INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT
NONRULE POLICY DOCUMENT

Title: **Approval and Validation of Alternate Emission Factors**
Identification Number: **Air-014-NPD**
Date Originally Effective: **October 10, 1997; Published 4/1/98 (21 IR 2621)**
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Other Policies Repealed or Amended: **None**
Brief Description of Subject Matter: **Procedures and Validation Requirements for Approval of Alternate Emission Factors**
Citations Affected: **326 IAC 2-6-4(c)(5)(E)**

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 30 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 45 days prior to presentation to the appropriate board. If the nonrule policy is presented to more than one board, it will be effective 30 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

An alternate emission factor (AEF), for purposes of this policy, is defined as a representative value that attempts to relate the quantity of a pollutant released to the atmosphere (either directly, or through vents, stacks, or ducts that may or may not be associated with an air pollution control device) with the activity causing the release of that pollutant. An AEF is usually expressed as the concentration, mass emission rate, or as the weight or mass of the pollutant divided by a unit of time, weight, volume, or duration of the activity emitting the pollutant. AEFs are developed using a variety of methods. These may include emissions testing, material balance determinations, continuous emissions monitoring systems (CEMS), trade industry studies, or other methods approved by the commissioner. In most cases the methodology used in developing or validating an AEF is determined by the process for which the AEF is being developed. For instance, an AEF for particulate matter emissions from a baghouse may be developed using U.S. EPA Reference Method 5. However to develop an AEF for uncontrolled VOC emissions from a paint line, a mass balance equation may suffice.

An AEF may be used to calculate potential emissions for permitting determinations, to estimate source emissions for billing, or to develop emission inventories for use in air quality planning. With the exception of the emissions statement rule, 326 IAC 2-6-4(c)(5)(E), which requires the use of emission factors from AP-42 or other documentable methodology accepted by IDEM or U.S. EPA, there are no provisions that mandate the specific source of an emission factor. Traditionally, calculations for permitting purposes are made using emission factors from AP-42, (the) Compilation of Air Pollutant Emission Factors, produced by the U.S. EPA Office of Air Quality Planning and Standards. U.S. EPA has compiled and rated emission factors in this document based upon information available at the time of the compilation.

AP-42 emission factors range in quality from A to E depending on the number and quality of source specific studies on which they are based. Additionally, U.S. EPA maintains other sources of emission factors which are considered equivalent to AP-42.

Objective

This non-rule policy outlines the requirements for approval and validation of an AEF that sources may use to provide an accurate estimation of emissions. This policy describes some common examples where sources may wish to develop an AEF, or validate an AEF that they have submitted to the department. Validation of an AEF involves the source proving to the satisfaction of the department that the emissions from the subject unit are at or below a certain level. AEF validation testing will often take place when a source requests to use an AEF as part of a permit application. For example, validation testing of emission factors from AP-42, or equivalent, which have a low rating may be necessary. Additionally, if a source elects to take a synthetic minor limit to avoid PSD they may have to perform emission testing to show emissions are truly below PSD threshold levels. This policy details the submittal request procedure including the information sources should provide prior to developing or validating alternative emission factors. This policy was written to provide consistency in addressing the issues that may arise concerning generic emission factors or other published data. Adherence to this policy will allow the agency to determine whether the alternative emission values submitted can or cannot be validated by this agency for use by the source.

Policy

An AEF may be developed under circumstances where no emission factor exists, or when a source believes that published emission factors do not accurately represent their specific process, operation, or pollution control equipment efficiency. An AEF is an emission factor that is not found in AP-42 or another equivalent source (a New Source Performance Standard (NSPS), National Emissions Standard for Hazardous Air Pollutants (NESHAP) or other U.S. EPA database of emission factors). The department recognizes that source specific emission estimations, when properly derived, are preferable to the generic estimations developed by

U.S. EPA.

Generic emission factors are, by their general nature, at risk of being supplanted by site-specific data. With this non-rule policy, the department recognizes that there may be differences in emissions even for facilities in the same group to which the AEF is applied, and that changes in facility operation may also affect the magnitude of emissions. If a source requests to either use or develop an AEF they should be aware that the AEF is binding, enforceable, and if necessary, will be incorporated into their operating permit. However, upon successfully demonstrating the validity of the AEF, the source is eligible to use the information for permitting determinations, annual emission reporting, or calculating billing fees.

Sources may propose to use an AEF as part of their permit application package for a construction permit. This often involves the use of an emission factor other than an accepted factor from AP-42, or equivalent, however it may also include the use of a factor from AP-42, or equivalent, with a low rating, or no rating at all. The use of a low rated emission factor often affects the applicability of the source with respect to a specific rule or limitation (PSD, Title V, etc.).

Existing sources may elect to establish an alternate emission factor for a specific unit or units at anytime. This type of AEF is often used for calculating billing fees, annual emission statements, or adjusting production throughput limits.

In some situations, a source may elect to develop an AEF, and during the course of validating the AEF may find the emission rate higher than originally believed. Although the most recent AEF is binding, any AEF may be supplanted by further AEF development. However, once a source submits a request to develop an AEF to IDEM and completes any required validation, the resulting AEF will be binding until supplanted by further AEF development.

If a source elects to develop or validate a new or existing AEF, they should be aware that if the test results indicate a failure to comply with an applicable rule limit (SIP, NSPS, NESHAP, etc.), a referral to IDEM's Office of Enforcement may result. Additionally, if a source proposes to use an AEF in order to avoid a certain permitting threshold level (ie PSD), and finds the emissions are in excess of the proposed AEF, a referral to IDEM's Office of Enforcement may also result. Therefore, sources should carefully consider all possible scenarios prior to electing to develop an AEF.

Procedure

Determine the AEF on a single facility basis. It is not appropriate to use an AEF developed for another facility unless the facilities are identical, both in design and method of operation. For identical facilities, the justification should include a detailed discussion of operating conditions and a description of the installations. Submit to the department for validation the proposed AEF, including the methodology to be used to develop the AEF, under the following scenarios:

1. If a source is seeking to use an AEF for a construction permit, and is basing the AEF on testing conducted at a similar facility in another state or a pilot plant, the construction or operating permit may contain a requirement to conduct testing to validate the AEF.
2. If a source wishes to develop an AEF or AEFs for an existing process or processes for use in permitting determinations and/or rule applicability such as emission offset, or PSD review.
3. If a source wishes to develop an AEF for emissions estimates for emission statements or calculating permitting fees.

If a source has decided to pursue the development of an AEF, or where testing is necessary to validate a proposed AEF, sources should contact the OAQ Compliance Data Section prior to any testing so an acceptable test protocol can be agreed upon. In most cases these will simply be compliance test protocol forms submitted according to the requirements of 326 IAC 3-6. However in other cases the protocol may be a detailed description of a material balance proposal or a description of how testing by trade associates or industry research groups were conducted.

Once a source has decided to develop an AEF, or validate a proposed AEF, they should provide, at a minimum, the following information as part of the request:

1. Test protocol pursuant to 326 IAC 3-6-2.
2. Detailed descriptions of the process.
3. Descriptions of control devices or control technology and relevant operating parameters.
4. Raw materials used in the process which may impact emissions (different fuels, oily scrap versus clean scrap, volatile organic compounds (VOC) content of different paints, etc.)
5. Discussion of how the process will operate during the AEF determination or validation.
6. Identification of the standard AP-42 (or equivalent source) emission factor for the process or control devices in operation (if an AP-42, or equivalent factor exists).
7. Discussion of why the standard AP-42, or equivalent emission factors, are not appropriate to use if an AP-42 or equivalent factor exists.
8. Discussion of why a new AEF is being requested, if the source is requesting a new AEF to replace an AEF already granted.

The request should be submitted to the *Office of Air Quality, Permits Branch* and explain why the AEF is appropriate. If a source within the jurisdiction of a local agency requests to develop or validate an AEF, the source should provide the local agency with the same information and justification.

In certain instances, AEFs developed through extensive testing conducted by trade associates or industry research groups, which

have been published and validated through peer review, subject to the approval of this office, may be used without further validation as described in this policy. The use of data generated by a certified CEMS, operated and maintained in accordance with the applicable regulations may be used without further validation as described in this policy. Additionally, the use of a material balance may be considered as an acceptable emission factor (without the need for further validation) provided the source owner or operator can substantiate the information provided to the satisfaction of the department. However, the use of any one of these acceptable options does not preclude the department from requiring compliance tests in permits issued by the department pursuant to the general authority provided by Title 326 of the Indiana Administrative Code.

If emission testing is required to validate the AEF, the reference method testing should meet the requirements of 326 IAC 3-6, as applicable. This requires a minimum of three (3) complete test runs conducted while the unit is operating at 95-100% of maximum capacity under conditions representative of normal operations, or another operating scenario approved by the commissioner, using test methods acceptable to the department. More than one test series may be required if the proposed AEF conflicts with other available information, or if the results of the initial test series are inconclusive. The OAQ Compliance Data Section will review the completed test data and prepare a summary report for the appropriate IDEM section (e.g., Permits, Data Support, Air Planning) acknowledging the AEF as valid or invalid.

IDEM will maintain a record of all AEFs granted. This information will be available for public inspection during normal business hours by contacting IDEM's Office of Air Quality, Compliance Data Section. The records will contain information necessary to substantiate the AEF with the exception of confidential information pursuant to 326 IAC 17.1. If you have any questions regarding the information contained in this non-rule policy document, you may contact Mr. Jarrod Fisher at (317)-233-2723.

DEPARTMENT OF STATE REVENUE
Departmental Notice #2
June 1, 2005
Prepayment of Sales Tax on Gasoline

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

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

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

The prepayment rate of sales tax on gasoline for the six – (6) month period beginning July 1, 2005, is seven and eight-tenths cents ($0.078) per gallon.

Using the most recent retail price of gasoline available (as required by IC 6-2.5-7-14(b)), the Department has determined the statewide average retail price per gallon of gasoline to be one dollar and forty four cents ($1.440). The most recent retail price of gasoline available was based on data contained in the May 2005 Petroleum Marketing Monthly as published by the Energy Information Agency.

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

Period			Rate Per Gallon
July 1, 1994	to	December 31, 1994	2.9 cents
January 1, 1995	to	June 30, 1995	3.7 cents
July 1, 1995	to	December 31, 1995	3.3 cents
January 1, 1996	to	June 30, 1996	3.3 cents
July 1, 1996	to	December 31, 1996	3.4 cents
January 1, 1997	to	June 30, 1997	4.0 cents
July 1, 1997	to	December 31, 1997	3.9 cents
January 1, 1998	to	June 30, 1998	4.0 cents
July 1, 1998	to	December 31, 1998	2.9 cents

January 1, 1999	to	June 30, 1999	3.0 cents
July 1, 1999	to	December 31, 1999	2.4 cents
January 1, 2000	to	June 30, 2000	3.6 cents
July 1, 2000	to	December 31, 2000	4.6 cents
January 1, 2001	to	June 30, 2001	4.9 cents
July 1, 2001	to	December 31, 2001	4.9 cents
January 1, 2002	to	June 30, 2002	4.9 cents
July 1, 2002	to	December 31, 2002	3.2 cents
January 1, 2003	to	June 30, 2003	5.3 cents
July 1, 2003	to	December 31, 2003	6.6 cents
January 1, 2004	to	June 30,2004	6.5 cents
July 1, 2004	to	December 31, 2004	6.6 cents
January 1, 2005	to	June 30, 2005	7.6 cents
July 1, 2005	to	December 31, 2005	7.8 cents

Indiana Department of State Revenue
John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE

04-990060.LOF

LETTER OF FINDINGS NUMBER: 99-0060
Sales/Use Tax
For the Year 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 this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax-Manufacturing Exemptions

Authority: Ind. Code § 6-2.5-5-4; Ind. Code § 6-2.5-5-5.1

Taxpayer protests the Department's assessment of use tax with respect to various items of tangible personal property it claims were used in its manufacturing process.

II. Sales/Use Tax-Statute of Limitations

Authority: Ind. Code § 6-8.1-5-2

Taxpayer protests the Department's assessment with respect to several items that it claims were assessed outside the statute of limitations for such assessments.

III. Tax Administration-Penalty

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

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

STATEMENT OF FACTS

Taxpayer is a business engaged in the production of batteries. During the year in question, Taxpayer operated two Indiana facilities in controversy. For the year in question, Taxpayer made several purchases that it asserted were used in its battery production. In addition, for several purchases, Taxpayer maintained that the items were assessed outside of the statute of limitations. Taxpayer was assessed use tax and penalty for these purchases, which Taxpayer protested.

I. Sales/Use Tax-Manufacturing Exemptions

DISCUSSION

Taxpayer protested the assessment of a number of items based on their use for the production of other tangible personal property. To qualify for the sales tax exemption for production, the items must be directly used or consumed for the direct production of tangible personal property. Ind. Code § 6-2.5-5-4 and -5.1. Here, the items in question did not meet the statutory standard for exemption.

FINDING

Taxpayer's protest is denied.

II. Sales/Use Tax-Statute of Limitations

DISCUSSION

With respect to several invoices for products used at one facility, Taxpayer protested that the assessment was untimely. Taxpayer has provided sufficient information to conclude that the assessment was made outside the statutory period provided by Ind. Code § 6-8.1-5-2.

FINDING

Taxpayer's protest is sustained.

III. Tax Administration-Penalty

Taxpayer also protests the imposition of the penalty for negligence for the years in question. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10-2.1. The Indiana Administrative Code further provides:

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

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

(1) the nature of the tax involved;
(2) judicial precedents set by Indiana courts;
(3) judicial precedents established in jurisdictions outside Indiana;
(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

45 IAC 15-11-2.

With respect to the penalty, Taxpayer has presented a case that it acted with reasonable care expected of taxpayers generally, and thus the penalty should be waived.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220010353.LOF

LETTER OF FINDINGS NUMBER: 01-0353
Income Tax
For Tax Years 1996-1998

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

ISSUE

I. Adjusted Gross Income Tax—Unitary Status

Authority: Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983); 45 IAC 3.1-1-153

Taxpayer protests its classification as a non-unitary business.

STATEMENT OF FACTS

Taxpayer is a fifty-percent (50%) partner in two partnerships which operate in the equipment leasing and asset based financial industry. The Indiana Department of Revenue ("Department") conducted an audit for the tax years involved and as a result issued proposed assessments. Taxpayer disagrees with these assessments. Further facts will be supplied as necessary.

I. Adjusted Gross Income Tax—Unitary Status

DISCUSSION

Taxpayer protests the proposed assessments for adjusted gross income tax for the tax years at issue. The Department concluded that taxpayer was not in a unitary relationship with two partnerships it owned equally with a related corporate partner. Taxpayer disagrees and believes that it is in a unitary relationship with the partnerships.

The U.S. Supreme Court discussed unitary business in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983). In that case, the Court explained a three-factor formula to determine unity. Factor one is functional integration, factor two is centralization of management and factor three is economies of scale. The Court explains:

> The State Court of Appeals relied on a large number of factors in reaching its judgment that appellant and its foreign subsidiaries constituted a unitary business. These included appellant's assistance to its subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the "considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion," *117 Cal. App. 3d, at 997, 173 Cal. Rptr., at 127*, the "substantial" technical assistance provided by appellant to the subsidiaries, *id. at 998-999, 173 Cal. Rptr., at 128*, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries. In each of these respects, this case differs from *ASARCO* and *F.W. Woolworth*, and clearly comes closer than those cases did to presenting a "functionally integrated enterprise," *Mobil, supra, at 440*, which the State is entitled to tax as a single entity.
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> …
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> Id., at 179.

In the instant case, taxpayer has provided insufficient documentation of functional integration. Taxpayer has not provided any evidence that it has employees, or expenses related to operating a functional business. Without operation of a functional business, it stands to reason that there could not be any functional integration with another business. Since taxpayer has failed to satisfy the first factor of unity as explained in Container Corporation, and all three must be satisfied to qualify as a unitary business, there is no need to address the remaining two factors.

Next, 45 IAC 3.1-1-153(c) explains:

> If the corporate partner's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of partnership income attributable to Indiana shall be determined as follows:
>
> (1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.
>
> (2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to apportionment.

Since taxpayer's activities do not constitute a unitary business under established standards, and since the partnership derives business income from sources within and without Indiana, 45 IAC 3.1-1-153(c)(1) provides that the three factor formula is appropriate to determine taxpayer's partnership income attributable to Indiana.

In its protest, taxpayer refers to several Financial Institutions Tax (FIT) regulations to support its claim that it is a unitary business. Since the tax at issue is Adjusted Gross Income Tax, FIT regulations are not relevant and will receive no further discussion. Taxpayer has provided insufficient documentation to establish that it is part of a functionally integrated enterprise, which is necessary to qualify as a unitary business under Container Corporation.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010354.LOF

LETTER OF FINDINGS NUMBER: 01-0354
Income Tax
For Tax Years 1996-1998

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

ISSUE

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STATEMENT OF FACTS

Taxpayer is a fifty-percent (50%) partner in two partnerships which operate in the equipment leasing and asset based financial industry. The Indiana Department of Revenue ("Department") conducted an audit for the tax years involved and as a result issued proposed assessments. Taxpayer disagrees with these assessments. Further facts will be supplied as necessary.

I. Adjusted Gross Income Tax—Unitary Status

DISCUSSION

Taxpayer protests the proposed assessments for adjusted gross income tax for the tax years at issue. The Department concluded that taxpayer was not in a unitary relationship with two partnerships it owned equally with a related corporate partner. Taxpayer disagrees and believes that it is in a unitary relationship with the partnerships.

The U.S. Supreme Court discussed unitary business in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983). In that case, the Court explained a three-factor formula to determine unity. Factor one is functional integration, factor two is centralization of management and factor three is economies of scale. The Court explains:

> The State Court of Appeals relied on a large number of factors in reaching its judgment that appellant and its foreign subsidiaries constituted a unitary business. These included appellant's assistance to its subsidiaries in obtaining used and new equipment and in filling personnel needs that could not be met locally, the substantial role played by appellant in loaning funds to the subsidiaries and guaranteeing loans provided by others, the "considerable interplay between appellant and its foreign subsidiaries in the area of corporate expansion," *117 Cal. App. 3d, at 997, 173 Cal. Rptr., at 127*, the "substantial" technical assistance provided by appellant to the subsidiaries, *id. at 998-999, 173 Cal. Rptr., at 128*, and the supervisory role played by appellant's officers in providing general guidance to the subsidiaries. In each of these respects, this case differs from *ASARCO* and *F.W. Woolworth*, and clearly comes closer than those cases did to presenting a "functionally integrated enterprise," *Mobil, supra, at 440*, which the State is entitled to tax as a single entity.
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> Id., at 179.

In the instant case, taxpayer has provided insufficient documentation of functional integration. Taxpayer has not provided any evidence that it has employees, or expenses related to operating a functional business. Without operation of a functional business, it stands to reason that there could not be any functional integration with another business. Since taxpayer has failed to satisfy the first factor of unity as explained in Container Corporation, and all three must be satisfied to qualify as a unitary business, there is no need to address the remaining two factors.

Next, 45 IAC 3.1-1-153(c) explains:

> If the corporate partner's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of partnership income attributable to Indiana shall be determined as follows:
>
> (1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.
>
> (2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to apportionment.

Since taxpayer's activities do not constitute a unitary business under established standards, and since the partnership derives business income from sources within and without Indiana, 45 IAC 3.1-1-153(c)(1) provides that the three factor formula is appropriate to determine taxpayer's partnership income attributable to Indiana.

In its protest, taxpayer refers to several Financial Institutions Tax (FIT) regulations to support its claim that it is a unitary business. Since the tax at issue is Adjusted Gross Income Tax, FIT regulations are not relevant and will receive no further discussion. Taxpayer has provided insufficient documentation to establish that it is part of a functionally integrated enterprise, which is necessary to qualify as a unitary business under Container Corporation.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20020166.LOF

LETTER OF FINDINGS NUMBER: 02-0166
Gross Income Tax and Adjusted Gross Income Tax
For the Years 1993, 1996-1999

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

of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax -- Property factor

Authority: Ind. Code § 6-8.1-5-1; 45 IAC 3.1-1-44.

Taxpayer protests the Department's change in its property value for apportionment purposes.

II. Gross income tax—Out-of-state sales and agency

Authority: Ind. Code § 6-2.1-1-10; Ind. Code § 6-8.1-5-1; *Indiana Dept. Of Revenue v. Surface Combustion Corp.*, 111 N.E.2d 50 (Ind. 1953).

Taxpayer protests the imposition of gross income tax with respect to the sale of tangible personal property that it claimed was produced outside Indiana for assembly in Indiana, or alternatively that it received the proceeds in an agency capacity, and that the proceeds it received were not subject to a markup.

STATEMENT OF FACTS

Taxpayer is a business engaged in the manufacture of steam generating and related equipment. Taxpayer was audited for the years in question. Taxpayer has protested three aspects of the assessment. The first aspect was that the Department auditor included property in Indiana at a different value than taxpayer had listed it, which changed taxpayer's apportionment factors. Second, taxpayer protested an assessment of gross income tax for various contracts for which taxpayer maintains were not Indiana sales for gross income tax purposes, or alternatively that it was an agent for another affiliated company. Third, with respect to the payments made by taxpayer to the affiliated company, the taxpayer protested the addition of a ten percent markup from the amount ultimately received by the affiliated company.

I. Adjusted Gross Income Tax- Property factor

DISCUSSION

First, taxpayer protests the value of a parcel of real estate in Indiana. The real estate in question had a plant located on it, which for several years had been engaged in production. However, due to a change in market circumstances that substantially reduced demand for its key product, the plant was forced to shut down. The county and taxpayer agreed to a lower value for the real estate for property tax purposes based on the lack of economic usefulness of the real estate and building. The Department, however, used the value based on the historical cost listed on the taxpayer's federal income tax return.

