returns. An administrative hearing was conducted during which taxpayer explained the basis for its protest, and this LOF results.

DISCUSSION

I. Exclusion of Taxpayer's Telemarketing Subsidiary from Taxpayer's Consolidated Indiana Income Tax Returns.

As one part of its funeral and cemetery business, taxpayer owns a telemarketing subsidiary. This telemarketing subsidiary operates in Indiana and in other states. In Indiana, taxpayer hires part-time employees who work out of borrowed office space. The borrowed space is provided by one of the taxpayer's other subsidiaries. The telemarketing subsidiary owns a small amount of personal property, but it does not own its own offices or other real property within the state.

The part-time employees phone Indiana residents soliciting the sale of pre-need funeral insurance policies. If a particular resident expresses interest in a pre-need funeral insurance policy, the telemarketer sends the potential customer an insurance application. The application is for an insurance policy issued by one of taxpayer's other subsidiaries; the telemarketing subsidiary does not sell these policies but cultivates consumer interest in the sale of this form of insurance. If the potential customer fills out an application, is accepted as an insured, and proceeds to make premium payments, the telemarketing subsidiary becomes entitled to a commission on the particular sale.

Therefore, telemarketing subsidiary's business consists of hiring part-time employees who facilitate the sale of insurance policies sold by a related insurance company.

As it was in the original protest, the issue is whether the Department was correct when it decided to exclude the telemarketing subsidiary from the 1999, 2000, and 2001 returns.

The information provided by taxpayer indicates that the telemarketing subsidiary had as many as 17 part-time employees during 1999. During 2000 and 2001, these 17 part-time employees were "merged with employees of Taxpayer." In late 2001, the 17 part-time employees were terminated "as the Taxpayer shifted away from pre-need marketing initiatives."

The Department is prepared to accept taxpayer's contention that the telemarketing subsidiary is "doing business" within Indiana pursuant to 45 IAC 3.1-1-38. On the basis of taxpayer's evidence, the telemarketing subsidiary "operates a business enterprise or activity in [Indiana]." 45 IAC 3.1-1-38. As a consequence of this business enterprise, the telemarketing subsidiary, "has adjusted gross income derived from sources within the state...." 45 IAC 3.1-1-111.

The Department has addressed the identical issue insofar as taxpayer's 1998 consolidated return. In that LOF, the Department found that although the telemarketing subsidiary had established an Indiana nexus during 1998, the telemarketing subsidiary was properly excluded from the 1998 consolidated return. The Department did so because – pursuant to IC 6-3-2-2(l), (m) – including the telemarketing subsidiary in the consolidated return would not result in a "fair, equitable, or realistic representation of taxpayer's adjusted gross income." The Department arrived at this conclusion because including the telemarketing subsidiary in the consolidated return would permit taxpayer to "import" into its overall adjusted gross income calculation an untoward amount of the telemarketing subsidiary's federal losses thereby offsetting the entire amount of taxpayer's Indiana adjusted gross income.

In the absence of any compelling reason to do otherwise, the Department is not prepared to depart from its original conclusion that the telemarketing subsidiary's marginal business presence is sufficient to justify including the telemarketing subsidiary in the 1999, 2000, and 2001 consolidated returns.

FINDING

Taxpayer's protest is respectfully denied.

II. Ten-Percent Negligence Penalty.

Taxpayer asks that the Department abate the ten-percent negligence penalty. Taxpayer does so on the ground that it has demonstrated reasonable cause for the filing positions it has taken.

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...."

In regards to the 1999, 2000, and 2001 assessments, the Department agrees that taxpayer has demonstrated a reasonable basis for the positions taken.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0120040336P.LOF

LETTER OF FINDINGS NUMBER: 04-0336P
Income Tax
Calendar Year 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of 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 negligence penalty.

II. Tax Administration - Interest

Authority: IC 6-8.1-10-1

The taxpayer protests the interest assessment.

STATEMENT OF FACTS

The negligence penalty and interest were assessed on the filing of an individual income tax return for the calendar year 2000.

The taxpayer is an individual residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be waived as (1) the error was the result of a reasonable assumption by the taxpayer that the State of Indiana would recognize gambling losses since the Federal government recognizes gambling losses, and (2) the error was not the result of willful intent.

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

The Department finds the taxpayer was ignorant of tax regulations. As ignorance 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.

I. Tax Administration – Interest

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

DEPARTMENT OF STATE REVENUE

0120040363P.LOF

LETTER OF FINDINGS NUMBER: 04-0363P
Income Tax
For the Calendar Years 2000 & 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 payment and filing of amended income tax returns for the calendar years 2000 and 2002.

The taxpayer is an individual residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the late penalty be waived as the filing of the amended returns was late due to the lateness of the amended K-1s which were received from a Sub-S corporation the taxpayer has an interest in.

The Department points out that the corporation from which the K-1s came is owned by the taxpayer. Thus, the taxpayer is responsible for the late K-1s and fails to establish reasonable cause.

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

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

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0420040365P.LOF

LETTER OF FINDINGS NUMBER: 04-0365P
Sales Tax
For the months of November 2003, December 2003, January 2004, and February 2004

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 payment of monthly sales tax returns for the months of November 2003, December 2003, January 2004, and February 2004.

