DEPARTMENT OF INSURANCE
May 26, 2005
Bulletin 130
The Use of Credit Information in Underwriting and Rating Insurance Policies

This Bulletin is directed to all insurance companies, as defined by IC 27-1-2-3, that write personal lines property and casualty products in this state. The Department issued Bulletin 123 on December 5, 2003, regarding the use of credit information. In May 2004, the Attorney General's office reviewed the Department's Bulletin 123 and opined that the interpretation of the word "solely" therein placed restrictions on insurers that were not intended by the Indiana General Assembly. On February 9, 2005, the Attorney General affirmed this opinion as a formal opinion. *See; AG Op 2004-8*. The Commissioner has reviewed the statute, supporting information, and the opinion of the Attorney General. The Commissioner believes that the Indiana General Assembly through its duly elected members is responsible for setting the public policy for the state of Indiana. When the General Assembly passes a statute that is clear and unambiguous the Department of Insurance, as an agency of state government, is charged with implementing the clear meaning of that statute. The Attorney General has stated that IC 27-2-21 is not ambiguous in its use of the term "solely". Therefore, the Commissioner hereby issues this Bulletin 130 and withdraws Bulletin 123.

IC 27-2-21 prescribes the use of credit information by insurance companies. An insurer may use credit information in underwriting or rating a consumer. If an insurer chooses to use credit information the insurer must disclose its intention to use credit information to the consumer. The insurance scoring model must be filed with the Department of Insurance. This filing is confidential under IC 5-14-3-4(a)(1) and IC 27-2-21-20(d) and not available for public inspection. Companies should identify their filings as made pursuant to IC 27-2-21 and should separate all confidential documents and clearly identify them as confidential as described in Bulletin 111. Pursuant to IC 27-2-21-20 the scoring model and other scoring processes are confidential.

As outlined in IC 27-2-21-22, a consumer reporting agency, as defined at IC 27-2-21-6, may not provide or sell data or lists that include information submitted in conjunction with an insurance inquiry about a consumer's credit information or a request for a credit report or insurance score. This includes the expiration dates of an insurance policy. The restrictions contained in IC 27-2-21-22 do not apply to data or lists that a consumer reporting agency supplies to: (1) an insurance producer from whom the information was received; or (2) an insurer (including any affiliates and/or parent company) on behalf of which the insurance producer acted.

The insurer shall not deny, cancel, decline to renew an insurance policy, or base a renewal rate solely on the basis of credit information. The absence of credit information or the inability to calculate an insurance score may not be considered unless the insurer either treats the consumer as having neutral credit information or persuades the Department that the absence or the inability to calculate relates to the risk for the insurer. In such an event the insurer shall treat the consumer in a manner approved by the Commissioner. Any adverse action by an insurer must be based upon a credit report or score that was obtained no longer than ninety (90) days from the date the insurance policy is first written or a renewal is issued. The insurance score or credit report must be updated as outlined in IC 27-2-21-16(7).

An insurer shall not use an insurance score that is calculated using income, gender, address, ZIP code, ethnic group, religion, marital status, or nationality of the consumer as a factor. A credit inquiry not initiated by the consumer or a credit inquiry requested by the consumer for the consumer's own credit information can not be used as a negative factor in the insurance score. A credit inquiry related to insurance coverage may not be used as a negative factor. Multiple lender inquiries, made within thirty (30) days of one another, related to a home mortgage or multiple lender inquiries, made within thirty (30) days of one another, related to the automobile lending industry may not be used as a negative factor. A collection account with a medical industry code may not be used as a negative factor in a credit score.

In addition to specific guidance on credit scoring the insurance laws provide other protections that insurers should be aware of when developing and using insurance scores. IC 27-1-22-25 states that a motor vehicle insurance rating plan or the premium rate charged may not establish a higher rate for a policyholder based on the fact that the policyholder has filed a voluntary petition under the federal bankruptcy law. Therefore, an insurer that writes motor vehicle insurance may not use an insurance score that uses bankruptcy as a factor. Pursuant to IC 27-2-17, an insurer may not may not cancel or refuse to issue or renew a policy of property or casualty insurance based solely on the geographical location of the risk within Indiana. And under IC 27-1-22-3(a)(4), property and casualty premium rates shall not be unfairly discriminatory. An insurer that violates any of these provisions is subject to administrative proceedings under IC 27-4-1-4 as an unfair and deceptive act or practice in the business of insurance and subject to penalties including monetary fines and suspension or revocation of the insurer's certificate of authority.