Per 45 IAC 3.1-1-44, "[p]roperty owned by the taxpayer is valued at original cost. If the original cost cannot be ascertained, the property is valued at fair market value as of the date of acquisition by the taxpayer." As such, the Department's determination of the value of the real estate must stand, notwithstanding future events that reduced the property's actual value.

FINDING

Taxpayer's protest is denied.

II. Gross income tax- Out of state sales and agency

DISCUSSION

Second, taxpayer argues that certain gross receipts that it received were not taxable. Two subarguments exist here. First, taxpayer argues that manufactures the products outside Indiana, and that only the installation occurs in Indiana. Thus, under the holding of *Indiana Dept. Of Revenue v. Surface Combustion Corp.*, 111 N.E.2d 50 (Ind. 1953), in which a transaction involving tangible personal property manufactured outside Indiana but assembled at a business site in Indiana was held to be exempt from gross income tax, taxpayer's sales would be exempt. However, taxpayer has not provided sufficient information to substantiate this argument, and accordingly has not met its burden per Ind. Code § 6-8.1-5-1.

In the alternative, taxpayer asserts that it is merely a passthrough entity. In particular, taxpayer states that it divided several years ago into two separate corporations. One corporation—the taxpayer in this case— is responsible for manufacturing property, while the other is engaged solely in installation and construction of that property. In general, when a customer wished to have the property installed at the customer's facility, the customer would contract with the corporation whose business was installation. However, for various reasons largely related to liability, some contracts would indicate that the taxpayer was to receive the proceeds for the installation. In turn, taxpayer would pay the proceeds to the installing corporation. Taxpayer has argued that this created an agency relationship which would exempt the taxpayer's proceeds from gross income tax under Ind. Code § 6-2.1-1-10 (repealed effective January 1, 2003). However, taxpayer has not provided sufficient information to substantiate this argument, and accordingly has not met its burden per Ind. Code § 6-8.1-5-1.

Taxpayer also protested a ten percent markup based on the amounts that the installing corporation received. Here, taxpayer has provided sufficient documentation to conclude that the manufacturing corporation's proceeds were exactly those received by the installing corporation-no more and no less. Accordingly, this portion of the protest should be sustained.

FINDING

Taxpayer's protest is sustained with respect to the markup used by the auditor. Taxpayer's protest is otherwise denied.

DEPARTMENT OF STATE REVENUE

0420020251.LOF

LETTER OF FINDINGS NUMBER: 02-0251
Use Tax
For the Years 1998, 1999, and 2000

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

ISSUE

I. Use Tax—Assessment; Production Supplies and Parts Washer Cleaner

Authority: IC 6-8.1-5-1(b); IC 6-2.5-3-2; IC 6-2.5-3-4; IC 6-2.5-5-3(b); IC 6-2.5-5-5.1(b); IC 6-2.5-5-6.

Taxpayer protests the assessment of use tax on various maintenance chemicals and supplies.

II. Use Tax—Assessment; Trial Materials

Authority: IC 6-2.5-5-6.

Taxpayer protests the assessment of use tax on trial materials.

III. Use Tax—Assessment; Materials to Repair Roof Collapse

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

Taxpayer protests the assessment of use tax on materials used to repair non-production areas of its facility.

IV. Use Tax—Assessment; Machinery, Tools, and Equipment

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

Taxpayer protests the assessment of use tax on items used partially and wholly outside of exempt production.

V. Use Tax—Assessment; Rental of Tangible Personal Property

Authority: IC 6-2.5-4-1; IC 6-2.5-4-10; IC 6-2.5-3-2(a).

Taxpayer protests the assessment of use tax on rentals of equipment used partially and wholly outside of exempt production.

VI. Use Tax—Assessment; Publications and Subscriptions

Authority: IC 6-2.5-5-17.

Taxpayer protests the assessment of use tax on non-newspaper publication purchases.

VII. Use Tax—Assessment; Catering Service Charges

Authority: IC 6-2.5-5-20(c)(3).

Taxpayer protests the assessment of use tax on catered food and services.

VIII. Use Tax—Assessment; Other Purchases

Authority: IC 6-2.5-3-2(a); IC 6-2.5-3-4(a).

Taxpayer protests the assessment of use tax on various miscellaneous items.

STATEMENT OF FACTS

Taxpayer manufactures flexible retail and industrial plastic packaging used to protect food and other products. Taxpayer has one Indiana location, has locations in other states, and is headquartered in South Carolina. An audit was conducted; it did not adjust reported sales tax. An examination of purchases was made and use tax was assessed where the Department determined it to be due. Taxpayer filed a protest to the assessments and a hearing officer was assigned to hear the protest. A hearing date was set for February 8, 2005. Taxpayer phoned the hearing officer on February 7, 2005 to request that the hearing be rescheduled. Taxpayer and the hearing officer mutually agreed to a one week extension, rescheduling the hearing for February 15, 2005. Taxpayer did not appear for the hearing either in person or by phone. This Letter of Findings is written based upon the information submitted and available within the case file.

I. Use Tax—Assessment; Production Supplies and Parts Washer Cleaner

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). IC 6-2.5-3-2 imposes an excise tax—known as the use tax—on the storage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction. There are exemptions to the imposition of the use tax; IC 6-2.5-3-4 exempts property upon which the sales tax has been paid and exempts property eligible under IC 6-2.5-5.

Taxpayer had purchased exempt from sales tax various chemicals for use in its manufacturing operation. Among these was part washer cleaner used in maintenance to clean production equipment. The cleaner was not used to produce product. IC 6-2.5-5-3(b) exempts manufacturing machinery, tools, and equipment if the taxpayer acquiring the property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. IC 6-2.5-5-5.1(b) exempts tangible personal property if the taxpayer acquiring the property acquires it for direct

consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. IC 6-2.5-5-6 exempts tangible personal property if the taxpayer acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business.

The Department has considered the relevant exemption statutes but because the supplies are used to clean production equipment and are not consumed in the manufacturing of tangible personal property, no exemption for use tax exists in these circumstances.

Taxpayer also had purchased exempt from sales tax other supplies, such as labels, envelopes, ribbons, forms, and reports that were consumed outside of Taxpayer's production operation. Because these supplies are not consumed during the production of tangible personal property or incorporated into tangible personal property, no exemption from use tax exists in these circumstances.

Additionally, Taxpayer had purchased exempt from sales tax other supplies such as chemicals for their boiler that were partially used for taxable purposes such as area heat. Because these chemicals are not consumed during the production of tangible personal property or incorporated into tangible personal property for sale, no exempt use from use tax exists in these circumstances.

FINDING

For the reasons discussed above, Taxpayer's protest is denied.

II. Use Tax—Assessment; Trial Materials

DISCUSSION

Taxpayer used raw materials that had been purchased exempt from sales tax in trials. To be exempt under IC 6-2.5-5-6, the trials must be sold in business. No evidence was presented to demonstrate the trials were sold in business.

FINDING

For the reason discussed above, Taxpayer's protest is denied.

III. Use Tax—Assessment; Materials to Repair Roof Collapse

DISCUSSION

During the audit period, Taxpayer had a roof collapse over a manufacturing area due to heavy snows. Emergency repairs were made rapidly with little contract detail—so that production could be reestablished quickly. An exemption certificate was issued by Taxpayer to the contractor for the materials used in these repairs. Invoices did not disclose sufficient evidence to determine the materials that were taxable and those that were exempt. Taxpayer's engineer estimated that 10% of the materials purchased were for taxable non-production purposes. Communications by the auditor with the contractor identified the use of additional materials that were taxable. These materials were not included in the estimate by Taxpayer's engineer. Reconciliation of the differences in the estimates of taxable and exempt materials could not be accomplished and better information was not available. Due to what appeared to be additional taxable construction beyond the estimates by Taxpayer's engineer, the auditor for the Department determined that 12.5% of the materials purchased exempt from sales tax were used in a taxable manner. This is the best information available as to the taxable amount of constructions materials that were purchased exempt from sales tax. Taxpayer was unable to provide better information.

IC 6-8.1-5-1(b) states that tax assessments made by the Department are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1 authorizes the Department to make an assessment of unpaid tax based on the best information available. In this situation, Department has employed the best information available method and Taxpayer has not provided better information to rebut the assessment.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

IV. Use Tax—Assessment; Machinery, Tools, and Equipment

DISCUSSION

Taxpayer purchased exempt from sales tax machinery, tools, and equipment—such as trash carts, storage cabinets, maintenance and cleaning tools, space heaters, air conditioners, fans, and scales. These purchases were not used within the production process. Taxpayer also purchased exempt from sales tax a chiller and boiler, as well as production equipment partially used for area heating and air conditioning. Taxpayer also purchased exempt from sales tax machinery, tools, and equipment—such as parts for fork lifts and area heating and air conditioning—that the Department determined were used partially outside the production process. Taxpayer provided information to indicate the taxable proportion of use. No additional information was presented to the Department outside of the audit to indicate taxable and exempt use of the above tangible personal property.

IC 6-8.1-5-1(b) states that tax assessments made by the Department are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1 authorizes the Department to make an assessment of unpaid tax based on the best information available. In this situation, Department has employed the best information available method and Taxpayer has not provided additional better information to rebut the assessment.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

V. Use Tax—Assessment; Rental of Tangible Personal Property

DISCUSSION

Taxpayer rented exempt from sales tax equipment that included articulation boom lifts and scissor lifts. These rentals were for maintenance and other taxable uses. Taxpayer also rented exempt from sales tax tow motors determined to be used 30% of the time in a taxable manner for loading and unloading trucks, movement of raw materials and finished goods, and maintenance. IC 6-2.5-4-1 and IC 6-2.5-4-10 imposes sales tax on the retail transaction of rentals—the transfer of tangible personal property for consideration. IC 6-2.5-3-2(a) imposes use tax on the use of tangible personal property acquired in a retail transaction. Use tax is due on these rentals. Taxpayer has not provided additional information subsequent to the audit to rebut the determination of exempt and taxable use.

FINDING

For the reason stated above, Taxpayer's protest is denied.

VI. Use Tax—Assessment; Publications and Subscriptions

DISCUSSION

Taxpayer purchased exempt from sales tax subscriptions, publications, directories, and pamphlets. IC 6-2.5-5-17 exempts newspapers from sales tax. All other publications are taxable. Accordingly, use tax is due.

FINDING

For the reason stated above, Taxpayer's protest is denied.

VII. Use Tax—Assessment; Catering Service Charges

DISCUSSION

Taxpayer purchased catered food upon which service charges were made—but not taxed. Taxpayer also purchased exempt from sales tax other catered food. IC 6-2.5-5-20(c)(3) states that prepared food is not exempt from sales taxation; thus, catered food is taxable.

FINDING

For the reason stated above, Taxpayer's protest is denied.

VIII. Use Tax—Assessment; Other Purchases

DISCUSSION

Taxpayer purchased signs, cleaning supplies, office supplies, software, computer equipment, clothing, roofing and other building materials, video equipment, and charge card purchases from outside Indiana upon which sales tax was not charged.

IC 6-2.5-3-2(a) imposes use tax on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction—regardless of the location of that transaction or of the retail merchant making that transaction. IC 6-2.5-3-4(a) exempts from the imposition of use tax purchases made in which sales tax was paid or the purchase is exempted under IC 6-2.5-5. Taxpayer would need to have shown the Department evidence that either sales tax has been paid on these purchases or that the purchases are exempt under a statutory provision. No such evidence or documentation was provided by Taxpayer.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

28-20020320.LOF

LETTER OF FINDINGS NUMBER: 02-0320
Controlled Substance Excise Tax
For the Period: April 23, 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

Controlled Substance Excise Tax—Assessment; Liability

Authority: IC 6-8.1-5-1(b); IC 6-7-3-5; IC 6-7-3-6(b)(2); IC 6-7-3-10(b); IC 6-7-3-11; IC 6-7-3-13; Bryant v. State of Indiana, 660 N.E.2d 290, (Ind. 1995); Indiana Dept. of Revenue v. Adams, 728 N.E.2d 728 (Ind. 2002); Hall v. Indiana Dept. of Revenue, 660 N.E.2d 319 (Ind. 1995).

Taxpayer protests the assessment of CSET on possession of marijuana.

STATEMENT OF FACTS

Taxpayer was charged in County Circuit Court with:

(1) Dealing in marijuana, Class C Felony

(2) Possession of marijuana, Class D Felony
(3) Maintaining a common nuisance, Class D Felony.

A motion to suppress evidence was filed and was granted. Taxpayer pleaded guilty to: (3) Maintaining a common nuisance. The charges pertaining to the dealing in and possession of marijuana were dismissed. A detective for the County Drug Task Force received a letter from the County Prosecutor's office requesting that a Controlled Substance Excise Tax assessment be prepared on the 1,054.32 grams of marijuana seized from Taxpayer's residence. The Criminal Investigation Division of the Indiana Department of Revenue received the detective's Letter of Request for Assessment. The Department prepared an Activity Report and specifically noted that Taxpayer plead guilty to an unrelated charge to the dealing in and possession of marijuana. Taxpayer filed a protest to the assessment and a hearing was held. This letter of findings is the result.

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). In Indiana, the manufacture, possession, or delivery of marijuana is taxable. IC 6-7-3-5 imposes the Controlled Substance Excise Tax on controlled substances that are delivered, possessed, or manufactured in Indiana in violation of IC 35-48-4, **Offenses Relating to Controlled Substances**, or 21 U.S.C. 841 through 21 U.S.C. 852, (Federal Controlled Substances Act) **Offenses and Penalties**. The tax does not apply to a controlled substance that is distributed, manufactured, or dispensed by a person registered under IC 35-48-3. Under the CSET provisions, a taxpayer who delivers, possesses, or manufactures marijuana is required to pay $3.50 for each gram. IC 6-7-3-6(b)(2). A receipt for payment of CSET is valid for 30 days. IC 6-7-3-10(b). A person may not deliver, possess, or manufacture a controlled substance subject to CSET without having paid the tax. IC 6-7-3-11. A person who fails or refuses to pay CSET is subject to a penalty of 100% of the tax in addition to the tax. *Id.* An assessment for CSET due is considered a jeopardy assessment; the department is required under Indiana statute to demand immediate payment and is required to take action to collect the tax due. IC 6-7-3-13.

The Indiana Supreme Court has stated that the assessment of CSET is a punishment and, therefore, a jeopardy within the double jeopardy clause. Bryant v. State of Indiana, 660 N.E.2d 290, 297 (Ind. 1995). It is the second jeopardy that is constitutionally barred. Jeopardy in the imposition of CSET attaches when the Department serves a person with an assessment notice and demand. *Id.* at 299. The Indiana Supreme Court has stated that the exclusion and suppression of evidence in a criminal proceeding does not apply in the Department proceeding to assess CSET. *See* Indiana Dept. of Revenue v. Adams, 728 N.E.2d 728 (Ind. 2002).

At the tax protest hearing before the Department, Taxpayer stated that she lived with Husband and he smoked marijuana. Taxpayer stated that she was aware that Husband smoked marijuana and that he had a history of smoking marijuana. A person whom Husband had met came to the house in which Taxpayer and Husband lived to get some marijuana. Taxpayer stated to the Department at the hearing—the marijuana was sitting on a counter in the house. According to Taxpayer, the person was a police informant. Taxpayer was arrested and charged. Husband was later charged and he pleaded guilty to possession of marijuana.

In Hall v. Indiana Dept. of Revenue, 660 N.E.2d 319 (Ind. 1995), police entered and searched the home of a husband and wife. During their inspection of the property, the police discovered marijuana. The husband and wife were arrested and charged with possession of marijuana. Four days later the Department assessed CSET. The State dismissed the criminal charges against the wife. The husband pleaded guilty to possession of marijuana. The husband and wife protested the CSET assessment; the Department denied the protest. The husband and wife appealed to the Indiana Tax Court. The Tax Court concluded that the CSET assessment against the husband was a second jeopardy, but that the rights of the wife had not been violated. The case was appealed to the Indiana Supreme Court; it held that the wife was liable for the CSET assessment.

The CSET assessment—based on Taxpayer's taxable possession of marijuana—is Taxpayer's only jeopardy. Taxpayer has not been subjected to prosecution or punishment for the criminal charges related to the dealing in or the possession of marijuana. Taxpayer did plead guilty to maintaining a common nuisance, but the CSET report states that the common nuisance charge is unrelated to dealing and possession. Because the dealing and possession charges were dismissed against Taxpayer, no jeopardy attached. Taxpayer is liable for the CSET assessment.

FINDING

Taxpayer's protest is denied

DEPARTMENT OF STATE REVENUE

0220020479.LOF

LETTER OF FINDINGS: 02-0479
GROSS INCOME TAX
For the 1998 Tax Year

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

Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Money Earned from Providing Construction Management Services – Gross Income Tax.

Authority: IC 6-2.1-2-2(a)(2); IC 6-8.1-5-1; 45 IAC 1-1-19; 45 IAC 1-1-49; 45 IAC 1-1-121(a).

Taxpayer claims that the Department of Revenue (Department) erred when it determined that money earned from providing construction management services was subject to the state's gross income tax. Taxpayer maintains that this money is not Indiana source income.

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 argues that it is entitled to abatement of the ten-percent negligence penalty.

III. Abatement of the Ten-Percent Underpayment Penalty.

Authority: IC 6-3-4-4.1(e); IC 6-8.1-10-2.1(b).

Taxpayer claims that the ten-percent quarterly underpayment penalty should be abated because taxpayer had adequate grounds for calculating its 1998 state income tax liability as it did.

STATEMENT OF FACTS

Taxpayer is an out-of-state company which was in the business of providing construction and design services to steel mill companies building new facilities or revamping existing facilities.

In 1996, taxpayer's sister company entered into a multi-year contract to design and build a steel mill in Indiana. The steel company hired the sister company to provide engineering, procurement, and construction management services. The sister company then subcontracted with taxpayer to provide all the construction management services that were to be performed in relation to the new steel mill. During a prior audit, the Department determined that taxpayer did not have Indiana source income for gross income tax purposes because actual construction at the Indiana site was not set to commence until 1997 and because all previous services were rendered at taxpayer's out-of-state location.

Taxpayer filed a 1998 consolidated corporate income tax return, but claimed that it had no Indiana gross income tax liability. During 2002, the Department conducted an audit of the 1998 tax year and found that taxpayer owed gross income taxes attributable to the Indiana construction project. Accordingly, the Department sent notices of proposed assessment. Taxpayer disagreed with the assessment and submitted a protest to that effect. Correspondence was exchanged between taxpayer and the Department with taxpayer contending that it had gone into receivership and declining the opportunity to further explain the basis for its initial tax protest. This Letter of Findings was written addressing the substance of taxpayer's tax protest. Questions concerning taxpayer's receivership are not at issue.

DISCUSSION

I. Money Earned from Providing Construction Management Services – Gross Income Tax.

Taxpayer earned money because it provided construction management services related to the construction of an Indiana steel mill. The Department concluded that a portion of this income stemming from the performance of services at the Indiana site (47 percent) was subject to gross income tax.

Taxpayer disagrees stating the income is not Indiana source income on the ground that less than five-percent of its construction management activities occurred in Indiana.

The issue is whether taxpayer received gross income when it performed management services in support of the Indiana steel mill project.

IC 6-2.1-2-2(a)(2) imposes the gross income tax "upon the receipt of... the taxable gross income derived from activities or businesses or any other sources with Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." Id. 45 IAC 1-1-19 states that, "For the purpose of this Act [IC 6-2.1] and these regulations a 'trade,' 'business' or the carrying on of 'commerce' includes any activity in which *a service is provided* or property is rented, sold, transferred, exchanged, manufactured, produced or otherwise generated gross income to the owner, transferor, manufacturer, or producer." (*Emphasis added*).

Taxpayer concedes that the money it earned constituted gross income. Under 45 IAC 1-1-19, the gross income a nonresident taxpayer receives from providing services within Indiana is subject to gross income tax is taxable. However, taxpayer argues the service income it received during 1998 is not taxable because its activities in Indiana were de minimis. Specifically, taxpayer states that, "Minimal service activities within Indiana have been held insufficient to impose gross income tax on income related to the performance of services."

45 IAC 1-1-49 provides that "a taxpayer may establish a 'business situs' in ways including, but not limited to.... [p]erformance of services." However, taxpayer claims that because most of the service work was performed at its out-of-state location and because its presence within Indiana was so limited, that it never established a "business situs" within the state. In support, taxpayer points to 45 IAC 1-1-121(a) which reads as follows:

Income from a contract for the performance of services within the state is subject to gross income tax. However, if the contract

calls for the performance of services both within and without the State by a nonresident with no in-state business situs and the non-resident's performance within the State is minimal or incidental in comparison to his performance out-of-state, no service income will be taxed. In determining what will be considered "minimal" or "incidental" the Department has formulated these guidelines. If five percent (5%) or less of the total hours or total fee under the contract in any tax year is attributable to services performed in Indiana, the entire proceeds of the contract received in that year are exempt from gross income tax.

Taxpayer states that it "did not perform more than five percent (5%) of its services in Indiana, therefore, none of the receipts received [] under the Agreement is subject to gross income tax." The parties' agreement does not bear out taxpayer's contention. The Agreement contains a "summary of our estimated manpower requirements for the project broken down between Home Office and Field Services." The agreement states that the steel mill project would consume 722,900 total man-hours, that 387,700 of those hours would be spent at the out-of-state home office, and that 335,200 hours would be spent at the Indiana construction site. Based on these figures, approximately 47 percent of the time spent on the project would be spent at the Indiana construction site. The 47 percent figure is the same number used by the audit in calculating taxpayer's gross income tax liability. Taxpayer's contention – that less than 5 percent of its services were provided in Indiana and that more than 95 percent were provided at its home office – is not supported. To the contrary, if one were to consider only that portion of the project related to "construction management" – which is taxpayer's contribution to the steel mill project – the 290,000 hours attributable to "construction management" were spent exclusively at the Indiana location.