The taxpayer is a company residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be waived as the taxpayer relied on advise from the Department, and, the taxpayer has a good compliance record.

The taxpayer states the taxpayer was filing under an incorrect number throughout 2003. When the taxpayer realized the taxpayer was filing under an incorrect number, the taxpayer applied for a new sales tax ID number. The taxpayer states the Department told the taxpayer to not send in any more payments under the incorrect number and to wait for the new number.

The Department points out the conversation with the Department employee happened three months after the liabilities in question were paid. Thus the conversation with the Department employee is not a factor in the waiver of penalty.

With regard to the compliance record, the Department points out the taxpayer has had numerous errors. The Department feels the taxpayer has a poor compliance record, and therefore, the compliance record is not 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 tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0120040412P.LOF

LETTER OF FINDINGS NUMBER: 04-0412P
Income 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 underpayment penalty for estimated tax.

STATEMENT OF FACTS

The underpayment penalty for estimated tax was assessed for the calendar year 2003.

The taxpayer is an individual residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the underpayment penalty be waived as the error was the result of the taxpayer being unaware of tax regulations. Also, the taxpayer cites a good compliance record as a factor in waiving the penalty.

With regard to the compliance record, the Department notes the taxpayer had a prior error in 1999. The Department does not consider the taxpayer's compliance record to be a factor in the waiver of the 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 ignorant of the tax duties. Ignorance is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

0220020501.SLOF

SUPPLEMENTAL LETTER OF FINDINGS: 02-0501
Indiana Corporate Income Tax
For 1998

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

ISSUES

I. Exclusion of Taxpayer's Telemarketing Subsidiary from Taxpayer's Consolidated Indiana Income Tax Return.

Authority: IC 6-3-2-2(a); IC 6-3-2-2(l); IC 6-3-2-2(m); IC 6-3-4-14(a); IC 6-3-4-14(b); 45 IAC 3.1-1-38; 45 IAC 3.1-1-110; 45 IAC 3.1-1-111.

Taxpayer argues that the Department of Revenue (Department) erred when it excluded taxpayer's telemarketing subsidiary from taxpayer's consolidated adjusted gross income tax return. Taxpayer maintains that, by virtue of the telemarketing subsidiary's activities within the state, the telemarketing subsidiary has established an Indiana nexus and that the telemarketing subsidiary should have been included in the calculation of its Indiana adjusted gross income.

II. Negligence Penalty.

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

Taxpayer asks that the Department exercise its discretion to abate the ten-percent negligence penalty. Taxpayer maintains that any errors it made were not due to negligence and that it is entitled to an abatement of the penalty.

STATEMENT OF FACTS

Taxpayer is an affiliated group of companies engaged in the funeral and cemetery business. Taxpayer submitted a consolidated

Indiana tax return reporting its state income tax liability for 1998. During an audit review of taxpayer's business records and tax returns, the Department decided that a number of adjustments were warranted. Included among those adjustments was a determination that taxpayer's telemarketing subsidiary should not have been included in the 1998 consolidated return. The decision to eliminate the telemarketing subsidiary had the result of increasing taxpayer's state income tax liability. Taxpayer challenged the decision resulting in various communications between the Department; the net result of those initial communications was that the Department declined to reverse its original decision excluding the telemarketing subsidiary. Taxpayer submitted a protest, and an administrative hearing was conducted. Subsequently, a Letter of Findings (LOF) was issued in which the Department found that the telemarketing subsidiary's activities were insufficient to establish an Indiana nexus and that – even if taxpayer were to establish an Indiana nexus for the telemarketing subsidiary – including the telemarketing subsidiary within the consolidated return would not fairly reflect taxpayer's overall adjusted gross income for 1998. Taxpayer disagreed with the LOF and requested a rehearing on the matter. The Department decided that it would be appropriate to grant the rehearing, a second administrative hearing was conducted, and this Supplemental Letter of Findings (SLOF) results.

DISCUSSION

I. Exclusion of Taxpayer's Telemarketing Subsidiary from Taxpayer's Consolidated Indiana Income Tax Return.

Taxpayer is a multi-state company which supplies consumers with funeral and cemetery services. As part of that business, taxpayer owns a telemarketing subsidiary which promotes the sale of pre-need insurance policies. The telemarketing subsidiary conducted similar sales activities in 30 to 40 other states. In its August 5, 2002, letter to the Department, taxpayer maintained that it "had one part-time employee working in the [Indiana] office...." In its July 23, 2003, letter to the Department, taxpayer claimed that it "had as many as seven employees working in Indiana." At the original administrative hearing, taxpayer asserted that the telemarketing subsidiary had between one and seven employees working in Indiana during 1998. Taxpayer now indicates that it had seven part-time employees during 1998 and that it paid the seven employees approximately $26,000 in wages during 1998.