DEPARTMENT OF INSURANCE
James Atterholt, Commissioner

DEPARTMENT OF INSURANCE
May 26, 2005
Bulletin 131
INDIANA COMPREHENSIVE HEALTH INSURANCE ASSOCIATION
ASSESSMENTS AND TAX CREDITS AS OF JANUARY 1, 2005

In previous years insurers who were members of, and paid an assessment to, the Indiana Comprehensive Health Insurance Association (ICHIA) were entitled to take a credit against taxes owed, including premium tax under IC 27-1-18-2. A company could carry forward the unused credits. In 2004, the Indiana General Assembly significantly changed this practice. Pursuant to IC 27-8-10-2.4, no additional tax credits will be earned for assessments paid by members on or after January 1, 2005. Any member of ICHIA that before January 1, 2005 paid an assessment and had not taken a credit against the premium taxes is not entitled to claim any unused tax credit for the taxable years beginning after December 31, 2004 and ending before January 1, 2007. Thereafter, a member that has unused credits on January 1, 2007, may take an annual credit of ten percent (10%) of the amount of the assessments paid before January 1, 2005, against which the credit has not been taken. The amount of the annual credit may not exceed the amount of premium tax that is due for the taxable year. If the amount of the tax credit available exceeds the member's liability for the taxable year, the member may carry forward the amount of the unused annual credit to subsequent taxable years. The unused annual tax credits carried forward are not subject to the ten percent (10%) limit. The tax credits available may be carried forward indefinitely, but the total amount of credits taken may not exceed the total amount of tax credits that were available on January 1, 2005.

Insurance companies paid estimated quarterly payments on April 15, June 15, September 15, and December 15, 2004 for taxable year 2005. The final return for taxable year 2004 was due March 1, 2005. ICHIA members may use available tax credits as of January 1, 2005 for the 2004 taxable year liability.

ICHIA traditionally has a "true up" assessment several months after the close of the calendar year. This "true up" assessment is computed after claims are submitted and processed allowing ICHIA to determine the true losses for the previous calendar year. This "true up" assessment may require an additional payment if the actual plan losses exceeded 2004 assessments or if the previous years assessments were higher than actual plan losses then the members would receive a credit for their 2005 assessments. For taxable year 2004 insurers should calculate their assessment credits as of December 31, 2004. If the "true up" for calendar year 2004 results in an additional payment, IC 27-8-10-2.4 does not permit tax credits to be accrued for assessments paid on or after January 1, 2005. If the "true up" for the calendar year 2004 results in a credit to the insurer the insurer should reduce their accumulated unused tax credits as of December 31, 2004, in accordance with the "true up" credit. This event should be reflected in the report required by IC 27-8-10-2.3. If the insurer has used the tax credit on their 2004 premium tax filing then the insurer should file an amended return to reflect the reduction in the assessment and thus the tax credit to which they were entitled.

INDIANA DEPARTMENT OF INSURANCE
James Atterholt, Commissioner

DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #4
Revised July 2005
(replaces Directive #4 dated November 2000)

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

Subject: Collection of Tax From Transient Merchants

References: IC 6-2.5-2; IC 6-2.5-8; IC 6-3-2; IC 6-3-4; IC 6-3-5; IC 6-8.1-5; IC 6-8.1-8; IC 6-8.1-9; IC 25-37-1

Introduction: The purpose of this directive is to outline the Department's position on the collection of sales tax and adjusted gross income tax from transient merchants.

Sales Tax: Under IC 6-2.5-2-2, the sales tax is imposed on a retail merchant's transactions which constitute selling at retail. The tax also applies to transient merchants, defined in IC 25-37-1 as one who engages in temporary business in Indiana. Before selling at retail in Indiana, a merchant is required to obtain a Registered Retail Merchant Certificate under IC 6-2.5-8 from the Department. A Retail Merchant Certificate application (BT-1) can be obtained either from the Department's website, www.in.gov/dor, from the Department's Tax order line: (317) 615-2581, or a district office.