Pursuant to IC 6-8.1-5-1, taxpayer has failed to meet its burden of demonstrating that the audit's calculation of taxpayer's gross income liability and the consequent assessment are wrong.

FINDING

Taxpayer's protest is respectfully denied.

II. Ten-Percent Negligence Penalty.

Taxpayer argues that the Department should waive the ten-percent negligence penalty because it had reasonable cause for deciding that it was not subject to gross income tax during 1998.

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 failure to report any of the income received from performing services constitutes the "reasonable care, caution, or diligence as would be expected from an ordinary reasonable taxpayer." 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten-Percent Underpayment Penalty.

Taxpayer asks that the Department abate the ten-percent penalty which was assessed because taxpayer underpaid its quarterly estimated taxes. Taxpayer makes this argument because it believes it had adequate grounds for determining its 1998 Indiana tax liability as it did.

IC 6-3-4-4.1(e) states as follows:

The penalty prescribed by IC 6-8.1-10-2.1(b) shall be assessed by the department on corporations failing to make payments as required in subsection (d) or (g). However, no penalty shall be assessed as to any estimated payments of adjusted gross tax plus supplemental net income tax plus gross income tax which equal or exceed:

(1) twenty percent (20%) of the final tax liability for such taxable year; or

(2) twenty-five percent (25%) of the final tax liability for the taxpayer's previous taxable year.

In addition, the penalty as to any underpayment of tax on an estimated return shall only be assessed on the difference between the actual amount paid by the corporation on such estimated return and twenty-five percent (25%) of the sum of the corporation's final adjusted gross income tax plus supplemental tax income tax liability for such taxable year.

IC 6-8.1-10-2.1(b) sets the amount of penalty as ten percent.

Taxpayer was assessed a penalty because it underpaid its quarterly estimated tax. Taxpayer does not challenge the manner in which the amount of penalty was calculated but repeats its substantive argument that the construction management income was not subject to the state's gross income tax. In effect, taxpayer asks the Department to abate the underpayment penalty because taxpayer presented a colorable argument justifying its failure to report the income. Taxpayer asks the Department to exercise a discretionary authority it does not have. Without finding that taxpayer was correct when it estimated its 1998 income tax liability, the Department has no authority to abate the underpayment penalty.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04-20020605.LOF

LETTER OF FINDINGS NUMBER: 02-0605
Sales/Use Tax
For the Years 1995-2001

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

ISSUE

I. Sales and Use Tax-Exemption Certificates

Authority: Ind. Code § 6-2.5-3-7, Ind. Code § 6-2.5-8-1; Ind. Code § 6-2.5-8-8.

Taxpayer protests the assessment of sales and use tax with respect to sales made to several customers Taxpayer believed were not subject to sales and use tax.

STATEMENT OF FACTS

Taxpayer is an individual engaged in the business of stone carving. Taxpayer does two primary activities in his business. First, Taxpayer takes stones provided by other persons and engraves those stones to customer specifications. Second, Taxpayer engages in carving items which are then sold to third parties.

For the years in question, Taxpayer neither registered as a retail merchant under Indiana law nor collected sales tax. Taxpayer was assessed sales tax with respect to his various sales. Taxpayer protested the assessment with respect to several sales. A hearing was held, and this letter of findings results.

I. Sales and Use Tax-Exemption Certificates

DISCUSSION

Taxpayer argues that the sales of materials to various purchasers were exempt. In particular, Taxpayer maintains that the purchases in question were made for the customer's subsequent resale, either for their business or for further sale. Further, Taxpayer argues that the purchases were transported outside Indiana, and are thus exempt on that basis.

Taxpayer has argued that the out-of-state customers/resellers should not bear the burden of filing for retail merchant certificate for Indiana, particularly given that the customers/resellers only sold their property outside Indiana.

Under Ind. Code § 6-2.5-3-7(a):

> A person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana, unless the person or the retail merchant can produce evidence to rebut that presumption.

Under Ind. Code § 6-2.5-3-7(b) (emphasis added):

> A retail merchant is not required to produce evidence of nontaxability under subsection (a) if the retail merchant receives from the person who acquired the property an exemption certificate which certifies, *in the form prescribed by the Department*, that the acquisition was exempt from use tax.

The basic purpose of a proper exemption certificate vis-à-vis a seller of personal property is to relieve that seller of the burden of proving that the purchaser used the items sold for an exempt use and associated record keeping for every retail purchase that may be exempt. Ind. Code § 6-2.5-3-7; Ind. Code § 6-2.5-8-8. Instead, the Department must then look to the purchaser to determine their liability for use tax.

However, when a seller does not receive a valid Indiana exemption certificate for whatever reason, then the seller and purchaser jointly bear the onus of showing that the property sold to the purchaser was used by the purchaser in a manner that was exempt from tax. Ind. Code § 6-2.5-3-7(a). Upon Departmental audit of a seller in a case such as this, the seller then bears the burden of showing by alternative means that the exemption claimed by the purchaser is proper. The question then shifts to alternative means of showing such exemptions.

Here, Taxpayer has presented exemption certificates from another state, or exemption certificates dated after the dates of the sales in question. Under the Indiana statute, this does not constitute a form prescribed by the Department. Even though the purchasers were located outside Indiana, an exemption certificate is required in order to make exempt purchases in Indiana. Ind. Code § 6-2.5-8-1, -8. However, the purchaser is not subject to the application fee due under Ind. Code § 6-2.5-8-1(b). The net effect is to assign an identification number to the merchant, and to permit the merchant to make tax-exempt purchases from the Indiana seller.

In cases in which a seller does not receive an exemption certificate, the means of a taxpayer to show that the sale was exempt from tax is to follow the flow of transactions and establish exemption based on that flow. Here, Taxpayer has not met that burden, and is accordingly denied.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030029.LOF

LETTER OF FINDINGS NUMBER: 03-0029
Sales and Use Tax
For the Tax Period 1999-2001

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

ISSUE

I. Sales and Use Tax - Imposition

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

The taxpayer protests the assessment of sales tax.

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

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

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

STATEMENT OF FACTS

The taxpayer is a corporation primarily involved in the sale of pre-owned vehicles. The taxpayer also finances some of the vehicles sold. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department", assessed additional sales tax, penalty, and interest. The taxpayer protested the assessment and a hearing was held. This Letter of Findings results.

I. Sales and Use Tax -Imposition

DISCUSSION

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.

Indiana imposes a sales tax on the transfer of tangible personal property in a retail transaction. The retail merchant is required to collect and remit the sales taxes due to the state. IC 6-2.5-2-1.

In performing the audit, the department's auditor compared the Bureau of Motor Vehicles listing of vehicles registered under the taxpayer's identification number, the taxpayer's dealer jackets, and the amounts remitted to the department. The total amount due is the balance of the tax collected per the taxpayer's records or dealer jackets plus the amount the Bureau of Motor Vehicles report should have been paid. The total of the taxpayer's records and the Bureau of Motor Vehicles records were each decreased by the amounts that appeared on both sets of records. The remaining amount was decreased by the amount the taxpayer had actually remitted to the department. The difference is the amount of tax due the department per the audit.

The taxpayer contended that keyboarding errors caused some automobile sales to accidentally be listed twice. The taxpayer presented substantial documentation that some vehicle sales were actually duplicated in the audit. Therefore, in several instances the audit includes two assessments for sales tax associated with one sale of an automobile. Each retail transaction is only subject to the imposition of the sales tax once. Therefore, the duplicate assessments must be deleted from the assessment.

FINDING

The taxpayer's protest is sustained as to the assessments shown to be duplicated in the assessment.

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

DISCUSSION

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.

The taxpayer's carelessness and inattention to detail in the keeping of accurate records constituted negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

03-20030083.LOF

LETTER OF FINDINGS NUMBER: 03-0083
Income Tax Withholding
For the Years 1999, 2000, and 2001

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

ISSUE

Income Tax Withholding—Distributions to non-resident shareholders

Authority: IC 6-8.1-5-1(b); IC 6-3-4-13.

Taxpayer protests the assessment of income tax that it was required to have withheld from a distribution to a non-resident shareholder.

STATEMENT OF FACTS

Taxpayer is an Indiana S-corporation with 10 shareholders, 3 of whom are out-of-state residents. An audit examination revealed that no withholding income tax was being withheld on the non-resident shareholders' distributions. Audit assessed the S-corporation with the withholding income tax due on the non-resident shareholders' distributions.

Taxpayer filed a protest to the assessment. A hearing date was set for February 22, 2005. Taxpayer did not appear for the hearing. This letter of findings is written based upon the information available within the file.

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). IC 6-3-4-13 requires an S-corporation to withhold Indiana income tax on distributions made to non-resident shareholders. Under the statute, the corporation is liable to the State of Indiana for the amount of income tax that the corporation is required to withhold. *Id.* The withholding of the income tax by the corporation does not relieve a shareholder of the obligation to file an Indiana income tax return. *Id.* But if a corporation fails to withhold and pay to the state of Indiana any amount of tax required to be withheld—and the tax is paid by the shareholder, that amount of tax paid by the shareholder shall not be collected from the corporation; but the corporation shall not be relieved from liability for interest and penalties due, caused by the corporation's failure to withhold the tax due. *Id.* In this instant case, the out-of-state shareholder has not filed an Indiana income tax return since 1996. Because the S-corporation had a duty to withhold and submit the income tax due on a non-resident distribution and because the non-resident has not filed an income tax return, Taxpayer is not relieved of the tax liability; the income tax that should have been withheld by the S-corporation Taxpayer is to be paid to the Department by S-corporation Taxpayer—including interest and penalties.

The fact that an R&D credit was available to be claimed does not abrogate the duty of the S-corporation to have withheld the income tax due on the non-resident shareholder's distribution and to have submitted the tax to the State of Indiana.

FINDING

For the reasons stated above, Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030191.LOF

LETTER OF FINDINGS NUMBER: 03-0191
Sales and Use Tax
For The Tax Period 1999-2001

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

ISSUES

I. Sales and Use Tax - Imposition

Authority: IC 6-2.5-2-1, IC 6-8.1-5-1 (b), IC 6-8.1-5-4, IC 6-2.5-8-8.

The taxpayer protests the assessment of sales and use tax.

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

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

STATEMENT OF FACTS

The taxpayer is a corporation doing business as a retail jewelry store. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use tax, interest, and penalty for the tax period 1999-2001. 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. 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.

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 claimed that many sales were exempt from the sales tax.

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.

The taxpayer did not have exemption certificates for these sales. Therefore, they were properly included in the taxpayer's total sales subject to Indiana sales tax.

The taxpayer's sales tax liability was computed by preparing a schedule comparing the taxpayer's taxable sales invoices to the taxpayer's sales tax returns filed with the department. Sales without exemption certificates were separately identified. The taxpayer was given credit for all sales that had been reported to the state. The taxable sales were totaled and tax assessed.

The taxpayer claimed that this method did not fairly and accurately reflect the actual amount of sales tax due to Indiana. To prove this contention, the taxpayer presented sales recap sheets for the tax period. The taxpayer asserted that these recap sheets indicate that there were many refunds and returns that lowered the total amount of sales against which tax should be assessed. The taxpayer did not produce source documents such as invoices or receipts to back up the recap sheets as required by the law. Therefore, the recap sheets are inadequate to sustain the taxpayer's burden of proof.

FINDING

The taxpayer's protest to the assessment of sales tax is denied.

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

DISCUSSION

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

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

The taxpayer disregarded its duty to keep adequate records of its sales and sales tax collected. The taxpayer's inattention to this duty resulted in a substantial under remittance of sales tax to the state. This breach of the taxpayer's duty constitutes negligence.

FINDING

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

DEPARTMENT OF STATE REVENUE

04-20030345.LOF

LETTER OF FINDINGS NUMBER: 03-0345
Gross Retail Tax—Commercial Printing
For Years 2000 & 2001

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date

of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Gross Retail Tax—Commercial Printing

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-1-1; IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; 45 IAC 15-5-3(8); 45 IAC 2.2-1-1; 45 IAC 2.2-2-1; 45 IAC 2.2-4-1; *The Frame Station v. Indiana Department of Revenue*, 771 N.E.2d 129 (Tax Ct., 2002)

Taxpayer protests the assessment of gross retail tax on retail unitary transactions in its commercial printing business.

STATEMENT OF FACTS

Taxpayer, an S corporation whose two equal shareholders comprise the operations staff, is a commercial printer. Items taxpayer prints include business cards, posters, brochures, and stationery. Taxpayer also takes custom orders for specialty items such as wedding invitations with raised lettering, signs, and other marketing supplies. Further facts will be added as necessary.

I. Gross Retail Tax—Commercial printing

DISCUSSION

Taxpayer, an S corporation whose two equal shareholders comprise the operations staff, is a commercial printer. Items taxpayer prints include business cards, posters, brochures, and stationery. Taxpayer also takes custom orders for specialty items such as wedding invitations with raised lettering, signs, and other marketing supplies. Taxpayer collects and remits the state's gross retail tax on materials it prints. The invoice form itemizes labor and materials. Taxpayer does not collect or remit the state's gross retail tax on the labor portion of the billing invoice. The audit found that sales of printed materials fell under the definition of a retail unitary transaction pursuant to 45 IAC 2.2-1-1. A retail unitary transaction includes all items of property and/or services for which a total, combined charge is computed for payment. The audit stated that it was inconsequential that services, which are not otherwise taxable, such as printing on material supplied by the customer, are included. Therefore, the invoice total, both labor and materials for printed materials, were subject to the state's gross retail tax.

Taxpayer's protest relies on phone calls made to the Department. Taxpayer stated that phone calls to the Department elicited assurances that taxpayer's labor charges were not taxable, only the materials charges were taxable. In addition, taxpayer was informed that the transactions at issue were not retail unitary retail transactions. Taxpayer stated that he was advised not to collect or remit gross retail tax on the labor charges, and was referred to Sales Tax Bulletins # 60 and # 69. Sales Tax Bulletin # 60 does not apply to taxpayer as it concerns construction contractors. Sales Tax Bulletin # 69 also does not apply to taxpayer as it concerns exemptions for items purchased by commercial printers, not the products commercial printers sell. Taxpayer is currently collecting and remitting the state's gross retail tax on labor and materials based on the audit's advice, but feels the 2000 and 2001 assessments are improper because taxpayer relied on erroneous information.

Pursuant to IC § 6-8.1-5-1(b) and 45 IAC 15-5-3(8), a "notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the assessment is made." Pursuant to IC § 6-2.5-2-1, a "person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state." *See also*, 45 IAC 2.2-2-1.

The specific statutes and regulations at issue in this protest concern the nature of retail unitary transactions. IC § 6-2.5-1-1 defines a "unitary transaction" as follows: it "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." IC § 6-2.5-1-2 defines a "retail transaction" as a "transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-1." A "retail unitary transaction" is a "unitary transaction that is also a retail transaction." IC § 6-2.5-4-1 provides in pertinent part:

(b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:
  (1) acquires tangible personal property for the purpose of resale; and
  (2) transfers that property to another person for consideration.

(c) For purposes of determining what constitutes selling at retail, it does not matter whether:
  (1) the property is transferred in the same form as when it was acquired;
  (2) the property is transferred alone or in conjunction with other property or services; or
  (3) the property is transferred conditionally or otherwise.

(e) The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:
  (1) the price of the property transferred, without the rendition of any service; and
  (2) except as otherwise provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.

45 IAC 2.2-1-1 tracks the language of IC § 6-2.5-1-1 in defining a unitary transaction. 45 IAC 2.2-4-1 tracks the language of IC § 6-2.5-4-1(c) and IC § 6-2.5-4-1(e) in defining a retail unitary transaction.

Indiana's Tax Court in *The Frame Station v. Indiana State Department of Revenue*, 771 N.E.2d 129 (Tax Ct., 2002), ties together all these statutes and regulations, and applies them to a business similar in nature to the one at issue in the present tax protest. The issue in *Frame Station* was whether their sales of custom-framed art constituted a retail unitary transaction and were therefore subject to Indiana's gross retail tax. Frame Station provided custom framing services, framing its customer's art in frames that it had built or specially ordered. When Frame Station billed its customers, it recorded separate subtotals on the invoices, one for the framing service and the other for the physical frame itself. During the tax years at issue, Frame Station's customers paid no money in advance for custom framing; rather, they paid a total price for the framing service and frame when they picked up the completed project. Frame Station collected and remitted gross retail tax only on the price of the frame itself, not on the price for framing the art. An audit determined Frame Station's services were also subject to the state's gross retail tax because both the sale of the frame and the service of framing the art constituted a retail unitary transaction pursuant to IC § 6-2.5-4-1(e).

The Tax Court held that Frame Station's transactions were taxable retail unitary transactions pursuant to IC § 6-2.5-4-1(e). The Court examined the statute, stating it "permits the imposition of sales tax on the otherwise non-taxable services when the services are performed with respect to property prior to the transfer of the property" to the buyer or customer. *Frame Station*, 771 N.E.2d 129 at 131.The Court cited a prior decision that stated a retail unitary transaction exists when the transfer of the property and rendition of services were "inextricable and indivisible." Identifying the point at which the transfer of property occurs is key. If services are performed prior to the transfer of property, then the transaction constitutes a taxable retail unitary transaction under IC § 6-2.5-4-1(e).

As applied in the instant case, the evidence did show that taxpayer's customers pay the total price for their printed materials when they pick them up, after all printing services have been performed. The services are performed prior to the transfer of the printed materials. Therefore, these transactions are taxable retail unitary transactions.

FINDING

Taxpayer's protest concerning the assessment of the state's gross retail tax on retail unitary transactions in its commercial printing business is denied.

DEPARTMENT OF STATE REVENUE

0220030369.LOF

LETTER OF FINDINGS: 03-0369
Indiana Corporate Income Tax
For the Years 1996 through 2000

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

ISSUE

I. Combined Indiana Income Tax Return – Adjusted Gross Income Tax.

Authority: IC 6-3-2-2(l); IC 6-3-2-2(m).

Taxpayer argues that the Department of Revenue erred when it required that taxpayer – along with three other related entities – submit a combined Indiana corporate income tax return reflecting the parties' income.

STATEMENT OF FACTS

There are five parties involved in the original audit and in the subsequent protest. These five companies are commonly owned.

1. Predecessor Company: This company was in the chemical and manufacturing business until 1993 when it reorganized itself into different operating companies. After the 1993 reorganization, Predecessor Company retained a separate identity and existence.

2. Successor Company: As part of the 1993 reorganization, this company was formed "to acquire and operate [Predecessor Company's] global chemicals business." Successor Company has an Indiana presence consisting of a sales office staffed by a secretary. This Indiana office takes orders from customers throughout the United States. A regional sales manager and global manager also work out of Indiana taxpayer's office. It is admitted that Successor Company has an Indiana nexus; it has an Indiana business situs, has Indiana employees, sells products to Indiana customers, and receives income from doing business within the state. In the original 1993 restructuring, ownership of the intellectual property was transferred from Predecessor Company to Successor Company.

3. Delaware Company: This company is another of Predecessor Company's offspring. At some point following the 1993 reorganization, Predecessor Company/Successor Company transferred to Delaware Company intellectual property rights –

consisting of "patent rights, trade secrets, and know-how." Successor Company now pays Delaware Company royalties for the right to use the intellectual property originally owned by Predecessor Company.

4. Fiber Company: A related out-of-state company which pays additional royalties to Delaware Company for the right to use the intellectual property.

5. Compounds Company: A second related out-of-state company which also pays royalties to Delaware Company for the right to use the intellectual property.

The Department of Revenue (Department) conducted an audit review of Successor Company's tax returns and business records. The audit review examined records for the years 1996 through 2000. Following that review, the Department concluded that Successor Company, Delaware Company, Fiber Company, and Compounds Company should report their income on a "combined return" in order to "fairly reflect" the parties' Indiana income. As a result of that determination, the Successor Company owed additional income tax. Thereafter, the Department issued notices of "Proposed Assessment" for three of the five years under consideration.

Taxpayer challenged the audit's decision requiring four of these entities to file a combined Indiana tax return arguing that Successor Company "is the only entity that has nexus in Indiana." It is taxpayer's assertion that Delaware Company, Fiber Company, and Compounds Company "do not have the requisite Indiana nexus and should not be subject to the Indiana Adjusted Gross Income Tax." Taxpayer submitted a protest to that effect, and an administrative hearing was conducted during which taxpayer elaborated on this argument. Subsequently, taxpayer submitted additional information outlining the original 1993 stock distribution which led to the restructuring of the Predecessor Company and the formation of the four entities now represented within the combined return. This Letter of Findings results.

DISCUSSION

I. Combined Indiana Income Tax Return – Adjusted Gross Income Tax.

In 1993, Predecessor Company "spun off" ownership of its "global chemicals businesses" by means of a "restructuring program." The Predecessor Company continued in existence as a "significant investor" in the Successor Company. As part of that restructuring program, Predecessor Company assigned to Successor Company the rights to certain specified intellectual property. Delaware Company was formed as a means to effectuate the transfer of the intellectual property from Predecessor Company to Successor Company.