The telemarketing subsidiary conducts its Indiana business operation from a location (or locations) owned by taxpayer's other Indiana subsidiaries. The telemarketing company does not own any real property in Indiana. Taxpayer has indicated that telemarketing subsidiary owns approximately $1,000 worth of office furniture. Taxpayer has submitted information indicating that the Indiana telemarketing subsidiary was "charged" with the purchase of computer software containing residential telephone listings. This computer software costs approximately $2,700. The office furniture and software represent the telemarketing subsidiary's personal property located within Indiana.

Taxpayer's telemarketing business works like this:

1. Telemarketing subsidiary hires part-time employees who work out of office space provided by another of taxpayer's subsidiaries.
2. Telemarketing subsidiary's part-time employees call Indiana residents soliciting the sale of pre-need funeral insurance policies.
3. If the recipient of the phone call expresses interest, the telemarketer will send the prospective customer an insurance policy application form. The telemarketer does not sell the insurance policy; the telemarketer opens up the possibility that the prospective customer will complete the application and buy insurance from the related insurance company.
4. Prospective customer sends a completed application form to related insurance company. Related insurance company then decides whether to accept the application. If it does, the transaction is completed, one of taxpayer's local funeral homes is designated the beneficiary, and customer sends premium payments to related insurer.
5. Once related insurer begins to receive the insured's payments, the related insurance company owes taxpayer a commission by virtue of the fact that telemarketing subsidiary solicited the sale of the underlying insurance policy.
6. Yet another of taxpayer's subsidiaries – acting as common paymaster – receives and then forwards the commissions to the individual telemarketer who originally invited the sale.

Therefore, telemarketing subsidiary's Indiana business consists of hiring part-time employees who facilitate the sale of insurance policies sold by a related insurance company. In consideration of a completed sale, the insurance company pays commissions to taxpayer's common paymaster subsidiary, which then forwards those commissions to the originating part-time employee. Telemarketer owns personal property in Indiana consisting of office furniture and a computerized phone list.

The issue is whether taxpayer was correct when it originally decided to include the telemarketing subsidiary in its consolidated state income tax return.

IC 6-3-4-14(a) provides that, "An affiliated group of corporations shall have the privilege of filing a consolidated return with respect to the taxes imposed by IC 6-3."

The Department's regulation states that, "An affiliated group as defined in IC 6-3-4-14(b) may file consolidated returns for Adjusted Gross Income Tax and Supplemental Net Income Tax...." 45 IAC 3.1-1-110. The term "affiliated group," is defined at 45 IAC 3.1-1-111 which provides that, "The Adjusted Gross Income Tax Act adopts the definition of 'affiliated group' contained in Internal Revenue Code Section 1504, except that no member of the affiliated group may be included in the Indiana return unless it has adjusted gross income derived from sources within the state, as that phrase is defined in IC 6-3-2-2."

I.R.C. § 1504 defines, among other things, the degree of ownership which must exist before related businesses can be considered to be members of a federal "affiliated group." For purposes of this SLOF, it will be assumed that taxpayer owns the telemarketing subsidiary and that there are no I.R.C. "ownership" questions which otherwise affect the parties' qualifications to be included as members of a federal "affiliated group."

However, meeting the I.R.C. § 1504 ownership criteria – standing alone – is insufficient to qualify the related businesses to file an Indiana consolidated tax return. In this situation, the telemarketing subsidiary must have received "adjusted gross income derived from sources within the state, as that phrase is defined in IC 6-3-2-2." 45 IAC 3.1-1-111.

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

> With regards to corporations and non resident persons "adjusted gross income derived from sources within Indiana," for purposes of this article shall mean and include:
>
> (1) income from real or tangible personal property located in this state;
> (2) income from doing business in this state;
> (3) income from a trade or profession conducted in this state;
> (4) compensation from a trade or profession conducted in this state; and
> (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

The Department's regulation sets out a definition for "doing business" within the state. The regulation states:

> For apportionment purposes, a taxpayer is "doing business" within the state if it operates a business enterprise or activity in such a state including, but not limited to:
>
> (1) Maintenance of an office or other place of business in the state
> (2) Maintenance of an inventory of merchandise or material for sale, distribution, or manufacture, or consigned goods
> (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
> (4) Rendering services to customers in the state
> (5) Ownership, rental or operation of a business or of property (real or personal) in the state
> (6) Acceptance of orders in the state
> (7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income. 45 IAC 3.1-1-38.

The Department agrees with taxpayer's contention that the telemarketing subsidiary is "doing business" within Indiana pursuant to 45 IAC 3.1-1-38. By virtue of the part-time employees, the borrowed sales offices, and the telemarketing subsidiary's ownership of personal property in this state, the telemarketing subsidiary "operates a business enterprise or activity in [Indiana]." 45 IAC 3.1-1-38. Moreover, the telemarketing subsidiary, "has adjusted gross income derived from sources within the state...." 45 IAC 3.1-1-111.

Nonetheless, the Department remains disinclined to overrule the audit's determination that the telemarketing subsidiary should not have been included in the taxpayer's 1998 consolidated Indiana tax return. The Department is not convinced that the result would fairly or accurately reflect the taxpayer's 1998 Indiana income. IC 6-3-2-2(l) provides as follows:

> If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for *or the department may require*, in respect to all or any part of the taxpayer's business activity, if reasonable;
>
> (1) separate accounting;
> (2) the exclusion of any one (1) or more of the factors;
> (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. (*Emphasis added*).

In addition, IC 6-3-2-2(m) provides:

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

IC 6-3-2-2(l), (m) provides the Department discretionary authority to adjust the allocation and apportionment provisions of the adjusted gross income tax in order to arrive at an equitable and accurate allocation of the taxpayer's Indiana income. The goal is to "fairly reflect... the income derived from sources with the state...." IC 6-3-2-2(m).

During 1998, the telemarketing subsidiary employed approximately seven part-time employees. The telemarketing subsidiary paid those seven part-time employees approximately $26,000 in wages during 1998. The $26,000 in Indiana wages represents about one-tenth of one percent of the taxpayer's payroll "everywhere." During that same year, the telemarketing subsidiary sustained – in its 30 to 40-state telemarketing business –approximately $8,000,000 in losses. Those losses were sustained because the telemarketing subsidiary's nationwide operation earned approximately $20,000,000 during 1998 but spent almost $28,000,000. Some of those expenditures were explained as the cost of salaries, advertising, and interest; eighteen percent of the expenditures –

approximately $5,000,000 – is classified by the taxpayer as "other." If the taxpayer were permitted to include the telemarketing subsidiary in its 1998 Indiana consolidated return, taxpayer would be entitled to "import" 57 percent of the $8,000,000 nationwide loss into the Indiana adjusted gross income computation and then employ that amount to entirely offset the income earned by all of taxpayer's Indiana business operations. If the telemarketing subsidiary was included in the taxpayer's consolidated return, the overall apportionment would increase by approximately 1.5%. That comparatively minor increase in the apportionment calculation would result in a 120% *decrease* in taxpayer's adjusted gross income. Instead of reporting $3,800,000 in adjusted gross income, taxpayer would instead report a "loss" of $630,000. The Department does not quarrel with taxpayer's arithmetic, but it continues to maintain that the proposed reporting methodology does not accurately or fairly reflect taxpayer's business activity or Indiana income.

Based upon the telemarketing subsidiary's marginal Indiana business presence, taxpayer seeks to import into the Indiana adjusted gross income calculation a disproportionate amount the telemarketing subsidiary's federal losses and to entirely offset the income it earned in this state. The Department is unable to agree that the result would be a fair, equitable, or a realistic representation of taxpayer's Indiana adjusted gross income.

FINDING

Taxpayer's protest is respectfully denied.

II. Negligence Penalty.

Taxpayer asks that the ten-percent negligence penalty be abated on the ground that the positions on its original return were correct and that the, "Taxpayer has adequately demonstrated reasonable cause for the positions taken in its 1998 tax return."

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

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

The Department is unable to agree that taxpayer exercised "reasonable care" sufficient to justify abating the ten-percent negligence penalty. During the extended period of time during these issues have remained unresolved, the taxpayer has provided inconsistent, contradictory, and incomplete information related to its business operations. To cite two examples, taxpayer provided conflicting information regarding the number of part-time employees working for the telemarketing subsidiary and – when asked to supply documentation establishing the telemarketing subsidiary's 1998 employment roster – supplied W2 forms from 1999 for employees working for an entirely different company.

Although taxpayer has raised legitimate questions concerning its 1998 Indiana corporate income tax returns, the Department is unwilling to conclude that taxpayer exercised the "reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030248.LOF

SUPPLEMENTAL LETTER OF FINDINGS: 03-0248
Indiana Corporate Income Tax
For the Tax Years 1997 to 2000

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

ISSUE

I. Money Received in an Agency Capacity – Gross Income Tax.

Authority: IC 6-2.1-2-2(a)(1); IC 6-2.1-2-2(a)(2); 45 IAC 1.1-1-2; 45 IAC 1.1-6-10; Criterion Catalyst, Co. v. Dept. of State Revenue, No. 49T10-9612-TA-00180 (Ind. Tax Ct., Feb. 2, 1999); Ind. Tax Ct. R. 17.

Taxpayer – on behalf of taxpayer operating company – argues that it is not subject to Indiana gross income tax on money it received while purportedly acting in an agency capacity. According to taxpayer, by rendering an unfavorable opinion in the original Letter of Findings, the Department simply compounded that original, erroneous determination.

STATEMENT OF FACTS

Taxpayer is an out-of-state company which filed consolidated Indiana tax returns. One particular return included an operating company which was in the business of running an Indiana riverboat casino. The operating company is hereinafter referred to as "taxpayer operating company." Taxpayer operating company did not own the casino; it managed the day-to-day operations of the Indiana casino on behalf of the casino owner.

The Department of Revenue (Department) conducted an audit review of taxpayer's business records and tax returns. The Department concluded that taxpayer operating company had received money from the casino owner which was subject to gross income tax. Taxpayer disagreed with this conclusion arguing that the money was received from the casino owner while taxpayer operating company was acting in an agency capacity. According to taxpayer operating company, it was not subject to gross income tax on these amounts because it received the money while acting as an agent and because taxpayer operating company was simply being reimbursed – on a dollar-for-dollar basis – for the money it had paid to the casino's employees.