By 1994, Delaware Company was – by means not entirely clear – the owner of the intellectual property consisting of trademarks, patents, and "know-how." In 1994, Delaware Company and Successor Company entered into a "License Agreement" which permitted Successor Company the right to make use of the intellectual property in return for which the Successor Company promised to make royalty payments to Delaware Company based upon the Successor Company's "aggregate Net Sales Value" of licensed products manufactured and sold by Successor Company. During 1998, 1999, and 2000, Successor Company paid Delaware Company approximately 90 million dollars in royalty payments.

Delaware Company also entered into agreements with Fiber Company and Compounds Company because those two entities also paid royalties to Delaware Company.

According to the audit report, "related foreign corporations" also paid royalties to Delaware Company. In addition, Delaware Company received "a nominal amount of royalties" from "other sources."

The issue is whether the audit was justified in requiring that Successor Company file a combined return reporting not only its own income but that of Delaware Company, Fiber Company and Compounds Company.

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

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

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

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

(1) separate accounting;

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

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

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

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

the taxpayer's Indiana income.

Taxpayer's collective business structure remains somewhat ill-defined; however, a number of facts can be established with some certainty. These five entities are owned by the same shareholders. Successor Company has an Indiana nexus; it has an Indiana office, employees, and sells products to Indiana customers. Successor Company paid substantial sums of money to Delaware Company for the right to use intellectual property originally owned by Predecessor Company. Fiber Company and Compounds Company also paid substantial royalties for the right to use the intellectual property.

Other aspects of taxpayer's collective business relationship are more ambiguous. It is not entirely clear how the intellectual property – transferred from Predecessor Company to Successor Company in 1993 – came to be owned by Delaware Company. It is not entirely clear why Successor Company is now paying royalties for the right to use the intellectual property which it once owned. It is totally unclear as to what use Delaware Company puts these royalty payments. Do the royalty payments simply accumulate in Delaware Company's bank account? Does Delaware Company spend these millions of dollars to "manage" the intellectual property and to accurately "account for the royalty receipts?" Taxpayer describes the function of Delaware Company as follows: "The responsibility of [Delaware Company] is to effectively manage the granting of these [property] rights and to account for the royalty receipts and ensure their accuracy." However, the Department is unable to discern why managing property rights and accounting for royalty receipts would be worth 90 million dollars in payments spread out over three-years. Neither is it entirely clear why Fiber Company and Compounds Company also pay millions of dollars in royalties to Delaware Company. The Department must conclude that the royalty/licensing agreement is primarily intended as an artifice to minimize Successor Company's state tax liability because the licensing agreement – outside the favorable tax consequences – does not seem to have economic substance or business purpose.

Given that conclusion, the audit was wholly justified in requiring that Successor Company, Delaware Company, Fiber Company and Compounds Company file a combined return in order to more accurately reflect the parties' Indiana income. The alternative proposed by taxpayer would distort the Successor Company's income because it would reflect – as putative "business expenses" – millions of dollars in royalty payments Successor Company paid to a related company. The Department does not agree with taxpayer's assertion that recognizing these royalty payments as legitimate, substantive "business expenses" would more fairly recognize the parties' Indiana income.

The plain language of the law states that "[i]f 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 department may require, in respect *to all or any part of the taxpayer's business activity*... the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income." IC 6-3-2-2(l) (*Emphasis added*). The requirement that these parties submit a combined return is a solution narrowly tailored to effectuate the purpose set out in IC 6-3-2-2(l).

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220030484.LOF

LETTER OF FINDINGS: 03-0484
Indiana Corporate Income Tax
For the Years 1998 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. Combined Filing Requirement – Adjusted Gross Income Tax.

Authority: IC 6-3-2-2(m); IC 6-8.1-5-1(b); Hi-Way Dispatch, Inc. v. Indiana Dept. of State Revenue, 756 N.E.2d 587 (Ind. Tax Ct. 2001); Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue – in calculating taxpayer's Indiana income – erred when it recomputed taxpayer's adjusted gross income to reflect on a combined basis all members of taxpayer's federal affiliated group of companies.

STATEMENT OF FACTS

Taxpayer is a Delaware corporation headquartered in Texas. Taxpayer manufacturers paper and paper products. Taxpayer does business in Indiana. Taxpayer owns various subsidiaries.

The Department of Revenue (Department) conducted an audit of taxpayer's business records and tax returns. The audit concluded that taxpayer should be required to file a combined Indiana tax return that included taxpayer's wholly owned subsidiaries. This adjustment to the tax return resulted in an assessment of additional Indiana corporate income tax. The Department sent notices of proposed adjustment which reflected the audit's determination and the consequent, additional tax assessment.

Taxpayer disagreed with the requirement that it file a combined return and with the additional tax assessment. Taxpayer submitted a protest. An administrative hearing was conducted during which taxpayer's representative explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Combined Filing Requirement – Adjusted Gross Income Tax.

Taxpayer is an out-of-state company which does business in Indiana. Taxpayer owns 100 percent of various subsidiaries. Taxpayer files a consolidated federal income tax return which includes each member of the affiliated group. Although each member is organized as a separate corporation, the taxpayer (parent company) and the subsidiaries share the same corporate officers.

The audit concluded that the taxpayer and its subsidiaries should be required to file a combined Indiana tax return in order to more fairly reflect taxpayer's Indiana income. The audit determined that the "members of the affiliated group operate a unified, highly integrated worldwide business enterprise for their mutual benefit." The audit concluded that "Indiana income as reported is distorted by inter-company charges for trademark royalties."

The audit refers to royalty payments made by taxpayer to one of its wholly owned affiliates hereinafter referred to as "Delaware subsidiary." The particular business arrangement, by which taxpayer became obligated to pay Delaware subsidiary royalties, began in 1996 when taxpayer – as the owner of certain trademarks, patents, and "know-how" (hereinafter "intellectual property") – granted Delaware subsidiary the right to sublicense that intellectual property.

Thereafter, taxpayer and Delaware subsidiary signed an agreement by which taxpayer was permitted to make use of its own intellectual property. In consideration, taxpayer agreed to pay Delaware subsidiary three percent of its gross sales though the agreement limited the amount of royalties by specifying that the total annual royalty fee paid Delaware subsidiary would not exceed 25 percent of taxpayer's net income for the year. The agreement specified that taxpayer would retain its original ownership of the intellectual property. However, the agreement did not indicate the amount of compensation Delaware subsidiary paid taxpayer for the original right to sublicense the intellectual property; the agreement did not specify if Delaware subsidiary would pay *any* compensation for the right to sublicense the intellectual property.

The audit does not indicate what Delaware subsidiary did with the royalties. The audit did not specifically determine if Delaware subsidiary loaned the royalties back to taxpayer. However, the audit did establish that taxpayer incurred interest charges which were owed Delaware subsidiary. During 1999, taxpayer incurred approximately $153,000,000 in interest charges. During 2000, taxpayer incurred approximately $169,000,000 in interest charges. These interest charges were owed to Delaware subsidiary.

Summarizing, the intellectual property sublicensing/licensing agreement worked like this:

1. Taxpayer owned intellectual property;
2. Taxpayer granted Delaware subsidiary the right to sublicense this intellectual property; Delaware subsidiary apparently paid no consideration for this property;
3. Delaware subsidiary licensed the intellectual property to taxpayer;
4. Taxpayer paid Delaware subsidiary royalties;
5. Taxpayer became obligated to Delaware subsidiary for interest charges.

The audit found that taxpayer should be required to file an Indiana combined return because the royalty and interest payments distorted taxpayer's Indiana income and because "the Taxpayer group functions as one economic entity... [and] the members of the group bring synergies to the whole with such advantages unavailable to each company standing alone."

Taxpayer disagrees. Taxpayer states that the Delaware subsidiary has significant substance, has employees, owns property, and that Delaware subsidiary "manages and expands the value of the patent portfolio." Taxpayer states that Delaware subsidiary is an active business with employees and significant assets throughout the United States.

Taxpayer claims that the standard three-factor formula accurately represents taxpayer's income derived from Indiana. In addition, taxpayer maintains that the Department is estopped from requiring that taxpayer file a combined return because the Department – in its previous audits – never suggested such a filing requirement was appropriate.

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

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

It is apparent from the language contained with IC 6-3-2-2(l) that the standard apportionment filing method is the preferred method of representing a taxpayer's income derived from Indiana sources. The alternate methods of allocation and apportionment

– including the combined reporting method of which taxpayer complains – are employed when the standard apportionment formula does not fairly reflect the taxpayer's Indiana income.

The Department is prepared to agree with taxpayer's assertion that Delaware subsidiary is more than simply an empty business shell created simply as an imaginative tax shelter. The Department has no reason to dispute taxpayer's contention that transferring its intellectual property to Delaware subsidiary allowed taxpayer to preserve certain federal tax advantages. The Department has no reason to dispute taxpayer's contention that Delaware subsidiary conducts business activities other than simply holding taxpayer's intellectual property. However, the Department is not prepared to attach the same economic substance to the licensing agreement that taxpayer does. Taxpayer transferred licensing rights to Delaware subsidiary but did so despite the absence of any indication that taxpayer received consideration for doing so. Taxpayer then agreed to pay substantial amounts of annual royalty fees to Delaware subsidiary for permission to exploit the same intellectual property. Taxpayer agreed to pay these royalty fees despite the fact that – by the terms of the parties' own agreement –taxpayer continued to be "the sole owner of the entire right, title and interest in and to the Licensed Trademarks and the goodwill associated therewith...."

Although the audit was not able to determine whether Delaware subsidiary was simply loaning the royalty payments back to taxpayer, taxpayer has not fully addressed the questions raised by its payment of hundreds of million dollars in "interest" payments to Delaware subsidiary.

The audit concluded that taxpayer's licensing agreement, royalty payments, and interest obligations represented taxpayer's attempt to cultivate and harvest tax benefits devoid of any substantive, underlying business purpose. The audit's conclusion on these matters is presumed correct. "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1(b).

The audit's decision requiring filing a combined return is justified in part under IC 6-3-2-2(l) because the subsidiaries included within the filing – including the Delaware subsidiary – are taxpayer's wholly owned entities; taxpayer and the subsidiaries are "controlled directly or indirectly by the same interests...." The combined filing requirement is justified in part because the royalty payments are derivative of the taxpayer's Indiana business activity; that Indiana activity consists of the marketing of goods bearing taxpayer's trademarks; the value of the goods marketed within the state is attributable in part to taxpayer's patents and taxpayer's "know-how."

Taxpayer has not met its burden of demonstrating that the proposed assessments are incorrect.

In addition to challenging on its face the combined filing requirement, taxpayer argues that it relied on the Department's past acquiescence to the taxpayer's decision to file non-combined returns and that the Department is now estopped from belatedly changing that position. Taxpayer is interposing the defense of "equitable estoppel." Equitable estoppel is a defensive doctrine which "prevents one party from taking unfair advantage of another when, through false language or conduct, the person to be estopped has induced another person to act in a certain way...." Black's Law Dictionary 571 (7th ed. 1999).

Taxpayer maintains that, after having relied upon earlier determinations that taxpayer was not required to file a combined return, the Department may not afterwards back-track on its position to the taxpayer's detriment.

"Equitable estoppel cannot ordinarily be applied against government entities." Hi-Way Dispatch, Inc. v. Indiana Dept. of State Revenue, 756 N.E.2d 587, 598 (Ind. Tax Ct. 2001). However, application of the doctrine against a government entity is not absolutely prohibited. Id. The exception to this general rule is where "the public interest would be threatened by the government's conduct." Id.

The Department does not agree that it is estopped from requiring that taxpayer and its subsidiaries file a combined tax return. There is no indication that the circumstances which the audit found sufficient to justify its combined filing requirement were the same circumstances present during the previous audits. There is no indication that the Department required or instructed taxpayer to file a separate return but only that the Department acquiesced to the filing of the previous, separate returns. There is no indication that the Department engaged in false, unfair, or deceptive practices which induced taxpayer to arrive at a conclusion that it could indefinitely continue to file separate tax returns. There is no indication that the Department's decision to require a combined return implicates the public's interest.

The Department concludes that taxpayer's estoppel argument is without merit.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0320040079.LOF

LETTER OF FINDINGS NUMBER: 04-0079
Withholding Tax
Responsible Officer
For the Tax Period 1998-2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of

publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

1.Withholding Tax-Responsible Officer Liability

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

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

STATEMENT OF FACTS

The taxpayer was an officer of a corporation that did not remit the proper amount of withholding taxes during the tax period 1998-2000. The Indiana Department of Revenue assessed the unpaid withholding taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. This Letter of Findings is based on the taxpayer's submissions and documentation in the file.

1. Withholding Tax-Responsible Officer Liability

DISCUSSION

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

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

The taxpayer produced substantial documentation that she had no duty to collect and remit withholding taxes to the state. Therefore, she is not personally responsible for the payment of the corporate withholding taxes.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

42-20040084.LOF

LETTER OF FINDINGS NUMBER: 04-0084 IFTA
International Fuel Tax Agreement (IFTA)
For Years 2000, 2001, AND 2002

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

ISSUES

I. IFTA – Assessment

Authority: IFTA.VII.R700

The taxpayer protested the department's assessment after an IFTA audit based on insufficient and inadequate documentation.

STATEMENT OF FACTS

Taxpayer operated one qualified recovery vehicle, 3 non-qualified recovery vehicles and one non-qualified service vehicle. The qualified recovery vehicle is a tri-axle tractor used to transport replacement tractors and tow disabled tractors when repairs cannot be made on road. The person that prepared the quarterly IFTA Filings died in February of 2003, prior to the audit. The party presenting records on behalf of the taxpayer was not familiar with the methodology used by the person who originally prepared the documents. The audit found the taxpayer failed to present mileage records relevant to the qualified vehicle or reported mileage amounts, or other relevant records that could be used to reasonably determine actual mileage and fuel information. The audit was adversely affected by severe taxpayer imposed scope limitations. The taxpayer's estimate as to the yearly mileage of the qualified vehicle was accepted, and an assessment for the IFTA liability was prepared from this mileage.

I. IFTA – Assessment

DISCUSSION

The department, pursuant to an IFTA audit, requested taxpayer records pursuant to IFTA Article VII, R700 requirements. Taxpayer protested based on the loss of the party responsible for keeping records. The record keeper, who was also the manager of the business, was diagnosed with a fatal illness and died shortly thereafter. Understandably, the record keeper was less than focused on his responsibilities for IFTA filings during the latter portion of the audit period.

Taxpayer makes no argument aside from this recitation of the circumstances related to the relevant IFTA records. The audit

computations have already reflected the department's recognition of the difficulties confronting the taxpayer. The department will also note that the audit period was for three years, and that the records for this entire period were uniformly inadequate.

Consequently, the department concludes that the taxpayer has not provided sufficient information or basis to overturn the audit assessment. Taxpayer does not cite any IFTA provisions to support this protest and fails to provide proof that the assessment was either erroneous or excessive.

FINDINGS

Taxpayer protest denied.

DEPARTMENT OF STATE REVENUE

0220040142P.LOF

LETTER OF FINDINGS NUMBER: 04-0142P
Income
For Tax 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—Negligence Penalty

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

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

STATEMENT OF FACTS

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

I. Tax Administration—Negligence Penalty

DISCUSSION

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

If a person:

…

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

…

the person is subject to a penalty.

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

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

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

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

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). In its protest letter, taxpayer states that it timely filed and timely paid all tax liabilities. Since the Department issued assessments for unpaid tax, and taxpayer paid the assessments except for the penalties, it stands to reason that taxpayer did not timely pay all tax liabilities. Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20040147.LOF

LETTER OF FINDINGS NUMBER: 04-0147
Adjusted Gross Income Tax and Penalty
For the Years 2000-2001

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

ISSUE

I. Adjusted Gross Income Tax-Addback of state and local income taxes

Authority: Ind. Code § 6-3-1-3.5; O.R.C. Ann. §§ 5733.05-.06.

Taxpayer maintains that the Department of Revenue erred when it added back a portion of its Ohio Franchise Tax

II. Tax Administration-Penalty

Authority: Ind. Code § 6-3-4-4.1; Ind. Code § 6-8.1-10-2.1; 45 IAC 15-11-2.

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

STATEMENT OF FACTS

Taxpayer is a company doing business in multiple states, including Indiana. On its corporate income tax return, taxpayer reported its federal taxable income, adding back Indiana income taxes and a portion of its Ohio Franchise Tax. However, taxpayer did not add back a portion of Ohio Franchise Tax that it considered to be a tax on its net value as a company, rather than its income. The Department added back the excluded portion of the tax to arrive at its adjusted gross income, and assessed a negligence penalty. Taxpayer has protested this addback, and a hearing was held.

I. Adjusted Gross Income Tax-Addback of state and local income taxes

DISCUSSION

Under Indiana's corporate income tax, Ind. Code § 6-3-1-3.5(b)(3) provides that, for corporations, amounts taken as a deduction for state taxes "based on or measured by income" are to be added to federal taxable income to arrive at adjusted gross income.

Under Ohio's Franchise Tax, effectively two taxes are imposed. The first tax is a tax on the net worth of companies. For most corporations (including taxpayer in this case), the book value of the company, with minor modifications, is computed. Then, the taxpayer computes an apportionment factor based on its property, sales, and payroll in Ohio relative to its values nationally, multiplies the apportionment factor by the book value, and a tax of 0.4% is imposed on that value, up to a limit of $150,000. O.R.C. Ann. §§ 5733.05(C), 5733.06(C). The second tax is a tax imposed on the net income of the company, similar in most respects to Indiana's corporate adjusted gross income tax. O.R.C. Ann. § 5733.05(B), 5733.06(A)-(B). Once these two amounts are computed, the taxpayer pays the higher of the two taxes. Taxpayer in this case paid the amount represented by the net income tax. O.R.C. Ann. § 5733.06.

Taxpayer argues that, since the franchise tax is based on the privilege of doing business in Ohio regardless of net income, the portion of the franchise tax that is represented by the net worth portion should not be treated as a tax "based on or measured by income" for purposes of determining its adjusted gross income for Indiana purposes. Taxpayer agrees that the amount above the amount computed solely on its net worth is properly added back for Indiana purposes.

Two questions come out of this protest: one, is the franchise tax based on or measured by income; two, if it is not, what portion of the tax is a tax based on or measured by income?

Here, what has transpired is that taxpayer's Ohio state tax, by virtue of the "higher of" calculation dictated by Ohio law resulting in the tax on the income portion being due to Ohio, is a tax "based on or measured by income" within the meaning of Ind. Code § 6-3-1-3.5(b)(3). Accordingly, the full amount should have been added back.

FINDING

Taxpayer's protest is denied.

II. Tax Administration-Penalty.

Taxpayer also protests the imposition of the penalty for negligence for the years in question. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC 6-8.1-10-2.1. The Indiana Administrative Code further provides:

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

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes

that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;
(2) judicial precedents set by Indiana courts;
(3) judicial precedents established in jurisdictions outside Indiana;
(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

45 IAC 15-11-2.

With respect to the penalty, taxpayer has presented a case that it acted with reasonable cause, and thus the penalty should be waived.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

04-20040149

LETTER OF FINDINGS NUMBER: 04-0149
Use Tax—Mining Exemption
Penalty—Request for Waiver
For Tax Years 2000, 2001, 2002

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

ISSUES

I. Use Tax—Mining exemption

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-2 through IC § 6-2.5-3-7; IC § 6-2.5-5-3(b); 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4; 45 IAC 2.2-3-8; 45 IAC 2.2-3-12(c); 45 IAC 2.2-4-26; 45 IAC 2.2-5-9; 45 IAC 2.2-5-12(f)

Taxpayer protests the assessment of use tax on purchases of tangible personal property used in fulfilling construction contracts, arguing that it is entitled to a "pass-through" mining exemption.

II. Penalty—Request for waiver

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

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

STATEMENT OF FACTS

Taxpayer's principal business activity is that of a land development contractor making improvements to realty on land taxpayer does not own. Contracted-for work performed by taxpayer includes clearing land, moving and excavating earth, installing water and sewage lines, constructing roads and highways, improving ditches and drainages, and preparing building sites. Taxpayer has also contracted with mining companies for box cut excavations, creating access from the top of the cut to the underground mine entrance. In connection with contract work for mining companies, taxpayer constructs slurry ponds and coarse refuse pits, rail spur lines and bridges, and coal load-out site improvements. Under some contracts, taxpayer would subcontract work that was outside its area of expertise to more specialized companies, such as concrete construction, asphalt paving, building construction, commercial landscaping and rock blasting.

The audit determined that pursuant to 45 IAC 2.2-3-7, 45 IAC 2.2-3-8, and 45 IAC 2.2-4-26, taxpayer was liable for use tax on materials used in performing its contracts where sales tax was not paid at the point of purchase. Taxpayer protested the use tax assessment and 10% negligence penalty, arguing that because of the way these particular jobs were performed, taxpayer should be allowed a "pass-through" exemption from the mining companies to them, based on an agent-principal relationship. More facts will be added as necessary.

I. Use Tax—Mining Exemption

DISCUSSION

According to taxpayer, during the tax years at issue, taxpayer's company and two others, all three equally owned by taxpayer

and his three brothers, entered into an unusual "contract." According to the sworn affidavits submitted in support of taxpayer's protest, the president of the two mining companies, pursuant to the "informal mutual consent of my other brothers... orally authorized" taxpayer to develop coal mines for the mining companies. The development began in 2000 and continued through 2002. Expenditures were in excess of $15.25 million dollars. The "parties" allege that this informal, oral contract was "[c]ontrary to normal company job bid procedures... industry standard operating procedure and company operating procedure" because there was no competitive public bid and no written contracts. Essentially, the president of the two mining companies alleges that "[a]t all times during the mine development process, [taxpayer] was operating under the direction and control of" the two mining companies. It is the informal nature of this "contract" that gives rise to taxpayer's agent-principal/pass-through exemption argument, and that it should not be held liable for the use tax assessment and 10% negligence penalty.