Taxpayer (on behalf of itself and taxpayer operating company) submitted a protest challenging the audit's determination that the money was subject to Indiana gross income tax. An administrative hearing was conducted during which taxpayer explained the basis for its protest. A Letter of Findings (LOF) was issued in response to the protest with the Department concluding that taxpayer operating company was not acting as an agent and that the money was indeed subject to gross income tax. Taxpayer was not satisfied with the conclusions arrived at or the explanation provided in the LOF. Taxpayer requested a rehearing asking that the Department revisit the agency issue. The request for rehearing was granted and, based upon taxpayer's written presentation, this Supplemental Letter of Findings (SLOF) results.

DISCUSSION

I. Money Received in an Agency Capacity – Gross Income Tax.

Casino owner and taxpayer operating company entered into a "Project Development and Management Agreement" (Agreement) whereby taxpayer operating company arranged for the construction of the casino and agreed to subsequently provide for the day-to-day operation of the casino once construction was completed. Taxpayer operating company assisted in obtaining the casino license, but casino owner was the entity which actually held the casino's license.

Under the terms of the parties' Agreement, taxpayer operating company had the responsibility to recruit and train the casino staff members, create and implement a casino marketing program, obtain the casino license on behalf of the owner, acquire the necessary start-up supplies and equipment, and develop start-up and operating budgets.

Under the terms of the Agreement, the casino owner designated taxpayer operating company as the casino owner's "exclusive agent, to supervise, manage, direct and operate the [casino] during the Terms of this Agreement." Taxpayer operating company was granted "all the prerogatives normally accorded to management in the ordinary course of commerce, including... the collection of receivables, the incurring of trade debts, the approval and payment of checks, the advance of credit and the negotiating and signing of operational leases and contracts." In addition, the Agreement stipulated that "Unless this Agreement expressly provides for an item or service to be at [taxpayer operating company's] own expense, all costs and expenses incurred by [taxpayer holding company]... in the performance of [taxpayer operating company's] obligations under this Agreement shall be for and on behalf of [casino owner]." The Agreement specifically provides that, "All debts and liabilities incurred to third parties by [taxpayer operating company] on behalf of either the [casino] Owner or the Project are and shall remain the sole obligation of [casino] Owner."

In terms of the people who worked at the casino, taxpayer operating company was granted "sole authority to hire, promote, discharge, and supervise all personnel." With the exception of the casino manager, department managers, credit manager, and chief financial officer, all the casino employees were designated as employees of the casino owner. All of the costs related to the casino owner's employees were designated as an "Operating Expense of the Project and reimbursed to [taxpayer operating company] on a current basis."

After the Agreement was signed, casino owner began to pay taxpayer operating company money in the form of "management fees" in addition to money which taxpayer operating company characterized as reimbursement for expenses representing the payments advanced by taxpayer operating company to the casino owner's employees. Taxpayer operating company correctly included the "management fees" in the gross income tax base as originally filed. However, what still remains at issue is the amount of money which taxpayer operating company received from casino owner which was used to pay the casino employees. Taxpayer operating company contends that this money is not subject to gross income tax because it was received while it was acting in an agency capacity. According to taxpayer operating company, "it was under the control of the [casino owner]," it did not "have any right, title or interest in the money or property received from the transaction," but that the money "passed through to third parties." In sum, taxpayer operating company "was merely the agent through which the funds passed to the third parties."

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

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

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

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

establish an agency relationship.

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

The original LOF found that, "[N]either the parties' Agreement nor the parties' business practices indicate that taxpayer operating company was acting as a 'true agent' sufficient to warrant finding that the income was not subject to Indiana's gross income tax." The LOF did so finding that the casino owner did not exercise the degree of authority over taxpayer operating company characteristic of an agent/principal business relationship but that taxpayer operating company retained total operational control over the means and the manner in which the casino was operated. In addition, the LOF concluded that the taxpayer operating company failed to establish that it was merely acting as a conduit for the money which was eventually paid to the employees. Instead, the LOF found that taxpayer operating company had a direct, beneficial interest in the money it received from the casino owner.

In its request for rehearing, taxpayer maintained that the Department ignored the findings of the Indiana Tax Court in Criterion Catalyst, Co. v. Dept. of State Revenue, No. 49T10-9612-TA-00180 (Ind. Tax Ct., Feb. 2, 1999). In reviewing taxpayer's argument, the Department will set aside questions regarding the appropriateness of citing to an unpublished decision. *See* Ind. Tax Ct. R. 17 ("Unless specifically designated 'For Publication,' such written memorandum decisions shall not be published and shall not be regarded as precedent nor cited before any court except for the purpose of establishing the defense of res judicata, collateral estoppel, or the law of the case."). In the Criterion Catalyst case, Criterion was the sole general partner of a limited partnership. Under the terms of the parties' partnership agreement, the workers at the limited partnership's plant were designated as employees of Criterion. Criterion paid the employees' salaries. However, the limited partnership reimbursed Criterion for the amount of money paid to the employees. The Department assessed Criterion gross income tax on this amount of money. The Tax Court held that Criterion was acting as the general agent for the limited partnership, that the employees worked for the limited partnership, and that the reimbursements were intended to restore Criterion to the same position it held before it advanced the wages.

The Tax Court found that the reimbursement payments made to Criterion were not subject to gross income tax because the payments merely restored Criterion to the same position it occupied before it paid the employees. In addition, the court found that "no direct benefit inure[d] to Criterion Catalyst as a result of the labor of the [employees]." The court concluded that "Criterion Catalyst, as [limited partner's] agent is merely making payments to third parties for which Criterion is reimbursed."

Taxpayer operating company argues that it occupies the same position as that of Criterion and that it is being reimbursed on a dollar-for-dollar basis for the money it pays to the casino employees. The Department does not quarrel with taxpayer operating company's arithmetic but is unable to agree that taxpayer operating company has the same agency status as that occupied by Criterion. Criterion was acting as a disinterested intermediary between the limited partner's employees and the employees. Criterion had no direct interest in what the limited partner's employees were doing because Criterion did not benefit in the work performed by the limited partner's employees. In contrast, taxpayer operating company has a direct and immediate interest in the work performed by the casino employees who – for all intents and purposes – work for and are responsible to taxpayer operating company. Taxpayer operating company is in the business of running a riverboat casino. It was responsible for the design, construction, staffing, and start-up of the casino. After the initial start-up, taxpayer operating company retained complete responsibility for all aspects of the casino's day-to-day operation. Taxpayer operating company was granted the "the absolute discretion and authority to determine operating policies and procedures, standards of operation, credit polices, complimentary policies, win payment arrangements, standards of service and maintenance, food and beverage quality and service, pricing, and other standards affecting the [casino], or the operation thereof, to implement all such polices and procedures, and to perform any act on behalf of [casino owner] which [taxpayer operating company] deems necessary or desirable for the operation and maintenance of the [casino]...."

Taxpayer operating company casts itself in the role of a simple paymaster handing out monthly paychecks to employees who work for someone else. Taxpayer operating company oversimplifies its business interests beyond recognition. Under the terms of the casino operating Agreement, the casino owners may have been designated as employees of the casino owner. However the employees did not work for the casino owner; they worked for taxpayer operating company. Taxpayer operating company's business fortunes rose and fell with the interest of the casino and the employees who worked for that casino. Taxpayer operating company had an unconditional and immediate beneficial interest in the operation of this riverboat casino.

To characterize taxpayer operating company as a bemused and disinterested bystander is to ignore the authority that taxpayer operating company exercised over the casino and its employees and to ignore the interest that it had in the success or failure of the casino for which it was totally responsible.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE
Revenue Ruling #2004-04 ST
December 30, 2004

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

ISSUE

Sales and Use Tax—Medical Devices

Authority: IC 6-2.5-5-18(a); IC 6-2.5-1-25; 45 IAC 2.2-5-28(h); IC 6-2.5-8-8.

STATEMENT OF FACTS

The taxpayer manufactures and sells a proprietary dental product for treating dental malocclusion—the misalignment of teeth. Aligners cover a patient's teeth and are commonly are worn as a pair, over the upper and lower teeth. They are removed for meals, brushing, or flossing. Each aligner is worn for approximately two weeks, then is discarded; the patient then uses the next aligner in the progressive set. The taxpayer seeks a ruling as to whether the aligners are exempt from sales and use tax under IC 6-2.5-5-18(a).

DISCUSSION

IC 6-2.5-5-18(a), **Medical equipment, supplies, and devices**, states:

(a) Sales of durable medical equipment, prosthetic devices, artificial limbs, orthopedic devices, dental prosthetic devices, eyeglasses, contact lenses, and other medical supplies and devices are exempt from the state gross retail tax, if the sales are prescribed by a person licensed to issue the prescription.

IC 6-2.5-1-25 defines **prosthetic device** to mean: a replacement, corrective, or supportive device, including repair and replacement parts for the device, worn on or in the body to:

(1) artificially replace a missing part of the body;

(2) prevent or correct physical deformity or malfunction; or

(3) support a weak or deformed part of the body.

The face of IC 6-2.5-5-18(a) refers specifically to dental prosthetics. The application of the definition of **prosthetic** in IC 6-2.5-1-25(2) encompasses the aligners; they correct misaligned teeth. 45 IAC 2.2-5-28(h) further supports the exemption—stating that **medical devices** are those items, the use of which is directly required to correct injury to, or the malfunction of the purchaser's body.

In addition, the aligners are transferred to the patient and consumed directly by the patient—which is necessary for exemption from sales and use tax. It should be noted, however, when applicable—the seller is required to receive a proper Indiana exemption certificate from the purchaser, as required under IC 6-2.5-8-8.

RULING

The Department rules that the sale of the propriety dental aligners is exempt from sales and use tax.

CAVEAT

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

Indiana Department of State Revenue

DEPARTMENT OF STATE REVENUE

Revenue Ruling #2005-01 IT

January 27, 2005

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

ISSUE

Corporate Adjusted Gross Income Tax—Domestic International Sales Corporation

Authority: IRC § 991; IRC § 992; § IRC 993; IC 6-3-1.3.5(b); IC 6-3-2-1(b).