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

The specific statute at issue, IC § 6-2.5-5-3(b) provides an exemption from the state's gross retail and use taxes under certain circumstances:

> Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring the property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

Taxpayer maintains that because of its principal/agent relationship with the mining companies, it is entitled to the mining exemption and therefore should not be assessed use tax on items purchased without paying the state's gross retail tax. The specific regulation at issue, 45 IAC 2.2-5-9, sets forth, at great length, exactly how—and when—the exemption applies:

> (a) In general, all purchases of tangible personal property by persons engaged in extraction or mining are taxable. The exemption provided in this regulation extends only to manufacturing machinery, tools, and equipment directly used in mining or extraction. It does not apply to materials consumed in mining or extraction.
>
> (b) The state gross retail tax shall not apply to sales of manufacturing machinery, tools, and equipment which are to be directly used by the purchaser in extraction or mining.
>
> (c) Manufacturing machinery, tools, and equipment to be directly used by the purchaser in the extraction or mining process are exempt from tax provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the item being produced by mining or extraction. 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.
>
> (d) Pre-production and post-production activities. "Direct use in the extraction and mining process" begins at the point of the first operation or activity constituting part of the integrated production process." {sic} Utilization by the purchaser in extraction or mining begins with the first drilling of the shaft or well or the first removal of overburden in surface mining or quarrying. It ends when the item being mined or extracted has been physically removed from the mine, well, or quarry.
>
> (e) Equipment directly used in extraction or mining: Manufacturing machinery, tools, and equipment used directly in the mining or extraction process are taxable unless the machinery, tools, and equipment have an immediate effect upon mining or extracting the product. The fact that particular property may be considered essential to the conduct of the business of mining because its use is required either by law or practical necessity does not, of itself, mean that the property has an immediate effect upon the mining or extracting of the product. Instead, in addition to being essential for one of the above reason *[sic]*, the property must also be an integral part of an integrated process.
>
> (1) Examples of taxable machinery, tools, and equipment: transportation equipment used to convey fuel, supplies, and repair parts to coal mining equipment in the mine; field maintenance trucks used to transport men and materials to places where needed; and equipment used to load extracted and processed minerals from storage stockpiles to railroad cars.
>
> (2) Examples of exempt machinery, tools, and equipment: digging and extracting equipment used in the course of mining or extraction operations; machinery used to remove the overburden in surface mining; blasting and dislodging equipment; waste extraction and removal equipment and machinery used in the course of mining or extraction operations; derricks, pumps, pump houses, drilling rigs used in the production of oil and natural gas.
>
> (f) Storage equipment. Tangible personal property used in or for the purpose of storing raw materials or materials after

completion of the extraction or mining process is taxable.

(1) Temporary storage. Tangible personal property used in or for the purpose of storing work-in-process or semi-finished goods is not subject to tax if the work-in-process or semi-finished goods are ultimately completely produced for resale and in fact resold.

(2) Storage containers for finished goods after the completion of the extraction or mining process are subject to tax.

(A) Receiving tanks for natural gas, crude oil, or brine are taxable.

(B) Facilities for storing coal after extraction and processing from the mine are taxable.

(3) Storage facilities or containers for materials or items currently undergoing production during the production process are deemed temporary storage facilities and containers and are not subject to tax.

(g) Transportation equipment. Transportation equipment used in mining or extraction is taxable unless it is directly used in the mining or extraction process.

(1) Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable.

(2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.

(3) Transportation equipment used to transport work-in-process or semi-finished materials within the extraction or mining process is not subject to tax.

(4) Transportation equipment used to transport work–in-process, semi-finished, or finished goods between plants which are not part of the same integrated process is taxable.

(h) Maintenance and replacement.

(1) Machinery, tools, and equipment used in the normal repair and maintenance of machinery and equipment used predominantly in mining or extraction are subject to tax.

(2) Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, however, are exempt from tax.

(j) Testing and inspection.

(1) Machinery, tools, and equipment used to test or inspect the mineral, oil, gas, stone, etc., being mined or extracted is not taxable, as such machinery, tools, and equipment are directly used in the mining or extraction process.

(2) Testing or inspection equipment used to test or inspect machinery, tools, and equipment used in extraction or mining (as distinguished from testing or inspecting the mineral, oil, gas, stone, etc., being mined or extracted) is taxable.

See also, 45 IAC 2.2-3-8, 45 IAC 2.2-4-26, and Information Bulletin # 60, December 2002. Indiana's tax statutes and regulations, especially those governing contractors, all support the taxability of taxpayer's purchases of tangible personal property used or consumed in performing the "informal contract" with the mining companies, regardless of that informality, and regardless of the exempt status of the mining companies. *See*, IAC 2.2-3-12(c) and 45 IAC 2.2-5-12(f) for "other taxable transactions."

The specific assessments taxpayer is protesting are detour signs; fuel; blasting materials and labor supplied by a subcontractor where taxpayer states the mining company reimbursed taxpayer for those expenditures used to excavate box cuts. Taxpayer alleges the detour signs were used in government construction contracts for public roads. Taxpayer cited Sales Tax Information Bulletin # 60 (December 2002) in support. This Bulletin supports the general rule of taxability and cites 45 IAC 2.2-3-12(c) as further support for the taxability of tangible personal property such as detour signs. Information Bulletin #60, however, provides that the purchase, lease or use of such items must be "to comply with the requirements of a government construction contract…, provided the item is used solely in connection with the construction and/or repair of public roads…and is not used for any other purpose." Taxpayer has failed to establish that its purchase of the detour signs qualifies for exemption under the requirements of Information Bulletin #60. Therefore, the protest concerning detour signs is denied.

With respect to the tax assessed on fuel consumption, the audit found that the fuel "was consumed in administrative or transport vehicles" and for "off-road consumption in excavation or grading heavy equipment." Taxpayer argued that since the mining company was "an organization exempt from tax" under 45 IAC 2.2-4-26(c), that exemption should "pass through" to taxpayer and therefore no tax would be due on these fuel purchases. Since no such "pass through" exemption exists, and since the mining company, in all likelihood, could not have avoided tax liability on fuel consumed in activities not directly related to direct production of coal, taxpayer's protest on this issue must be denied.

Finally, taxpayer again argues that 45 IAC 2.2-4-26(c) insulates it from tax liability for the purchase of blasting materials and labor used to excavate box cuts, a pre-production activity. In all likelihood, the mining company could not have purchased said materials and labor exempt from tax; therefore, even if there were such a thing as a "pass through" exemption, there would be nothing to pass on. Therefore, taxpayer's protest must be denied.

FINDING

Taxpayer's protest concerning the assessment of use tax on purchases of tangible personal property used in fulfilling construction contracts, based on the theory of a "pass through" mining exemption, is denied.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due because it reasonably believed it was entitled to mining exemptions for the purchases at issue.

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

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

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

FINDING

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

DEPARTMENT OF STATE REVENUE

0420040185.LOF

LETTER OF FINDINGS NUMBER: 04-0185
Sales Tax
Responsible Officer
For The Tax Period 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

1. Sales Tax-Responsible Officer Liability

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

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

STATEMENT OF FACTS

The taxpayer was an employee of a corporation that did not remit the proper amount of sales taxes during the tax period 1996. The Indiana Department of Revenue assessed the unpaid sales taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Sales and Withholding Tax-Responsible Officer Liability

DISCUSSION

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

The proposed sales tax liability was issued under authority of IC 6-2.5-9-3 that provides as follows:

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 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.

The taxpayer produced substantial documentation that she had no duty to collect and remit sales and withholding taxes to the state. Therefore, she is not personally responsible for the payment of the corporate sales taxes.

FINDING

The taxpayer's protest to the 1996 responsible officer sales tax assessments is sustained.

DEPARTMENT OF STATE REVENUE

04-20040213.LOF

LETTER OF FINDINGS NUMBER: 04-0213
Gross Retail & Use Tax-Production Exemption
Penalty-Request for Waiver
For Tax Year 2000

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

ISSUES

I. Gross Retail and Use Taxes—Production exemption

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-6; IC § 6-2.5-3-7; IC § 6-2.5-5-5-3(b); IC § 6-2.5-5-5.1; 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4; 45 IAC 2.2-5-8

Taxpayer protests the assessment of use tax on two items used in taxpayer's automobile manufacturing business where no gross retail tax was paid at the point of purchase. Taxpayer claims the materials are exempt from tax because they are part of the production process.

II. Penalty—Request for waiver

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

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

STATEMENT OF FACTS

Taxpayer manufactures automobiles. During the tax year at issue, taxpayer failed to self-assess and remit use tax on purchases where no gross retail tax was paid at the point of purchase. Taxpayer is protesting the proposed assessment of use tax on two items: a "device" employees use to aid in installing back seats in vehicles without causing back injuries, and a paint purge thinner used to clean spray nozzles in the robotic arms that spray paint on vehicles. Additional facts will be supplied as necessary.

I. Gross Retail and Use Tax—Production exemption

DISCUSSION

Taxpayer protests the assessment of use tax on two specific items taxpayer uses in manufacturing automobiles. The first one, the "device," was developed by taxpayer's engineers as a result of employees incurring back injuries during the installation of back seats into the vehicles. The second one, the paint purge thinner system, cleans different colors of paint from robotic arm paint sprayer nozzles in between color paint applications for clear and clean paint applications. Taxpayer submitted two videotapes documenting the back seat installation and the paint application systems, plus a document attesting to the lack of injuries that followed the use of the "device" to install back seats.

The audit stated that taxpayer purchased seat turntables to use in removing car seats purchased from an outside vendor from the upper and lower levels of storage racks. The audit considered the seats to be raw materials. Taxpayer also purchased parts of lifters, which are used as the parts are removed from the "table" which, according to the audit, constitutes storage of raw materials. The audit also stated that taxpayer purchased paint purge chemicals and paint line chemicals without paying gross retail tax. The audit characterized these purchases as being used in maintenance, not production. The audit stated that the paint thinner is not mixed with the paint to be sprayed, but is used after one color stops and before the next color starts. "Production is halted for that particular piece of equipment while it is cleaned. Cleaning machinery is considered machine maintenance and not exempt...." A prior Letter of Findings denied taxpayer on this same issue.

Taxpayer stated in its protest that it had been working on measures to reduce injuries at the rear seat assembly process in the "trim and final" section of automobile production. Workers had sustained back injuries caused by the repetitive and awkward motion of lifting bulky and heavy (35 pounds) seats and installing them into vehicles. Taxpayer's engineers and workers developed a design for a "device" to help prevent such back injuries. This "device" holds several racks of rear seat assemblies at one time. Workers push buttons and the "device" automatically lifts and positions the rear seat to where the worker can install it into the vehicle without lifting the seats or moving his body into awkward and potentially injurious positions.

Taxpayer also purchased an air-powered lifter/scissor and powered turntable to install in the "device" that allows workers to lift the rear seat assemblies for installation. Taxpayer argues that the "device" is clearly not used for storage, but is an integral part of its production process. Taxpayer also states that use of the "device" has virtually eliminated the kinds of injuries workers were incurring before the "device" was developed. Taxpayer specifically cites 45 IAC 2.2-5-8(c)(2)(F) to support its contention that the "device" is an essential and integral part" of its back seat installation process: "Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production."

With respect to the paint purge thinner, taxpayer stated in its protest that it has a "very sophisticated and complex painting system which is fully automated." According to taxpayer, the process involves applying three coats of paint to each vehicle. The last

coat (top coat) is sprayed onto each vehicle by use of automatic paint robots, which are pre-programmed to make their arms perform various painting tasks based on vehicle type and model. They are also pre-programmed to match a specific topcoat color to each vehicle.

Taxpayer's typical production run consists of painting 400-600 vehicles per shift. Throughout each shift, the robots change colors as required, on average, every 9.5 vehicles. Each color change during the painting process takes three seconds and requires flashing paint thinner on the inside and tip of the robotic arms to purge the existing color paint. Taxpayer argues that without the use of the paint thinner, the old or existing paint color would mix with the new color paint, resulting in an unacceptable quality of paint on the vehicle and therefore resulting in an unmarketable product.

Taxpayer argues further that the painting process requires the paint robots to continuously apply rotating colors of paint to various types of vehicles on a moving conveyor. Taxpayer argues that the color changing process is an essential and integral part of the taxpayer's painting system, and use of the paint thinner is an essential and integral part of the color changing process.

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

The specific statute at issue, IC § 6-2.5-5-5.1, provides in pertinent part:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture.

The specific regulation at issue, 45 IAC 2.2-5-8, provides in pertinent part:

(a) In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. The exemption provided in this regulation extends only to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. It does not apply to material consumed in production or to materials incorporated into tangible personal property produced.

(b) The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property.

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. 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.

(d) Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The general rule, outlined in great detail in the regulation, is that purchases are either subject to the state's gross retail tax or the state's use tax unless the specific exemption applies. The parameters of the so-called "production exemption" are narrow: to be exempt, the tangible personal property must be directly used in the direct production of other tangible personal property. The regulation defines direct use and direct production as requiring "an immediate effect on the article being produced;" i.e., the production-exempt tangible personal property must be an essential and integral part of an integrated process."

Taxpayer's arguments with respect to the "device" are well taken. The document and videotape show that the "device" has enabled employees to install the back seats without injury. The audit characterizes the "device" as storage of raw materials. It appears that storage is ancillary to the "device's" function as providing a safe means by which taxpayer installs back seats into its vehicles while at the same time ensuring employee safety. Taxpayer's protest of this part of the assessment is sustained.

The Department has reviewed the videotape of the painting process, the prior Letter of Findings denying taxpayer on this issue, and all relevant statutes and regulations. A well-painted car is a marketable product. A badly painted car is not. The paint purge thinner is required to ensure that every vehicle is properly painted. However, that does not make the paint purge thinner part of production. Cleaning products are not part of a production process, no matter how important they are to the quality of the finished product. Taxpayer's protest of this part of the assessment is denied.

FINDING

Taxpayer's protest concerning the assessment of use tax on items taxpayer alleged fell within the production exemption to the state's gross retail and use taxes is sustained as to the "device," and denied as to the paint purge thinner.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty on the assessment.

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

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

Taxpayer has not set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Therefore, given the totality of all the circumstances, waiver of the 10% negligence penalty is not appropriate in this particular instance.

FINDING

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

DEPARTMENT OF STATE REVENUE

0120040297.LOF

LETTER OF FINDINGS: 04-0297
Individual Adjusted Gross Income Tax
For the Year 2002

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

ISSUE

I. Ohio Income – Adjusted Gross Income Tax.

Authority: IC 6-3-3-3(a); 45 IAC 3.1-1-74; 45 IAC 3.1-1-76; Ohio Rev. Code Ann. § 5733.40(A)(7).

Taxpayer argues that he is entitled to an Indiana tax credit based on the amount of state income taxes paid to Ohio.

STATEMENT OF FACTS

Taxpayer is an Indiana resident. Taxpayer is the 100 percent owner of an Ohio S-Corporation. Taxpayer receives income from the S-Corporation. Taxpayer received income from the S-Corporation during 2002. Taxpayer received a distributive share of the S-Corporation's income; taxpayer received an amount designated as wages from the S-Corporation; taxpayer received rent from the S-Corporation because taxpayer owned the building out of which the S-Corporation operated.

Taxpayer reported the S-Corporation income on an Ohio income tax return. The Department of Revenue (Department) determined that taxpayer owed Indiana income tax and sent taxpayer a notice of proposed assessment. Taxpayer disagreed with the proposed assessment 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. Ohio Income – Adjusted Gross Income Tax.

Taxpayer maintains that he does not owe Indiana income tax because he paid Ohio income tax. Taxpayer states that he is entitled to a credit for the Ohio tax paid and that the credit is sufficient to offset any purported Indiana income tax liability.

Taxpayer received money from the Ohio company in three forms; taxpayer received a "distribution;" taxpayer received "wages;" taxpayer received rent because he owned the building out of which the S-Corporation ran its business.

"An Indiana resident must report income form all sources, including out-of-state income in calculating Indiana adjusted gross income." 45 IAC 3.1-1-74. Therefore, on taxpayer's 2002 Indiana income tax form, taxpayer must indicate that he received the S-

Corporation distribution, wages from the S-Corporation, and rent received from the S-Corporation. If taxpayer received $1,000 in the form of a distribution, $500 in the form of wages, and $200 in rent, taxpayer must report $1,700 in income from received from the Ohio S-Corporation during that particular year.

However, Indiana has a "reciprocal" agreement with Ohio. 45 IAC 3.1-1-76 states in part that, "Residents who have income consisting of salaries, wages, and commissions from states with which Indiana has a reciprocal tax agreement must report all such income as it were from Indiana. These states include: Illinois, Michigan, Pennsylvania, Kentucky, Ohio, Wisconsin." Under the terms of the reciprocal agreement, the Indiana resident must pay the Indiana income tax on any "wages" received from the Ohio S-Corporation. In the example cited above, taxpayer must pay Indiana income tax on the $500. If Ohio withholds income tax on the $500, that it is a matter to be resolved between the taxpayer and Ohio. Taxpayer may not claim an Indiana credit for any amount of income tax withheld or paid on the $500. "Credit cannot be taken for any taxes withheld by or paid to any of these states in connection with salaries, wages, or commissions received from such states. If tax has been withheld by any of these states, a claim for refund should be filed with the state which withheld the taxes." 45 IAC 3.1-1-76.

However, Ohio does not view the issue of wages received from an S-Corporation quite so simply. In the example cited above, taxpayer's W-2 may state that he received $500 in wages; Ohio disagrees interpreting that matter of wages received from an S-Corporation somewhat differently. Ohio Rev. Code Ann. § 5733.40(A)(7) states in part as follows:

> For the purposes of Chapters 5733 and 5747 of the Revised Code, guaranteed payments or compensation paid to investors by a qualifying entity that is not subject to the tax imposed by section 5733.06 of the Revised Code shall be considered a distributive share of income of the qualifying entity. Division (A)(7) of this section applies only to such payments or such compensation paid to an investor who at any time during the qualifying entity's taxable year holds at least a twenty per cent direct or indirect interest in the profits or capital of the qualifying entity.

In other words, compensation or guaranteed payments made to an investor by a pass through entity – such as an S-Corporation – are considered as a distribution by the entity. Therefore, the $500 taxpayer received from the S-Corporation is designated by Ohio as a distributive share even though the $500 was originally labeled by the S-Corporation as "wages" on the W-2 form.

Under IC 6-3-3-3(a), taxpayer is entitled to claim a credit for any Ohio income tax paid on the $500 wage/distribution. "Whenever a resident person has become liable for tax to another state upon all or any part of his income for a taxable year derived from sources without this state and subject to taxation under IC 6-3-2, the amount of tax paid by him to the other state shall be credited against the amount of the tax payable by him." If taxpayer has paid $40 in Ohio income tax on the $500 wage/distribution, taxpayer can claim a credit of $40 on any amount of tax Indiana sees fit to impose against the same $500.

The S-Corporation originally designated the $500 paid taxpayer as "wages." Ohio law says the $500 amount is not a wage but is a "distribution" for purposes of Ohio income tax because taxpayer owns 100 percent of the S-Corporation. The Department will not quarrel with Ohio over the details of Ohio's own tax laws. Ohio says the wages are a distribution; therefore, taxpayer is entitled to an Indiana credit against the amount of Ohio tax paid on that specific amount.

Similarly, taxpayer is entitled to claim a credit against the designated distribution received from the S-Corporation and the amount of money taxpayer received from the S-Corporation in the form of rent. In the example cited above, taxpayer received $1,000 in the form of a designated distribution from the S-Corporation. 45 IAC 3.1-1-74 requires that taxpayer report that amount on his Indiana income tax form. However, IC 6-3-3-3(a) also allows the taxpayer to claim a credit for any Ohio income tax paid on the $1,000. If taxpayer paid $80 in Ohio income tax on the $1,000 designated distribution, taxpayer can claim an $80 credit against any amount of income tax Indiana sees fit to impose.

For the same reasons and in the same manner, taxpayer is entitled to a claim a credit for any Ohio income tax paid on the rent received from the S-Corporation.

FINDING

To the extent that taxpayer is able to substantiate the amount of Ohio income taxes paid on the wages, distribution, and rent received from his S-Corporation, taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

04-20040335.LOF

LETTER OF FINDINGS: 04-0335
Indiana Gross Retail Tax
For Tax Period 2000, 2002-2004

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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Retail Tax—Uncollectible Receivables Deduction

Authority: IC 6-2.5-6-9; I.R.C. § 166.

The Department and taxpayer interpret the requirements of IC 6-2.5-6-9 differently. The parties disagree as to when a taxpayer may "recognize" an uncollectible receivable.

II. Tax Administration: Negligence Penalty

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

Taxpayer protests the assessment of a negligence penalty.

STATEMENT OF FACTS

Taxpayer operates automobile dealerships. That is, taxpayer sells used cars. Taxpayer also provides financing for its customers' used car purchases. As an Indiana registered retail merchant, taxpayer is required to file state gross retail tax (sales tax) returns and remit Indiana sales tax to the state on a monthly basis.

In determining the amount of sales tax to remit, taxpayer includes the used car's total purchase price in its reported "gross retail income [derived] from retail transactions." From this base amount, taxpayer computes its sales tax liability.

Taxpayer's customers, from time-to-time, will default on their loan obligations. As a result, taxpayer may reacquire (i.e., repossess) the previously sold used car. Additionally, taxpayer may determine that the "delinquent" account receivable represents an "uncollectible receivable." This "uncollectible receivable" may be used by taxpayer to reduce its Indiana sales tax liabilities. Specifically, taxpayer can deduct from its reported tax base (i.e., from "gross retail income [derived] from retail transactions") the amount of the "uncollectible receivable."