The shareholders of the taxpayer request the Department to rule on the application of taxes administered under IC 6-3 concerning the treatment of a Domestic International Sales Corporation (DISC).

STATEMENT OF FACTS

The taxpayer is a corporation. The shareholders are contemplating the formation of a DISC, as defined in IRC § 992. The DISC will have an Indiana domicile and will receive qualified export receipts, as defined in IRC § 993, from affiliates of the corporation.

Under IRC § 991, the DISC will not be subject to federal income tax.

DISCUSSION

IRC § 991 states that a DISC is not subject to income taxes. A **Domestic International Sales Corporation** is defined in IRC § 992(a)(1) as:

For purposes of this title, the term "DISC" means, with respect to any taxable year, a corporation which is incorporated under the laws of any State and satisfies the following conditions for the taxable year:

(A) 95 percent or more of the gross receipts (as defined in section 993(f)) of such corporation consist of qualified export receipts (as defined in section 993 (a)),

(B) the adjusted basis of the qualified export assets (as defined in section 993(b)) of the corporation at the close of the taxable year equals or exceeds 95 percent of the sum of the adjusted basis of all assets of the corporation at the close of the taxable year,

(C) such corporation does not have more than one class of stock and the par or stated value of its outstanding stock is at least $2,500 on each day of the taxable year,

(D) the corporation has made an election pursuant to subsection (b) to be treated as a DISC and such election is in effect for the taxable year, and

(E) such corporation is not a member of any controlled group of which a FSC is a member.

IC 6-3-1.3.5(b) defines **adjusted gross income** for corporations. The calculation of adjusted gross income is tied to the federal Internal Revenue code—subject to modifications imposed by Indiana's tax code. None of those modifications encompass DISCs. IC 6-3-2-1(b) states the tax rate to be imposed on a corporation's adjusted gross income derived from sources within Indiana. Because IRC § 991 does not impose income tax on a DISC and because Indiana does not impose a modification on DISC adjusted gross income, the corporate taxpayer is not subject to Indiana adjusted gross income tax.

RULING

The Department rules that to the extent that the DISC is not subject to federal income taxes under IRC § 991, the DISC also would not be subject to Indiana adjusted gross income tax pursuant to IC 6-3-1-3.5 and IC 6-3-2-1.

CAVEAT

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

Indiana Department of State Revenue

DEPARTMENT OF STATE REVENUE

Revenue Ruling #2005-01 ST

February 10, 2005

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- Exemptions for Lease and Rental of Forklift Equipment

Authority: IC 6-2.5-2-1, IC 6-2.5-4-10, IC 6-2.5-5-3 (b), IC 6-2.5-8-8, 45 IAC 2.2-5-8 (c), 45 IAC 2.2-8-12, 45 IAC 2.2-8-12 (d).

The taxpayer requests the department to rule on whether or not it should collect and remit sales tax on leases and rentals of forklift equipment when their customers state that they are entitled to manufacturing, processing or fabrication exemptions.

STATEMENT OF FACTS

The taxpayer has recently acquired leases and rentals of forklift equipment. They are currently collecting and remitting sales tax on the leases and rentals. Some of their customers state that they are exempt from Indiana sales tax due to manufacturing, processing or fabrication.

DISCUSSION

Indiana imposes a sales tax on the transfer of tangible personal property in a retail transaction. IC 6-2.5-2-1. The rental or leasing of tangible personal property constitutes a retail transaction subject to the Indiana sales tax. IC 6-2.5-4-10. The transfer of tangible personal property pursuant to a conditional sales agreement is also a taxable retail transaction.

Indiana provides an exemption from the sales tax for property purchased "for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." IC 6-2.5-5-3 (b). To be considered exempt, the item leased must have an immediate effect on the property being manufactured. "Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property."

Exemption is not provided for pre-production or post-production activities. Exemption is only provided for activities during the production process, "an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired." 45 IAC 2.2-5-8 (k). Pre-production activities are any activities performed prior to the beginning of the integrated production process. Post-production activities take place after the end of the integrated production process.

Warehouse activities are not part of the production process. Therefore, equipment and materials used in warehouse activities do not qualify for exemption.

Indiana provides for exemption certificates from sales tax at IC 6-2.5-8-8 in pertinent part as follows:

(a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

(b) The following are the only persons authorized to issue exemption certificates:

(1) retail merchants, wholesalers, and manufacturers, who are registered with the department under this chapter;

(2) organizations which are exempt from the state gross retail tax under IC 6-2.5-5-21, IC 6-2.5-5-25, or IC 6-2.5-5-26 and which are registered with the department under this chapter; and...