The parties' disagreement concerns their respective interpretations of IC 6-2.5-6-9. In particular, the parties disagree as to when an "uncollectible receivable" can be "recognized." These differences have resulted in additional assessments of Indiana sales tax. Taxpayer now protests these assessments.

DISCUSSION

I. Gross Retail Tax—Uncollectible Receivables Deduction

Taxpayer's complaint concerns the timing of the "uncollectible receivables" (or "bad debt") deduction. Specifically, taxpayer questions the Department's determination as to when a taxpayer may recognize (or take) a properly realized IC 6-2.5-6-9 "uncollectible receivable" deduction, prior to amendment effective January 1, 2004. Taxpayer reads the statute as requiring—or at least permitting—monthly deductions. Taxpayer explains:

> [Taxpayer] takes this [uncollectible receivable] deduction on its monthly Indiana sales tax return for the month that the debt becomes uncollectible for federal income tax purposes. For example, if [taxpayer] writes off an uncollectible bad debt in the month of January for federal tax purposes, [taxpayer] takes the bad debt deduction on its Indiana sales return for January.

The Department, on the other hand, contends the Indiana sales tax "uncollectible receivable" deduction may be "recognized" only after a federal income tax return reporting the "uncollectible receivable" as a "bad debt" has been filed. That is, the Department views the federal income tax reporting requirement of IC 6-2.5-6-9 as a condition precedent; taxpayer, on the other hand, regards the federal reporting requirement as a condition subsequent.

IC 6-2.5-6-9, prior to amendment, provides (emphasis added):

> (a) In determining the amount of state gross retail and use taxes which he must remit under section 7 of this chapter, a retail merchant **shall deduct from his gross retail income from retail transactions made during a particular reporting period**, an amount equal to his receivables which:
>
> (1) resulted from retail transactions in which the retail merchant did not collect the state gross retail or use tax from the purchaser;
>
> (2) resulted from retail transactions on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and
>
> (3) **were written off as an uncollectible debt for federal tax purposes during the particular reporting period.**
>
> (b) If a retail merchant deducts a receivable under subsection (a) and subsequently collects that receivable, then the retail merchant shall include the amount collected as part of his gross retail income from retail transactions for the particular reporting period in which he makes the collection.

Resolution of this issue depends on the meaning of IC 6-2.5-6-9(a)(3)—i.e., the phrase "were written off as an uncollectible debt for federal tax purposes during the particular reporting period." The parties agree the term "written off" refers both to an accounting determination and to a federal income tax reporting requirement. The parties agree that substantively an IC 6-2.5-6-9 "uncollectible receivable" must qualify as an IRC § 166 "bad debt." The parties also agree that procedurally an amount deducted as IC 6-2.5-6-9 "uncollectible receivable" must be deducted on taxpayer's federal tax return as an IRC § 166 bad debt. But the question remains as to whether this latter requirement must *precede* the "recognition" of the IC 6-2.5-6-9 deduction?

The Indiana "uncollectible receivable" deduction is limited, by statute, to those receivables which were "written off as an uncollectible debt for federal tax purposes during the particular reporting period." IC 6-2.5-6-9(a)(3). The Department has interpreted

this language as establishing both a substantive and a procedural requirement. The amount of the "uncollectible receivable" to be deducted pursuant to IC 6-2.6-6-9, substantively, must represent an IRC § 166 "bad debt." And procedurally, the amount to be deducted must be reported on taxpayer's federal income tax return as "bad debt." Each requirement represents a condition precedent.

The statutory language is explicit. The language specifies that entitlement to the Indiana IC 6-2.5-6-9 "uncollectible receivable" deduction is conditioned on meeting the federal "bad debt" requirements of IRC § 166. The legislature adopted a regime to ensure that only those amounts representing IRC § 166 bad debt could be deducted from taxpayer's "gross retail income from retail transactions" for Indiana sales tax purposes. IC 6-2.5-6-9(a)(3). For periods prior to January 1, 2004, a recognition that an amount meets the requirements of IRC § 166 occurs only when taxpayer claims a "bad debt" deduction on its federal tax return. Hence, the presence of a bad debt deduction on taxpayer's federal income tax return must be viewed as a condition precedent.

For periods on or after January 1, 2004, IC 6-2.5-6-9(d)(3) permits write-offs of bad debts on a monthly basis, subject to a taxpayer's substantiation that the debts became uncollectible and eligibility for a federal bad debt deduction for income tax purposes. Accordingly, taxpayer is sustained for those periods on or after January 1, 2004 subject to verification that the amounts were actually written off its books during that month.

FINDING

Taxpayer's protest is denied for periods prior to January 1, 2004. Taxpayer's protest is sustained for periods on or after January 1, 2004, subject to verification.

II. Tax Administration: Negligence Penalty

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

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

04-20040356.LOF

LETTER OF FINDINGS NUMBER: 04-0356
Use Tax—Agricultural Exemptions
Penalty—Request for Waiver
For Years 2001, 2002, 2003

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

ISSUES

I. Gross Retail and Use Taxes—Agricultural exemptions

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-3-6; IC § 6-2.5-3-7; IC § 6-2.5-5-1; IC § 6-2.5-5-2; 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4; 45 IAC 2.2-5-1(a) through 45 IAC 2.2-5-7; *Graham Creek Farms v. Indiana Department of State Revenue*, 819 N.E.2d 151 (Tax Ct., 2004)

Taxpayer protests the assessment of use tax on items obtained in retail transactions that taxpayer claims are entitled to agricultural exemptions.

II. Penalty—Request for Waiver

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

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

STATEMENT OF FACTS

Taxpayer owns two parcels of land in southern Indiana, purchased in 2000. Taxpayer receives rental income from the individual who actually farms the land. Because the land had been neglected for awhile, and because taxpayer wanted to turn it into productive farmland suitable for growing crops, taxpayer purchased a number of pieces of equipment to clear trees and tree limbs, dig ditches, and remove rocks so actual farming could be done. Taxpayer then purchased actual farming equipment for the tenant to use. Taxpayer remained the owner of these items, providing them to the tenant free of charge. The audit determined that all the purchases were retail transactions subject to the state's gross retail tax. However, taxpayer paid no retail tax at the point of purchase, believing all were

agriculturally exempt from taxation. The audit therefore assessed the state's consumer use tax on all the purchases. Taxpayer protested, arguing that since all the equipment was necessary to support the land's productivity as a farm, all the purchases were entitled to agricultural exemptions. Additional facts will be supplied as necessary.

I. Gross Retail and Use Taxes—Agricultural exemptions

DISCUSSION

Taxpayer protests the denial of its claim for application of the agricultural exemption to purchases connected to farming operations carried on land taxpayer rents out to another individual. Taxpayer essentially argued that the audit failed to acknowledge that taxpayer's land was a legitimate farm. The audit, however, did acknowledge that legitimate farming activities were occurring on taxpayer's land. The issue is whether taxpayer is entitled to certain agricultural exemptions based on how the farming activities are carried out.

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

The standards for sustaining a claim for agricultural exemptions for machinery and equipment can be found at IC § 6-2.5-5-1, IC § 6-2.5-5-2, and 45 IAC 2.2-5-2 through 45 IAC 2.2-5-7. IC § 6-2.5-5-2 exempts certain transactions involving particular items from the state's gross retail and use taxes if the following requirements are met: "transactions involving agricultural machinery or equipment are exempt... if" taxpayer "acquires it for use in conjunction with the production of food or commodities for sale" and if taxpayer is "occupationally engaged in the production of food or commodities which he sells for human or animal consumption." IC § 6-2.5-5-2. Exemptions are strictly construed against a taxpayer who asserts them as a defense against tax liabilities. *See, Graham Creek Farms v. Indiana Department of State Revenue*, 819 N.E.2d 151 at 156, and cases cited therein (Tax Ct., 2004). Even under a liberal interpretation of the agricultural exemption regulations, taxpayer's activities do not meet these statutory requirements.

45 IAC 2.2-5-1 through 45 IAC 2.2-5-7 provide definitions for the important terms in the statutes. A farmer is someone "occupationally engaged in producing food or agricultural commodities for sale.... Only those persons, partnerships, or corporations whose intention it is to produce such food or commodities at a profit and not those persons who intend to engage in such production for pleasure or as a hobby qualify within this definition." 45 IAC 2.2-5-1(a).

Taxpayer rents the land out. On documents taxpayer submitted in support of its protest, taxpayer is listed as the farm's operator, but does not receive checks for being in federal agricultural programs; the actual farmer(s) who rent and work the land receive the checks. Moreover, equipment used in pre-production, i.e., preparing the land so it can become productive, is not exempt at all, regardless of who uses it. Taxpayer's relationship to the agricultural activities carried out on land he rents out is that of a landlord. He may have actively purchased equipment and actively prepared the land for production, but that is not an exempt use of machinery and equipment. Further, for actual crop production, the growing of corn and soybeans, taxpayer receives no money from the sale of these crops. Taxpayer receives, once a year, a lump sum rental payment from those who actually work the land. Therefore, taxpayer is not "occupationally engaged in producing food or agricultural commodities for sale." 45 IAC 2.2-5-1(a). Therefore, the agricultural exemptions available for purchases used in agricultural production are not available to taxpayer.

FINDING

Taxpayer's protest concerning the audit's denial of the agricultural exemption on items purchased in connection with preparing land for crop production and for actual crop production is denied.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due because it reasonably believed it was entitled to agricultural exemptions for the purchases at issue.

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

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

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

FINDING

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

DEPARTMENT OF STATE REVENUE

0120040364.LOF

LETTER OF FINDINGS: 04-0364
Indiana Adjusted Gross Income Tax
For the Year 2000

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

ISSUE

I. Individual State Income Tax Assessment.

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

After taxpayer received a notice of "Proposed Assessment" for 2000 Indiana income taxes, taxpayer directed correspondence to the Department of Revenue challenging the propriety of the assessment.

STATEMENT OF FACTS

The Department of Revenue (Department) determined that taxpayer owed additional state income tax. On September 13, 2004, the Department sent taxpayer a notice of "Proposed Assessment."

Taxpayer first responded with a document entitled "Non-Statutory Abatement" which was received by the Department September 28, 2004. This document was purported to have been filed in "superior court, Wayne county, Indiana." Taxpayer's document contained numerous assertions including an allegation that the "Proposed Assessment" was an "abandoned paper." Taxpayer claimed that the "Proposed Assessment" was abandoned because it did not contain taxpayer's "full Christian Appellation," because it "ha[d] no foundation in law," and because the "Proposed Assessment" was "unintelligible and unrecognizable." The eight-page document cites to numerous authorities such as the "National Banking Act" and the "Revealed Law in Scripture." Summarizing, taxpayer concluded that the "Proposed Assessment" was "irregular, unauthorized, misnomered, defective upon its face and invalid and [was] abated for being a public nuisance."

Taxpayer thereafter offered a supplemental "Non-Statutory Abatement" containing similar, but not identical language which was also received by the Department on September 28, 2004.

Apparently in the belief that neither the original nor the supplemental "Non-Statutory Abatement" was sufficient, taxpayer submitted "Part Two of a Non-Statutory Abatement" In that document, taxpayer demanded that all records containing taxpayer's "nom de guerre" be "expurgated from all systems for the lawful reasons give in the plaint...."

Taxpayer subsequently submitted yet more detailed documents each of which named the Department as "Defendant." Taxpayer's subsequent documents cited as authority the "Congressional Record," "King Charles the First," the "Petition of Right," "Holy Scriptures," "Christian Common Law," the United States Supreme Court, and the "Great Charter of the Liberties of England and America."

Taxpayer declined to accept the Department's invitation to take part in an administrative hearing or to explain the basis for his challenge to the "Proposed Assessment." Taxpayer refused to accept first-class, certified letters from the Department offering him the opportunity to expand upon or further explain the basis for his challenge. The Department determined that it would treat taxpayer's numerous documents as a protest of the proposed assessment, determined that taxpayer had been provided a fair opportunity to explain the basis for his protest, and issued this Letter of Findings.

DISCUSSION

I. Individual State Income Tax Assessment.

The Department determined that taxpayer owed additional income tax and sent taxpayer a notice of "Proposed Assessment"

to that effect. Taxpayer responded, not with a specific protest, but with a series of documents styled as official filings with the "superior court, Wayne county, Indiana," presumably challenging the "Proposed Assessment" on various grounds. In the documents, taxpayer levels charges such as "attempt to plunder" against both the Department and specific employees of the Department.

The Wayne Superior Court Clerk of the Courts was unable to confirm that any of these filings have actually been submitted to that court. The various docket numbers referenced by taxpayer do not correspond with any of the docket numbers employed by the Wayne Superior Court. Without more, it is reasonable to conclude the documents are bogus court filings.

IC 6-8.1-5-1(a) states that, "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department."

The Department sent and the taxpayer received a proposed assessment based upon the best information available to the Department. Taxpayer has not challenged the accuracy of either the proposed assessment or the accuracy of the information upon which the assessment was based.

Taxpayer has the burden of demonstrating that the proposed assessment is incorrect. 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."

Pursuant to IC 6-8.1-5-1(c), taxpayer was given the opportunity to take part in an administrative hearing and to demonstrate that the proposed assessment was incorrect. Taxpayer declined the opportunity to participate in the hearing and refused to accept letters addressed to taxpayer asking for clarification of taxpayer's protest.

Taxpayer has plainly spent considerable time and effort submitting elaborately prepared documents. These documents are written as if they were filed in the Wayne Superior Court; the documents have not filed in that court and appear to be some sort of intricate charade. Taxpayer's documents contain assertions such as:

> [T]hings done during war *flagrante bello* generally do not follow legal form, because *silent leges inter armis*, and legal form is essential for, *forma legalis forma essentialias*, because when legal form is not followed, a nullity of the act is inferred, *forma non observat, infertur adnullatia actus* and they are imposed on account of perceived "necessity" based on arbitrary autonomous reason, which does not exceed the legal memory of man, is of a *specific* time and place, and is not good beyond the limits of the necessity, *necessitas est lex temporis et loci* and *bonum nessarium extra terminus necessitates non est bonum*, and *never* terminates the Law of Peace, but only *suspends* the Law of Peace, the Law of Peace always remaining in *esse, through repentance*, for an asylum for Good and Lawful Christian Men and Women because things incorporeal are never acquired by war, *incoproralis bello non adquiruntur*. (*Emphasis in original*).

Taxpayer's remaining arguments are as equally coherent as that cited above and appear to be no more than ornately drafted folderol; pursuant to IC 6-8.1-5-1(b), taxpayer has not met his burden of demonstrating that the proposed income tax is incorrect.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040447.LOF

LETTER OF FINDINGS NUMBER: 04-0447
Sales and Withholding Tax
Responsible Officer
For the Tax Period 1998-2001

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

ISSUE

1. Sales and Withholding Tax-Responsible Officer Liability

Authority: IC 6-2.5-9-3, IC 6-8.1-5-1(b), IC 6-3-4-8(f).

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

STATEMENT OF FACTS

The taxpayer was an officer of a corporation that did not remit the proper amount of sales and withholding taxes during the tax period 1998-2001. The Indiana Department of Revenue assessed the unpaid sales taxes, withholding taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Sales and Withholding Tax-Responsible Officer Liability

DISCUSSION

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

The proposed sales tax liability was issued under authority of IC 6-2.5-9-3 that provides as follows:

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 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.

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

The taxpayer produced substantial documentation that she had no duty to collect and remit sales and withholding taxes to the state. Therefore, she is not personally responsible for the payment of the corporate sales and withholding taxes.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420050005P.LOF

LETTER OF FINDINGS NUMBER: 05-0005P
Sales Tax
For the Calendar Year 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 of an annual income tax return for the calendar year 2002.

The taxpayer is an individual residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the late penalty should be abated as the tax was paid with the filing of the income tax return on the extension due date of October 14, 2004.

The Department points out that 90% of the tax due is required to be paid by the original due date when an extension has been filed. IC 6-8.1-6-1. In the instant case, the tax was paid at the extension due date, six months after the original due date.

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 due date. 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

0420050012.LOF

LETTER OF FINDINGS NUMBER: 05-0012
Sales and Use Tax
For The Tax Period 2002-2004

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.

ISSUES

I. Sales and Use Tax - Imposition

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-2-1, IC 6-2.5-3-2 (a), IC 6-2.5-2(c)(1), IC 6-6-6.5-8(d), 45 IAC 2.2-5-15, 45 IAC 2.2-4-27 (d).

The taxpayer protests the assessments of use tax on three airplanes.

STATEMENT OF FACTS

The taxpayer is a limited liability corporation which bought an airplane in each of the years 2002, 2003, and 2004. The Indiana Department of Revenue, hereinafter referred to as the "department," assessed Indiana use tax, interest, and penalty on each of the airplanes. The taxpayer protested the assessments of use tax. A hearing was held and this Letter of Findings results.

1. Sales and Use Tax -Imposition

DISCUSSION

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

Indiana imposes 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).

IC 6-6-6.5-8(d) provides for the payment of sales or use tax on an airplane as follows:

A person shall pay the gross retail tax or use tax to the department on the earlier of:

(1) The time the aircraft is registered; or

(2) not later than thirty-one (31) days after the purchase date;

unless the person presents proof to the department that the gross retail tax or use tax has already been paid with respect to the purchase of the aircraft as proof that the taxes are inapplicable because of an exemption.

The taxpayer bases its claim for exemption on the following provisions of IC 6-2.5-5-8 which states as follows:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property....

The law concerning the exemption for rental to others is further explained at 45 IAC 2.2-5-15 as follows:

(a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.

(b) General rule. Sales of tangible personal property for resale, renting or leasing are exempt from tax if all of the following conditions are satisfied:

(1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;

(2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and

(3) The property is resold, rented or leased in the same form in which it was purchased.

(c) Application of general rule.

(1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or value to the property through the rendition of services or performance of work with respect to such property.

(2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

The taxpayer states that it was in the business of renting aircraft and therefore qualifies for this purchase for rental exemption.

This exemption requires compliance with three elements. One of these requirements is that the taxpayer must be engaged in the reselling, renting or leasing of such property in its regular course of business. In the taxpayer's situation, the taxpayer is a limited liability corporation that rents airplanes only to its owners/members. In other words, the owners of the airplanes rent the airplanes to themselves. This is not an arms length transaction. This does not satisfy the requirement that the airplanes be rented in the regular course of the taxpayer's business.

The taxpayer also argues that the owner/members who operate its airplanes paid a lower lease rate because the owner/members paid for the gasoline pursuant to dry lease provisions. The taxpayer argues that the addition of the cost of the fuel to the lease would bring the lease rate closer to comparable lease rates. The taxpayer argues that the sales tax on the lease and the sales tax on the fuel collected and remitted by fuel sellers total the correct amount of sales tax due to the state. The issue of an appropriate lease rate is addressed at 45 IAC 2.2-4-27 (d) as follows:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
>
> (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
>
> ...

The rental rates charged by the taxpayer on which it collects and remits sales tax are not based upon the total cost of the airplanes. Rather, each owner/member pays monthly dues of two hundred dollars ($200.00) per month to defray the business costs of operating the airplanes such as insurance. This amounts to a reduction of the rental rates to reflect a deduction for expenses or costs incidental to the maintenance and operation of the airplanes. No sales tax is being collected on that portion of the actual receipts.

The taxpayer's use of the airplanes does not qualify it for the purchase for rental exemption from the use tax.

FINDING

The taxpayer's protest to the assessment of use tax on its airplanes is denied.

DEPARTMENT OF STATE REVENUE

0420050020P.LOF

LETTER OF FINDINGS NUMBER: 05-0020P
Sales Tax
For the months January, February, April, May, July, and August 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 sales tax for the months January, February, April, May, July, and August 2004.

The taxpayer is a company residing outside Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the late penalty be abated as the taxpayer misunderstood the EFT instructions and paid the tax quarterly.

The Department had sent instructions that the tax was to be paid monthly with the recap filed quarterly.

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

0220050021P.LOF

LETTER OF FINDINGS NUMBER: 05-0021P
Income tax
For the Calendar Year 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 of the income tax return for the calendar year 2002.

The taxpayer is a company residing outside of Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be abated as the error was unintentional, and, the taxpayer did not have the figures available at the time of the due date.

The taxpayer has over 150 reporting units. This plus the fact that the revenue for Indiana had increased 300% created a situation where the taxpayer did not have the information available to pay the tax at the due date.

The Department points out the taxpayer could have paid an estimate at the due date and then request a refund when the income tax return was filed.

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

0420050022.LOF

LETTER OF FINDINGS NUMBER: 05-0022
Sales Tax
Responsible Officer
For the Tax Period 2002-2003

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

1. Sales Tax-Responsible Officer Liability

Authority: IC 6-2.5-9-3, IC 6-8.1-5-1(b).

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

STATEMENT OF FACTS

The taxpayer was an officer of a corporation that did not remit the proper amount of sales and withholding taxes during the tax period October 2002-September 2003. The Indiana Department of Revenue assessed the unpaid sales taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Sales Tax-Responsible Officer Liability

DISCUSSION

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

The proposed sales tax liability was issued under authority of IC 6-2.5-9-3 that provides as follows:

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 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.

The taxpayer produced substantial documentation that he severed all his ties with the corporation on July 24, 2001. Therefore he had no duty to collect and remit sales taxes to the state for tax periods after that date. He is not personally responsible for the payment of the corporate sales taxes.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420050024.LOF

LETTER OF FINDINGS NUMBER: 05-0024
Sales and Use Tax
For the Tax Period 2001-2003

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.

ISSUES

I. Sales and Use Tax - Imposition

Authority: IC 6-2.5-3-2, IC 6-2.5-5-17, LOF # 04980304.

The taxpayer protests the imposition of use tax on certain magazine subscriptions.

STATEMENT OF FACTS

The taxpayer is an electric utility cooperative organized as a beneficial society under 501 (c)(2) of the Internal Revenue Code. Each month the taxpayer purchases a publication and distributes it to each of its members. After an audit, the Indiana Department of Revenue (department) assessed additional use tax on the taxpayer's use of the publication. The taxpayer protested the assessment of use tax. A hearing was held and this Letter of Findings results.

I. Sales and Use Tax -Imposition

DISCUSSION

Indiana imposes the use tax on "the storage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction." IC 6-2.5-3-2. The taxpayer purchases a publication and distributes it to its members. This use is generally subject to the use tax. The taxpayer contends, however, that the publication is a newspaper and therefore qualifies for exemption from this tax pursuant to IC 6-2.5-5-17.

In a previous audit of this taxpayer for the tax period 1995-1997, the department assessed use tax on the taxpayer's use of the same publication that it purchased and distributed to its members. The taxpayer also protested that assessment. A hearing was held on the protest and Letter of Findings #04-980304 was issued on May 12, 2000. That Letter of Findings held that the taxpayer owed

the use tax on its use of the publication after that date. The taxpayer owes the use tax on its use of the publication for the tax period 2001-2003.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120050034.LOF

LETTER OF FINDINGS: 05-0034
Indiana Adjusted Gross Income Tax
For the Years 1998 through 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. Federal Return.

Authority: 26 U.S.C.S. § 7701(a)(1); 26 U.S.C.S. § 7701(a)(14); United States v. Karlin, 785 F.2d 90 (3d Cir. 1986); United States v. Studley, 783 F.2d 934 (9th Cir. 1986); McKeown v. Ott, No. H 84-169, 1985 WL 11176 (N.D. Ind. Oct. 30, 1985).

Taxpayer states that he is not a "person" or an "individual" required to file federal income tax returns and that, as a result, he is not required to file corresponding Indiana tax returns.

II. Indiana Adjusted Gross Income Tax Liability.

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

Taxpayer maintains that because he did not file corresponding federal income tax returns, Indiana law and the directions on the Indiana IT-40 form do not require him to file state income tax returns.

STATEMENT OF FACT

Taxpayer resides in Indiana. The Department of Revenue (Department) determined that taxpayer owed Indiana income tax for 1998 through 2001 and sent taxpayer notices of "Proposed Assessment" dated August 24, 2004.

Taxpayer disagreed with the proposed assessments and sent a protest to that effect. The protest was received by the Department on January 25, 2005. An administrative hearing was conducted during which taxpayer further explained the basis for his protest. This Letter of Findings results.

DISCUSSION

I. Federal Return.

Taxpayer maintains that was not required to file a federal income tax return because he is neither an "individual" nor a "person" required to do so. Taxpayer argues that he is not a "person" required to report his income or to pay tax on that income because he is a "sovereign" and is not subject to the provisions of the Internal Revenue Code (IRC). Taxpayer errs. The IRC clearly defines "persons" and sets out which persons are subject to federal taxes. 26 U.S.C.S. § 7701(a)(14) defines "taxpayer" as any person subject to any internal revenue tax. 26 U.S.C.S. § 7701(a)(1) defines a "person" as any individual, trust, estate, partnership, or corporation. Taxpayer's argument that a "sovereign" individual – such as himself – is not a "person" within the meaning of the IRC has been uniformly rejected. In United States v. Karlin, 785 F.2d 90, 91 (3d Cir. 1986), the court affirmed the defendant's conviction for failing to file income returns and rejected the defendant's contention that he was "not a 'person' within the meaning of 26 U.S.C. § 7203" as "frivolous and require[ing] no discussion." In United States v. Studley, 783 F.2d 934, 937 n.3 (9th Cir. 1986), the court affirmed defendant's conviction for failing to file income tax returns on the ground that defendant was "an absolute freeborn, and natural individual" stating that "this argument has been consistently and thoroughly rejected by every branch of the government for decades." "*[A]rguments about who is a 'person' under the tax laws,* the assertion that 'wages are not income', and maintaining that payment of taxes is a purely voluntary function do not comport with common sense - let alone the law." McKeown v. Ott, No. H 84-169, 1985 WL 11176 at *2 (N.D. Ind. Oct. 30, 1985) (*Emphasis added*).

Taxpayer's argument, that he is not a "person" subject to the IRC or to the Indiana individual income tax, is not meritorious.

FINDING

Taxpayer's protest is denied.

II. Indiana Adjusted Gross Income Tax Liability.

Taxpayer argues that because he did not file federal returns for the years here at issue, he was not required to file state returns. According to taxpayer, because the IT-40 specifically requires that he "[e]nter [his] federal adjusted gross income from [his] federal

return," he was compelled by force of law and under penalty of perjury to not file state returns.

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

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

Adjusted Gross Income for Individuals Defined. For Individual, "Adjusted Gross Income" is Adjusted Gross Income as defined in Internal Revenue Code § 62 modified as follows:

(1) Begin with gross income as defined in section 61 of the Internal Revenue Code.

(2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.

(3) Make all modifications required by IC 6-3-1-3.5(a).

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

Taxpayer's contention – that he was compelled by force of law to not report Indiana adjusted gross income because he declared no federal adjusted gross income – is patently without merit. The statute is plainly written and is unambiguous. Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 62 not merely as reported by the taxpayer. *See* Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209, 1213 (Ind. Tax Ct. 1996). The directions contained within the Indiana income tax form provide the individual taxpayer with abbreviated directions for completing the form and not the means for determining the taxpayer's adjusted gross income. The Indiana tax form instructs the taxpayer to put what number in what box. However, the taxpayer must not only put *a* number in the box, he must put the *correct* number in the box. The directions on the tax form notwithstanding, taxpayer is nonetheless required to actually perform the calculations necessary to determine his liability for Indiana adjusted gross income tax.

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

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0320050038.LOF

LETTER OF FINDINGS NUMBER: 05-0038
Withholding Tax
Responsible Officer
For the Tax Period 1999

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

ISSUE

1. Withholding Tax-Responsible Officer Liability

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

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

STATEMENT OF FACTS

The taxpayer was an employee of a corporation that did not remit the proper amount of withholding taxes during the tax periods of July and August, 1999. The Indiana Department of Revenue assessed the unpaid withholding taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax and a hearing was held.

1. Withholding Tax-Responsible Officer Liability

DISCUSSION

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

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

The taxpayer produced substantial documentation that she terminated her employment with the corporation prior to the tax period. Therefore, she had no duty to collect and remit withholding taxes to the state. She is not personally responsible for the payment of the corporate withholding taxes.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420050070P.LOF

LETTER OF FINDINGS NUMBER: 05-0070P
Sales Tax
For the month October 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 of a monthly sales tax return for the month of October 2002.

The taxpayer is an out-of-state company.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the late penalty should be abated as the tax coupon book was sent late by the Department.

According to the taxpayer, in October 2002, the taxpayer opened a new location and applied for an account with the Department. The taxpayer did not receive the sales tax coupon book until January 2003 which caused the October 2002 return to be filed late.

According to Department records, the taxpayer did not register with the Department until January 8, 2003, and therefore, the Department was not able to send the sales tax coupon book in 2002.

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

The Department finds the taxpayer was inattentive of tax duties as the taxpayer did not register until January 8, 2003. 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

0220050071.LOF

LETTER OF FINDINGS: 05-0071
Indiana Adjusted Gross Income Tax
For the Year 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of

publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Voluntary Nature of the Indiana Adjusted Gross Income Tax.

Authority: IC 6-8.1-11-2; Couch v. United States, 409 U.S. 322 (1975); Flora v. United States, 362 U.S. 145 (1960); Helvering v. Mitchell, 303 U.S. 391 (1938); United States v. Gerads, 999 F.2d 1255 (9th Cir. 1993); McLaughlin v. United States, 832 F.2d 986 (7th Cir. 1987); McKeown v. Ott, No. H 84-169, 1985 WL 11176 at *2 (N.D. Ind. Oct. 30, 1985).

Taxpayer argues that the state may not require her to pay Indiana adjusted gross income tax because she has not volunteered to do so.

II. Indiana Adjusted Gross Income Tax Liability.

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

Taxpayer maintains that because she did not file a corresponding federal income tax return, Indiana law and the directions on the Indiana IT-40 tax form require that she not file a state income tax return.

III. Authority to Withhold Income Taxes.

Authority: IC 6-3-4-8(a); IC 6-3-4-8(a)(1); IC 6-3-4-8(d); IC 6-3-4-8(f).

Taxpayer argues that her employer was without authority to withhold Indiana income taxes from her paychecks and that, as a result, the Department of Revenue should promptly refund the amounts improperly withheld.

IV. Affidavit of Non-Liability.

Authority: Cheek v. United States, 498 U.S. 192 (1991); United States v. Connor, 898 F2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F2d 1328 (7th Cir. 1984); United States v. Romero, 640 F2d 1014 (9th Cir. 1981); Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994); Black's Law Dictionary (7th ed. 1999).

Taxpayer states that she is not liable for the income taxes indicated on the notice of "Proposed Assessment" because she submitted an "Affidavit of Non-Liability."

STATEMENT OF FACTS

Taxpayer lives in Indiana. The Department of Revenue (Department) determined that taxpayer owed Indiana income tax for the year 2000 and sent a notice of "Proposed Assessment" to that effect. Taxpayer – describing herself as a "living spirit inhabitant" – disagreed with the assessment and sent the Department correspondence stating as much. The correspondence consisted of an "Affidavit of Non-Liability," a five-page statement setting out various legal arguments, a "STATEMENT in Lieu of a IDOR Return," a "Lawful Notice: Change of Mailing Location," and a "RELIANCE Letter" prepared on taxpayer's behalf by John J. Schlabach an "Enrolled Agent." Although denying that she was a "protestor," taxpayer's factual and legal challenge to the proposed assessment was treated as a protest, and an administrative hearing was conducted during which taxpayer summarized the basis for her challenges. This Letter of Findings results.

DISCUSSION

I. Voluntary Nature of the Indiana Adjusted Gross Income Tax.

Taxpayer claims that the proposed assessment is without foundation because she did not volunteer to pay either federal or state income taxes. In particular, taxpayer cites to Flora v. United States, 362 U.S. 145, 176 (1960) which states, "Our system of taxation is based upon voluntary assessment and payment, not upon distraint." Taxpayer accurately quotes the case language, but the quotation is taken out of context. The issue before the Court was not whether the petitioner "volunteered" to pay income tax or whether the petitioner could unilaterally decide not to pay income tax. The issue before the Court was whether the petitioner could bring a refund action against the Internal Revenue Service without first having paid the proposed assessment. Id. at 146. The Court disagreed with petitioner's argument stating that to "to accept petitioner's argument, we would sacrifice the harmony of our carefully structured twentieth century system of tax litigation...." Id. at 176. The Court held that petitioner/taxpayer had to pay the assessment before bringing the refund action. Id.

Nevertheless, Indiana's tax law clearly states that the state's adjusted gross income tax scheme is based on "voluntary compliance." IC 6-8.1-11-2 reads as follows:

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

Nonetheless, taxpayer's basic premise is without merit. Neither the federal nor the state income tax law suggests that an individual can opt out of one's income tax liability by declaring that he or she did not "volunteer" to pay income tax. In describing

the nature of the federal tax system, the United States Supreme Court has stated that, "In assessing income taxes the Government relies primarily upon the disclosure by the taxpayer of the relevant facts. This disclosure it requires him to make in his annual return. To ensure full and honest disclosure, to discourage fraudulent attempts to evade the tax, Congress imposes sanctions. Such sanctions may confessedly be either criminal or civil." Helvering v. Mitchell, 303 U.S. 391, 399 (1938).

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

The Supreme Court has stated that the government's federal income tax system is "largely dependent upon honest self-reporting." Couch v. United States, 409 U.S. 322, 335 (1975). However, the government's reliance on its citizens' honest, self-reporting does not support the proposition that taxes themselves are optional. Taxpayer's bare assertion, that, based on precatory language such as that contained within IC 6-8.1-11-2, she no longer "volunteers" to pay income taxes, does not fall within any reasonable definition of "honest self-reporting."

FINDING

Taxpayer's protest is denied.

II. Indiana Adjusted Gross Income Tax Liability.

Taxpayer argues that because she did not file federal returns for the year here at issue, she was not required to file a state return. According to taxpayer, because the IT-40 specifically requires that she enter her federal adjusted gross income from her federal return and because she did not file a federal return, she was compelled by force of law and under penalty of perjury to not file a state return.

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

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

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

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

Taxpayer's contention – that she was compelled by force of law to not report Indiana adjusted gross income because she declared no federal adjusted gross income – is patently without merit. The statute is plainly written and is unambiguous. Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 62 not merely as reported by the taxpayer. *See* Cooper Industries, Inc. v. Ind. Dept. of State Revenue, 673 N.E.2d 1209, 1213 (Ind. Tax Ct. 1996). The directions contained within the Indiana income tax form provide the individual taxpayer with abbreviated directions for completing the form; the directions are not the means for determining the taxpayer's adjusted gross income liability. The Indiana tax form instructs the taxpayer to put what number in what box. However, the taxpayer must actually put *a* number in the box and must put the *correct* number in the box. The directions on the tax form notwithstanding, taxpayer is nonetheless required to actually perform the calculations necessary to determine his liability for Indiana adjusted gross income tax and must file a state return reflecting those calculations.

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

FINDING

Taxpayer's protest is denied.

III. Authority to Withhold Income Taxes.

Taxpayer claims that she is entitled to a refund of taxes withheld from her paychecks during 2000 because her employer was without authority to withhold the taxes.

IC 6-3-4-8(a) states that, "Except as provided in subsection (d), *every* employer making payments of wages subject to tax under IC 6-3, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department." (*Emphasis added*). IC 6-3-4-8(d) provides an exception for county employers which pay wages "to a precinct election officer... [or] or for the performance of the duties of the precinct election officers imposed by IC 3 that are performed on election day." The employer is without discretion in this matter; an "employer making payments of any wages[] *shall* be liable to the state of Indiana for the payment of the tax required to be deducted and withheld... and shall not be liable to any individual for the amount deducted from his wages and paid over in compliance or intended compliance with this section...." IC 6-3-4-8(a)(1) (*Emphasis added*).

Unless the employer can determine that a particular employee is not subject to Indiana adjusted gross income tax, that employer is required to withhold a portion of that employee's wages and forward that amount to the Department. There is no indication that taxpayer demonstrated to her employee that she was not required to pay Indiana income tax. Therefore, taxpayer's employer was required to withhold a portion of the taxpayer's wages from her paycheck. Once withheld, the employer held the taxes "in trust for the state of Indiana...." IC 6-3-4-8(f).

Taxpayer may not claim a refund of taxes based simply upon the mistaken notion that her employer was without authority to withhold her state income taxes.

FINDING

Taxpayer's protest is denied.

IV. Affidavit of Non-Liability.

At the time taxpayer submitted her challenge to the notice of "Proposed Assessment," she also submitted an "Affidavit of Non-Liability." In the affidavit, taxpayer disclaimed any liability for state income taxes stating that "For the Record, I am not in Receipt of any proper Commercial Paperwork that controverts the following true Facts." Among the "true facts" upon which taxpayer relies is the assertion that she "is not defined as a Taxpayer," and that she had "no 'income' for any years in question." Other "true facts" assert that taxpayer is not a corporation, that she did not volunteer to pay federal income tax, that she did not enter into a contract to pay federal income tax, and that she "incurred [no] liability for the federal income tax."

In order to assure the Department that the claims were correct, taxpayer swore – under her own "commercial liability and penalty of perjury" – that the claims were based upon true and not false facts. In addition, the affidavit specifies that if the arguments contained within "are not countered with proof within (14) fourteen day," that the arguments would be considered accurate.

By means of the affidavit, taxpayer seeks to establish that she is not liable for state income tax. An affidavit is defined as, "A voluntary declaration of facts written down and sworn to by the declarant before an officer authorized to administer oaths." Black's Law Dictionary 58 (7th ed. 1999).

Taxpayer's "affidavit" is simply a restatement of arguments challenging the legitimacy of the federal income tax. For example, taxpayer asserts that she is not a corporation and that she did not contract with the government to pay income taxes. However, taxpayer's legal arguments are meritless and do not comport with either the law or with ordinary, common sense. There is not one single federal or state court case with remotely supports taxpayer's ill-developed legal theories. To the contrary, federal and state court cases have consistently, repeatedly, and without exception concluded that an average citizen's wages – no matter in what form the taxpayers have attempted to characterize, define, or label those wages – are income subject to taxation. United States v. Connor, 898 F2d 942. 943 (3rd Cir. 1990) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income"); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); Coleman v. Commissioner of Internal Revenue, 791 F2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); United States v. Koliboski, 732 F2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable.") (Emphasis in original); United States v. Romero, 640 F2d 1014, 1016 (9th Cir. 1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax laws currently applicable.... [Taxpayers] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves."). As recently as 1991, the Supreme Court characterized as "frivolous" the notion that "the income tax law is unconstitutional." Cheek v. United States, 498 U.S. 192, 205 (1991).

In addressing taxpayer's argument, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United States Supreme Court and federal circuit courts, and this Court's opinion... all support the conclusion that wages

are income for purposes of Indiana's adjusted gross income tax." Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). *See also* Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer's "affidavit" – "subscribed and sworn" by a notary public – is simply a clumsy device to clothe taxpayer's unfounded legal conclusions with an air of legitimacy. The device is no more factually or legally effective than an affidavit claiming ownership of Jupiter's moons.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220020030.SLOF

SUPPLEMENTAL LETTER OF FINDINGS: 02-0030
Indiana Corporate Income Tax
For the Years 1995, 1996, and 1997

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

ISSUES

I. Money Received From the Sale of Computers and Related Services to Indiana Remarketers – Gross Income Tax.

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

Taxpayer argued that the money it receives from selling computers and computer-related services to Indiana remarketers is not subject to gross income tax.

II. Investment Income – Adjusted Gross Income Tax.

Authority: IC 6-3-1-20; IC 6-3-1-21; IC 6-3-2-2(b); IC 6-3-2-2(g) to (k); May Department Store Co. v. Indiana Dept. of State Revenue, 749 N.E.2d 651 (Ind. Tax Ct. 2001); 45 IAC 3.1-1-29; 45 IAC 3.1-1-30.

Taxpayer maintains that money it earns from investing excess funds in an "investment portfolio" is entirely "non-business income" for purposes of determining taxpayer's adjusted gross income.

STATEMENT OF FACTS

Taxpayer manufactures and sells computers and computer software. Taxpayer has business locations and personnel within and outside the Indiana. During 1995, 1996, and 1997, Taxpayer filed consolidated tax returns. During 2001, the Department conducted an audit review of Taxpayer's tax returns and business records. The audit review resulted in the assessment of additional corporate income taxes. Taxpayer disagreed with some conclusions contained within the audit report—and submitted a protest. An administrative hearing was conducted during which Taxpayer explained the basis for its report. A Letter of Findings was written based on the information presented at the hearing, the supplemental information Taxpayer supplied, and the information contained within the original audit report. Taxpayer sought and was granted a rehearing to reconsider the disposition. This Supplemental Letter of Findings results.

DISCUSSION

I. Money Received From the Sale of Computers and Related Services to Remarketers – Gross Income Tax.

Taxpayer sells its computers, software, and related services using a variety of methods including sales to two out-of-state remarketers. Remarketer One is headquartered in California; Remarketer Two is headquartered in Florida.

According to Taxpayer, the sales to Remarketer One were arranged in California and the equipment shipped from the point of manufacturer to Remarketer One's warehouse in Indianapolis. According to Taxpayer, the sales to Remarketer Two occurred in Florida and the computers shipped to Remarketer Two's distribution center in South Bend. According to Taxpayer—Taxpayer's in-state personnel were not involved in the sale of the computers, services, or associated software; the in-state personnel were not involved in the initiation, negotiation, or servicing of the either of these sales contracts.

The audit review assessed gross income tax on the money taxpayer received from Remarketer One and from Remarketer Two at the "low" and "high" rates—differentiating between the money taxpayer received for the sales of the computers and the money received for the provision of services related to those computers.

Gross income tax is imposed upon the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana. IC 6-2.1-2-2(a)(2). However, gross income derived from business conducted in commerce between Indiana and either another state or a foreign country is exempt from gross income tax to

the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution. IC 6-2.1-3-3.

Taxpayer argues that the money received from the sale of computers and services to the two remarketers is not subject to gross income tax because the underlying sales transactions were unrelated to the taxpayer's Indiana sales personnel and Indiana sales locations. 45 IAC 1.1-3-3(c) states that "Gross income derived from the sale of tangible personal property in interstate commerce is not subject to the gross income tax if the sale is not completed in Indiana." The regulation provides an example relevant to the specific issue raised by taxpayer.

> A sale to an Indiana buyer by a nonresident with an in-state business situs or activities but the situs or activities are not significantly associated with the sale because [the sale] was initiated, negotiated, and serviced by out-of-state personnel, and the goods are shipped from out-of-state. The in-state business situs or activities will be considered significantly associated with the sale if the sale is initiated, negotiated, or serviced by in-state personnel.