45 IAC 2.2-8-12 clarifies the law concerning exemption certificates in pertinent part as follows:

(a) Exemption certificates may be issed [sic.]only by purchasers authorized to issue such certificates by the Department of Revenue. Retail merchants, manufacturers, wholesalers and others who must register with the Department of Revenue and who qualify to purchase exempt from tax under this Act [IC 6-2.5] may issue exemption certificates with respect to exempt transactions. All persons or entities not required to register with the Department as retail merchants, manufacturers, or wholesalers, and who are exempt under this Act [IC 6-2.5] with respect to all or a portion of their purchases are authorized to issue exemption certificates with respect to exempt transaction provided an exemption number has been assigned by the Department of Revenue, or provided that the Department of Revenue has specifically provided a form and manner for issuing exemption certificates without the need for assigning an exemption number...

Pursuant to the statute and explanatory regulation, the production of a valid exemption certificate exempts the merchant from the duty of collecting and remitting sales tax. Without a valid exemption certificate, the burden shifts back to the merchant to prove that the sales were not actually subject to sales tax as provided in 45 IAC 2.2-8-12 (d) as follows:

Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the necessity for such proof...

The taxpayer should collect and remit sales tax unless the customer provides a valid exemption certificate. With a valid exemption certificate, the taxpayer need not concern himself its customers' records and supporting documentation on the exempt status of the leased equipment.

RULING

The Department rules that the taxpayer's proposed method of operations does not comply with the Indiana law.

CAVEAT

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

Indiana Department of State Revenue

DEPARTMENT OF STATE REVENUE

Revenue Ruling #2005-02 ST

January 19, 2005

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

ISSUE

Sales and Use Tax—Processing/Fabricating Charges on Structural Steel

Authority: Sales Tax Information Bulletin #60 (April 2004); 45 IAC 2.2-3-9(e); IC 6-2.5-4-9; IC 6-2.5-2-1; IC 6-2.5-4-1.

STATEMENT OF FACTS

The taxpayer bids on subcontracts to provide, install, and erect structural steel for buildings under construction in Indiana. If the taxpayer is the successful bidder, it then will enter into a lump-sum contract with the general contractor on the building project to furnish material, labor, tools and equipment, and supervision to complete the structural steel portion of the building in accordance with the architect's drawings. The typical executed contract is an AIA (American Institute of Architects) contractor—subcontractor form, with language modified to name the specific job.

If the taxpayer is the successful bidder, it also will:

(1) order the steel necessary from a steel service center to complete the job;

(2) separately contract with a third party processor/fabricator to bend, shape, cut, or otherwise fabricate or process the steel to meet the building specifications—if necessary; and

(3) subcontract the on-site steel installation and erection work to a third party that performs those services. The taxpayer actually does not perform installation or erection itself.

If the steel requires processing or fabrication, it is shipped directly from the steel service center or the steel producer (from whom the steel service center purchased the steel) to the processor/fabricator. The taxpayer takes title to the steel upon shipment to the processor/fabricator and holds title to the steel throughout the processing/fabricating process. After the steel is processed by the processor/fabricator, it is shipped directly to the jobsite—where the employees of the installer/erector install and erect the steel structure. Until it is installed/erected at the jobsite, the taxpayer holds title to the steel.

The taxpayer invoices the general contractor on a periodic basis as the steel is delivered to the jobsite and installed. The invoices break out the charges for steel delivered and its installation so that the general contractor can verify performance. However, the contracts are charged as lump-sum.

For the steel it purchases, the taxpayer receives an invoice from the steel service center that also specifies any delivery charge. The taxpayer provides the steel service center with a direct pay permit so that no sales tax is imposes on that invoice. When the steel is installed at the jobsite, the taxpayer remits use tax to the Department on the total amount invoiced by the steel service center, unless the taxpayer has received an exemption certificate from the contractor. Many of the building projects that taxpayer works on are for not-for-profit or tax exempt entities.

The taxpayer also receives an invoice from the installer/erector for installation and erection services only; sales tax is not included. The taxpayer does not remit use tax on the installation/erection charges.

The taxpayer also receives an invoice from the processor/fabricator for the processing and fabrication work done on the steel prior to its delivery to the jobsite. No sales tax is charged on an invoice from the processor/fabricator. At issue—the taxpayer is asking the Department to rule whether use tax is owed on charges for processing/fabrication.

DISCUSSION

The taxpayer enters into contracts to provide the labor and materials for placement of structural steel into buildings. It does so pursuant to lump-sum contracts with general contractors. **Sales Tax Information Bulletin #60** (April 2004), states that although a contractor may subsequently furnish a breakdown of charges for labor and materials, he does so without changing the nature of the lump-sum contract.

45 IAC 2.2-3-9(e), interpreting IC 6-2.5-4-9 with respect to construction materials, states that a contractor is liable for the use tax and must remit the amount due (measured by the purchase price) when he converts the construction materials into realty on land he does not own, pursuant to a contract that includes all elements of cost in the total contract price—*i.e.*, a lump-sum contract. IC 6-2.5-2-1 imposes sales tax on retail transactions made in Indiana. IC 6-2.5-4-1 defines a retail transaction as the transfer of tangible personal property for consideration. However, the charges for processing/fabricating services are non-taxable because no tangible personal property is transferred during processing/fabricating.

RULING

The Department rules that the charges for processing/fabricating are non-taxable.

CAVEAT

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

Indiana Department of State Revenue