45 IAC 1.1-3-3(c)(5). To establish that the sales of computers to the two remarketers were not associated with Taxpayer's Indiana sales location and Indiana sales personnel, Taxpayer provided eight current affidavits from key personnel located within and outside Indiana. These affidavits stated what business transactions were conducted where and by whom. The effect of the affidavits is to establish that Indiana merely is a warehousing and distribution outlet for the computers. Supplementing the affidavits are copies of the contracts between the Taxpayer and the remarketers. At the hearing, Taxpayer brought in their Indiana General Manager to testify that he and his personnel have no dealings with the remarketers. Taxpayer's tax attorney appeared at the hearing via telephone and provided additional testimony related to how the business divisions are structured, the functions of the business divisions, and the fact that Indiana sales and service personnel have no relationship with the remarketers. The testimony, documentation, and evidence presented are convincing to rebut the presumption of the audit concerning the sale of these computers to the remarketers.

Taxpayer also argues that the revenue received from Remarketer One and Remarketer Two—derived from the provision of computer services—is not subject to gross income tax because the services were related to the underlying interstate sales of computers. 45 IAC 1.1-2-5(a) states, "Gross income derived from the provision of a service of any character within Indiana is subject to the gross income tax. This is true even when a service contract calls for the furnishing of tangible personal property in the performance of the contract." The same regulation further states that, "Gross income derived from the provision of a service within Indiana... on goods belonging to another is subject to gross income tax even though such property is moved in interstate commerce before or after the performance of the service." 45 IAC 1.1-2-5(d).

Revenues received for services are subject to gross income tax. Taxpayer pre-loaded software onto the computers it sold to the remarketers. This pre-loading of software, done outside of Indiana, is the provision of tangible personal property. This software is placed into the computer during the manufacturing process to prepare the computer for sale. Taxpayer purchased the rights to third-party software packages—and is required to pay the third-parties for the software. These royalty amounts were separated out in the accounting breakdown of revenues. Taxpayer is providing tangible personal property; as such it is part of the intrinsic computer purchase. Since the computer itself is not subject to the gross income tax—for the reasons named above—neither is the included pre-loaded software—because it is not a service—but the sale of tangible personal property.

However, Taxpayer earned revenues for services it provided to Remarketers One and Two. Taxpayer provided the remarketers support documentation, advertising, and promotional materials. Taxpayer retained sales, warranty, and service records on behalf of the remarketers. Taxpayer conducted technical seminars and provided technical services for the remarketers. Despite the fact that the sales to the remarketers were conducted in interstate commerce, these support services were conducted in Indiana. In consideration, the remarketers compensated taxpayer. That compensation is subject to the gross income tax. Taxpayer did not present sufficient evidence to rebut the statutory presumption of IC 6-8.1-5-1(b).

FINDING

Taxpayer's protest is sustained—with the exception of the revenue for the services. Taxpayer is sustained on the sales of the computers and revenue from income allocated as royalty payments. Taxpayer is denied on the income it received from services provided to the remarketers.

II. Investment Income – Adjusted Gross Income Tax.

The discussion below is the same as was stated in the original Letter of Findings. Taxpayer conceded the issue at the rehearing. It is included in this Letter of Finding so as to provide a unified disposition of this case.

The audit review found that money taxpayer earned in the form of "short term interest" constituted "business income." Taxpayer disagrees concluding that what it calls "Portfolio income" arose from transactions outside taxpayer's regular business activities and that the money should be classified as "non-business income." Taxpayer maintains that the acquisition of the securities "did not arise out of or were not created in the regular course of [taxpayer's] trade or business operations and the purpose for acquiring the holding the securities was not related to or incidental to such trade or business operations." As a result, taxpayer maintains that the portfolio/security income should be allocated to the state in which taxpayer's headquarters is found.

Taxpayer states that it maintains a "substantial investment portfolio composed of various types of interest-bearing and discount securities and money-market investments." The investment portfolio was devised as a means of safely and profitably investing surplus cash with the goal of obtaining the most attractive return possible; taxpayer states that investment decisions are based strictly on

prevailing "economic and market conditions" and are unrelated to the needs of taxpayer's "regular trade or business." According to taxpayer, it maintains an investment department at its out-of-state headquarters and that all activities related to the management of the investment portfolio originate within this department. In order to manage its investment portfolio, taxpayer maintains a staff of personnel who have no duties or responsibilities within taxpayer's core business operation. Taxpayer describes that core business as the "development, manufacture, rental, sale and service of technical, commercial and scientific products, mainly data processing... and office equipment and a wide range of support and systems management services." In sum, taxpayer maintains a department and personnel, distinct from its core computer business, dedicated to investing taxpayer's surplus cash.

For purposes 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 allocated to Indiana or it 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, 749 N.E.2d 651, 656 (Ind. Tax Ct. 2001).

Taxpayer's argument, that this income constitutes "non-business income," is significant because if taxpayer is correct, all this income is allocated elsewhere and is not relevant in calculating taxpayer's Indiana adjusted gross income tax.

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 income 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 concluded that the money received from the portfolio investments was "business income." The information offered by taxpayer itself demonstrates that it regularly engages in the sale and purchase of securities in order to maximize the value of its surplus cash assets. The sales and purchase of securities is such an ordinary part of taxpayer's business that it maintains a separate business division and hires personnel specifically dedicated for that purpose. The investment 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 sale and purchase of securities constitutes an integral part of the taxpayer's business. Therefore, the income meets the "functional test." Although taxpayer may be correct in stating that it is in the computer business and not the investment business, that distinction is irrelevant. The issue is not whether or not taxpayer is in the investment business, the issue is whether the investment income is "business" or "non-business" income. In this instance, there is nothing extraordinary taxpayer's investment of excess cash in order to maximize the value of that cash. To the contrary, the practice appears to be a day-to-day part of taxpayer's overall business; the investment income is neither unusual nor unexpected and falls squarely within the definition of "business income."

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

02-20030347.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 03-0347
CORPORATE INCOME TAX
For Years 1997, 1998, 1999, 2000, and 2001

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

ISSUES

I. Gross Income Tax – Advertising fees

Authority: 45 IAC 1.1-1-2

Taxpayer protests the imposition of income tax on advertising fees collected from an Indiana limited partnership under the control of taxpayer.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation with retail activities outside Indiana. Taxpayer is the sole parent corporation of two other out-of-state corporations, one of which is a 99% owner in an Indiana limited partnership("partnership"), the other is a 1% owner in the same partnership. All retail operations for all of the affiliated companies are outside Indiana except for the Indiana limited partnership.

Taxpayer filed consolidated Federal income tax returns with all affiliated entities during the audit period. All state returns, including Indiana, were filed on a separate basis.

The auditor claims that taxpayer has income from co-op advertising fees charged to subsidiary companies, including the Indiana limited partnership. These fees are at the center of this protest as they were picked up on audit as being income for the taxpayer.

At the original hearing, the Department ruled that the income was taxpayer's income prior to taxpayer paying advertisers. Taxpayer requested a rehearing, which the Department granted.

I. Gross Income Tax – Advertising fees

DISCUSSION

Taxpayer claims that it does not receive fees for advertising from the Indiana limited partnership. Rather, taxpayer claims that the partnership reimburses taxpayer for the partnership's own expenses that were previously paid for by taxpayer. Alternatively, taxpayer contends that the income was for services performed outside Indiana.

Taxpayer's position is that it contracts with third party vendors for advertising services for its various retail outlets. Some of these third parties are domiciled within Indiana, but most are outside Indiana. Taxpayer pays on said contract and subsequently receives a dollar-for-dollar reimbursement from the partnership along with a management fee that taxpayer claims and on which it pays income tax. Taxpayer claims that the only taxable income received in this situation is by the third party vendors who provide the advertising services.

Under 45 IAC 1.1-1-2(b), a taxpayer must meet a two-part test in order to qualify as an agent. Those parts are:

(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 substantially, 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.

Thus, taxpayer must indicate that it was under the control of the partnership in pursuing the advertising arrangements, that the taxpayer's arrangement was intended by the parties, and that taxpayer did not otherwise control the funds that it received for the claimed scope of the agency.

Here, if taxpayer's argument is as it indicates, then it is properly exempt as acting in an agency capacity. However, information sufficient to document its argument, such as a contract or other agreement demonstrating taxpayer's duties as an agent or lack of control over the advertising funds, is lacking. Taxpayer's alternative argument was previously addressed in a letter of findings and that finding will not be disturbed.

FINDING

The taxpayer is denied.

INDIANA DEPARTMENT OF STATE REVENUE
Revenue Ruling # 2005 – 04 ST
April 21, 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 it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

1. Sales/Use Tax—Application of Sales/Use Tax to Tangible Personal Property Purchased for the Purpose of Leasing—Resale, Rental, and Leasing Exemption

Authority: IC 6-2.5-5-8

The taxpayer requests the Department to rule whether or not the taxpayer's purchase of an aircraft for the purpose of leasing is exempt from sales/use tax under I.C. 6-2.5-5-8, which exempts property acquired for resale, rental, or leasing in the course of one's business from sales/use tax.

2. Sales/Use Tax—Application of Sales/Use Tax to Use of Aircraft for Purpose of Providing Public Transportation—Public Transportation Exemption

Authority: IC 6-2.5-5-27, 45 IAC 2.2-5-61, 62, and 63

The taxpayer requests the Department to rule whether or not the taxpayer's use of an aircraft is exempt from sales/use tax under the public transportation exemption.

STATEMENT OF FACTS

There are two separate taxpayers to consider. The first taxpayer is a LLC with a principal place of business in Kentucky. This taxpayer is qualified to do business in Indiana and has filed Indiana Online Form BT-1 (the Business Tax Application), which registers the taxpayer for the Indiana gross retail sales tax. The second taxpayer, the lessee, is an Indiana corporation with a principal place of business in Indiana.

The LLC executed a contract with an Indiana helicopter dealer to purchase a new helicopter. The dealer delivered the helicopter to the LLC in Indiana. The LLC registered the helicopter in Indiana. Immediately after registering the helicopter, the LLC leased the helicopter to the lessee. The lessee based the helicopter at lessee's principal place of business in Indiana.

The terms of the lease agreement provide that the lessee has authorization to use the helicopter for charters, air taxi services, aerial tours, external load work, aerial photography, sightseeing and flight instruction so long as the lessee receives compensation from third parties for providing the helicopter and a licensed pilot for such named activities. Under the terms of the lease, the lessee could also use the helicopter for personal and business use. However, the lease agreement provides that the lessee's personal and business use of the helicopter should not exceed more than 10% of the total use of the helicopter during the term of the lease. The total use is based on hours used.

It is mandatory that all uses of the helicopter by the lessee comply with the applicable provisions of the regulations of the Federal Aviation Administration at all times. Thus, the lessee has to comply with Parts 91 and/or 135 of the Federal Aviation

Regulations (depending on the particular activity). In addition, it is mandatory that the lessee operate the helicopter pursuant to the authority issued under the regulations of the Federal Aviation Administration, which is a division of the U.S. Department of Transportation.

The lease agreement states that the amount of monthly rent owed is a function of the use of the helicopter. According to the agreement, the lessee owes $300 per hour for the first thirty hours per month of use. Thereafter, the lessee owes $275 per hour for all hours over thirty hours per month.

Under the terms of the agreement, the lessee holds itself out to the public as a provider of transportation services that are within the scope of the permissible uses stated under the lease agreement. It is the anticipation of the lessee that the primary use of the helicopter will be charters for the purposes of commercial photography, traffic watch and newsgathering by local news organizations, police patrol by local law enforcement, and power or pipeline patrol by local utility companies. The uses just mentioned involve the taking off of the helicopter, transporting of persons and property by air, and occasional landings at other locations. Despite occasional landings at other locations, the persons and property normally return to the location from which the charter began. Even though the lessee does anticipate some air taxi service (i.e., transporting persons and property from one location to another), it does not expect such service to be its primary use of the helicopter.

Issue #1—Discussion

The taxpayer requests the Department to rule whether or not the taxpayer's purchase of an aircraft for the purpose of leasing is exempt from sales/use tax under I.C. 6-2.5-5-8, which exempts property acquired for resale, rental, or leasing in the course of one's business from sales/use tax.

IC 6-2.5-5-8(b) states the following:

> Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.

According to 45 IAC 2.2-5-15(c), which addresses the application of the general rule of IC 6-2.5-5-8, the sale of the tangible personal property must be to one who "intends" to resell, rent or lease the property. The regulation provides that the exemption is not applicable to purchasers who possess the intention to consume, use, or add value to the property through either the rendition of services or the performance of work with respect to such property. 45 IAC 2.2-5-15(c) further states there is a mandatory condition that the purchaser be occupationally engaged in reselling, renting or leasing the acquired tangible personal property in the regular course of its business. Lastly, 45 IAC 2.2-5-15(c) provides that it is compulsory that the property acquired be resold, rented or leased in the exact form that it was purchased.

Here, the taxpayer, the LLC, acquired the helicopter for the purpose of leasing it to a third party. Assuming the form of the property was not changed and the taxpayer leases the helicopters in the regular course of its business, the taxpayer's purchase of the helicopter falls within the ambit of the exemption statute stated above.

Issue #1 Ruling

The Department rules that the taxpayer's purchase of the helicopter for the purpose of leasing is exempt from sales/use tax under I.C. 6-2.5-5-8, which exempts property acquired for resale, rental, or leasing in the course of one's business, providing that such helicopter was purchased in the regular course of the taxpayer's business and the form of the helicopter was not altered.

Issue #2—Discussion

The taxpayer requests the Department to rule whether or not the taxpayer's use of an aircraft is exempt from sales/use tax under the public transportation exemption.

IC 6-2.5-5-27 states that:

> 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.

45 IAC 2.2-5-61(b) defines "public transportation" to be the following:

> 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 U.S. Department of Transportation; however, the fact that a company possesses a permit or authority…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.

45 IAC 2.2-6-61(c) states further that only tangible personal property, which is reasonably necessary to the rendering of public transportation, qualifies for the public transportation exemption. To meet the "reasonably necessary" test it must be shown that the tangible personal property is both indispensable and essential in the direct transportation of persons or property. According to 45 IAC 2.2-6-61(d), the Indiana Department of Revenue has determined that vehicles that are used for public transportation are necessary to the rendering of public transportation.

Ultimately, taking the stated provisions into consideration, the taxpayer will qualify for the public transportation exemption if it, the taxpayer, shows that it is predominately engaged in public transportation and that the tangible personal property acquired is to be predominately used in providing public transportation. *See* Panhandle Eastern Pipeline, 741 N.E.2d 816. It is important to highlight that consideration must be given in order for the public transportation exemption to apply. *See* Grand Victoria Casino & Resort, L.P. v. Ind. Dep't of State Revenue, 789 N.E.2d 1041. Also, in order to prove that the tangible personal property acquired is "predominately" used in providing public transportation, the taxpayer must show that the acquired tangible personal property is engaged in public transportation more than fifty percent of the time. If such can be shown, then the taxpayer qualifies for an exemption of the entire purchase price of the acquired tangible personal property.

Under the facts of the case presented, the terms of the lease agreement provide that the lessee is authorized to use the helicopter for "for hire" activities. The facts also state that the lessee operates under the authority of the Department of Transportation and that the lessee's use of the helicopter for personal and business uses is restricted to no more than ten percent of the total use of the helicopter. Ultimately, to the extent that it can be shown that the "for hire" activities constitute "moving, transporting, or carrying persons and/or property for consideration," the taxpayer will be entitled to the public transportation exemption. Further, the use of the helicopter for charters, air taxi services, aerial tours, external load work, aerial photography and sightseeing is considered to be use in public transportation. The use of the helicopter for flight instruction is not considered to be use in public transportation.

Issue #2 Ruling

The Department rules that the lessee's use of the helicopter for providing public transportation is exempt from sales/use tax under the public transportation exemption so long as the lessee can prove that it meets the first-prong of the test, which is that the lessee is predominantly engaged in providing public transportation, and the second-prong of the test, which is that the lessee uses the helicopter predominately for providing public transportation. The Department, further, rules that the use of the helicopter for charters, air taxi services, aerial tours, external load work, aerial photography and sightseeing is use in public transportation. The use of the helicopter for flight instruction is not use in public transportation.

Caveat

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's acts 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 the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in a statute, a 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
Revenue Ruling #2005-05ST
April 26, 2005

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ISSUE

Sales and Use Tax- Application of Sales Tax to Foundations for Grave Markers

Authority: IC 6-2.5-4-9, 45 IAC 2.2-4-22 (d), (e).

The taxpayer requests that the department rule on how the sales tax applies to the installation of foundations for grave markers.

STATEMENT OF FACTS

The taxpayer is in the business of selling grave markers (tombstones). The taxpayer buys the stone and markets it along with the inscription to members of the general public and their families. The taxpayer treats the sale of such markers as tangible personal property and collects the appropriate sales tax.

Due to the substantial weight of the markers, a foundation must be installed prior to the placement of the markers. The foundation typically could be best described as a concrete slab that is installed in the ground upon which the marker is then placed. Sometimes the taxpayer will contract with a third party to install the foundation, pay such third party and pass along that charge to the purchaser of the marker. When the charge for the foundation is not contracted via a third party, the taxpayer themselves install the foundation and charge the buyer of the grave marker for the foundation along with the grave marker. The foundation, whether it is contracted through a third party or is installed by the taxpayer, is contracted for on a lump sum basis. In other words, it is for a flat charge in which materials and labor are included. The charge for the foundation is separately stated on the bill.

DISCUSSION

IC 6-2.5-4-9 provides as follows:

(a) A person is a retail merchant making a retail transaction when the person sells tangible personal property which:

(1) is to be added to a structure or facility by the purchaser; and

(2) after its addition to the structure or facility, would become a part of the real estate on which the structure or facility is located.

(b) Notwithstanding subsection (a), a transaction described in subsection (a) is not a retail transaction, if the ultimate purchaser or recipient of the property to be added to the structure or facility would be exempt from the state gross retail and use taxes if that purchaser or recipient had directly purchased the property from the supplier for addition to the structure or facility.

The Sales Tax Regulations clarify the liability of contractors for sales and use tax at 45 IAC 2.2-4-22 (d) and (e) as follows:

(d) Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

(1) Time and material contract. He converts the construction material into realty on land he does not own and states separately the cost for the construction materials and the cost for the labor and other charges (only the gross proceeds from the sale of the construction material are subject to tax); or

(2) Construction material sold over-the-counter. Over the counter sales of construction materials will be treated as exempt from the state gross retail tax only if the contractor receives a valid exemption certificate issued by the person for whom the construction is being performed or by the customer who purchases over-the-counter, or a direct pay permit issued by the customer who purchases over-the-counter.

(e) Disposition subject to the use tax. 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.

... (3) Lump sum contract. 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.

The taxpayer's situation does not fit into any of the cited examples where the contractor would collect sales tax on the finished product. Rather, the taxpayer or third party contractor changes tangible personal property into an improvement that becomes part of the real estate. The taxpayer either installs the foundation for the monument or arranges for another contractor to install the foundation pursuant to a lump sum contract. This clearly falls within the category that is subject to the payment of use tax by the contractor or the taxpayer at time of sale to the purchaser of the installed monument if the sales tax was not paid when the taxpayer or third party contractor purchased the tangible personal property that was converted into the real estate.

RULING

The Department rules that the installation of the foundation for the grave markers pursuant to a lump sum contract is treated as an improvement to real estate. A contractor under a lump sum contract, is responsible for paying the sales tax at the time materials are purchased, or if not paid, use tax on the cost of the materials.

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.

WATER POLLUTION CONTROL BOARD

A non-rule policy document is a policy or statement that interprets, supplements or implements a statute or rule. It is not intended by the department to have the effect of law and is not related solely to internal department organization. Per Indiana Code 13-14-1-11.5, a non-rule policy document may not be put into effect until 30 days after the policy or statement is made available for public inspection and comments and presented to the Water Pollution Control Board.

Non-rule policy documents that are open for inspection and comment are denoted by "comment period deadline: date" in the 'ADOPTED' column of the table below. Comments on a non-rule policy document that is open for comment may be submitted by the comment period deadline to: Non-rule Policy Document #, Lawrence Wu, Chief, Rules Development Section, Office of Water Quality; Indiana Department of Environmental Management, 100 North Senate Avenue, Room N1255, Indianapolis, Indiana 46204.

Nonrule Policy Documents

If you have questions about any of the documents found on this page, please contact the IDEM staff person or section listed at the end of each non-rule policy document. All documents are in PDF format. Click on a highlighted ID# to view the document.

ID#	POLICY TITLE	POLICY DESCRIPTION	ADOPTED	LAST REVISED	CITATION	CONTACTS
Water-001-NRD	Constructed Wetland Wastewater Treatment Facilities Guidance	Policy and technical guidance for the design, construction and operation of constructed wetland type sanitary wastewater treatment facilities	May 1, 1997	N/A	327 IAC 2,3,5,8 410 IAC 6-10	Jay Hanko (317) 233-8283
Water-002-NRD	Antidegradation Requirements for Outstanding State Resource Waters Inside the Great Lakes Basin	Provides a definition of significant lowering of water quality applicable to Outstanding State Resource Waters Inside the Great Lakes Basin	March 23, 1998	N/A	327 IAC 5-2-11.7(a)(2)(B)	Lonnie Brumfield (317) 233-2547 Dennis Clark (317) 308-3235
Water-003-NRD	Combined Sewer Overflow (CSO) Long-Term Control Plan Use Attainability Analysis Guidance	This document fulfills the mandates of Senate Enrolled Act 431 by providing guidance to municipal National Pollutant Discharge Elimination System (NPDES) permittees with combined sewer collection systems.	December 14, 2001	N/A	327 IAC 2,5	Bruno Pigott (317) 232-8631
Water–005-NRD	Review of Sanitary Sewer Construction Permit Applications For Communities with Combined Sewer Overflow Outfalls	This document outlines IDEM's procedures for review of sewer construction permit applications for communities with combined sewer overflow outfalls	April 9, 2003	N/A	327 IAC 3-1-1 through 327 IAC 3-6-32	Ken Lee (317) 232-8660

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