A Retail Merchant Certificate, however, is not related to a Transient Merchant License. A Transient Merchant License must be obtained from the county auditor of the county in which the merchant intends to do business (IC 25-37-1-4), if the county so requires. As of the issuance date of this Commissioner's Directive, Parke County was the only county with such a requirement.

Retail merchants who have no certificate (or an invalid one) are subject to imprisonment and a fine (Class B misdemeanor). Failure to remit any taxes collected by any retail merchant to the Department or a Department representative upon demand may, also, subject the merchant to a longer prison term and a higher fine (Class D felony). These criminal penalties are in addition to civil sanctions prescribed by IC 6-8.1-8. In particular, if a retail merchant fails to remit the tax collected, a notice of tax due will be issued, based on the best information available. Failure to pay the tax due could result in a levy against the merchant's property.

Individual Income Tax: Under IC 6-3-2-1, a tax is imposed on a nonresident's adjusted gross income derived from sources within Indiana. While IC 6-3-5-1 provides that nonresidents from states having reciprocal agreements with Indiana are not subject to Indiana adjusted gross income tax, such reciprocal agreements only apply to salaries, wages, tips and commissions. Therefore, reciprocity is not applicable to proceeds from a transient merchant's sales.

Under IC 6-3-4-4.1, a taxpayer is required to make a declaration of estimated tax if the taxpayer expects to owe $400 or more in income tax. IC 6-8.1-5-3 allows the Department to make an immediate assessment of tax, interest and penalties if it is determined that a taxpayer intends to: depart the state, remove his property, conceal his person or property, or to do any thing to jeopardize, prejudice, or render ineffective, proceedings to collect the tax. If the tax is not paid upon demand, a warrant will be issued. Refusal to pay the warrant can result in a levy against the taxpayer's property.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #16
July 2005
(Replaces Commissioner's Directive #16 dated December 2004)

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

SUBJECT: New or Replacement Tires on Vehicles

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

I. INTRODUCTION

The purpose of this Directive is to outline the procedures to be followed in collecting and remitting the tire fee. The statute does not apply to the sale of used or retreaded tires.

II. IMPOSITION OF FEE

There is a $0.25 fee imposed on each new tire sold in Indiana for use on a motor vehicle, and types of equipment, machinery, implements or other devices used in transportation, manufacturing, agriculture, construction or mining. Effective July 1, 2005, the fee includes tires mounted on farm tractors, implements of husbandry and semi trailers. "New tire" means a tire that has never been mounted on the wheel of a vehicle.

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

III. EXEMPTIONS

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

IV. REMITTANCE OF THE FEE

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

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

The tire fee is to be remitted using Form TF-103. This form is required to be filed with the remittance of the tire fee unless the payment is remitted through electronic funds transfer and then only a quarterly recap is required to be filed.

V. USAGE OF THE FEES COLLECTED

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

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #26
July 2005

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

SUBJECT: Confidentiality of Taxpayer Information

REFERENCES: IC 6-8.1-7-1; IC 6-8.1-7-3

I. INTRODUCTION

The Indiana Department of State Revenue ("Department") is committed to protecting the confidentiality of taxpayer information and privacy rights of Indiana taxpayers. These rights are ensured in the Indiana Code, the Indiana Administrative Code, and the Department's policies and practices. This Commissioner's Directive is intended to provide public notification to taxpayers of the Department's practices relating to the collection, use, and retention of confidential taxpayer information.

II. DISCLOSURE OF CONFIDENTIAL TAXPAYER INFORMATION

Disclosure of confidential taxpayer information by the Department is strictly prohibited except as provided by the laws of this State. The Department's disclosure of confidential taxpayer information is governed by guidelines provided by the Indiana General Assembly. These guidelines have been codified at IC 6-8.1-7-1 and IC 6-8.1-7-3. With limited exceptions, the disclosure of confidential taxpayer information is forbidden. IC 6-8.1-7-1(a) states:

> Unless in accordance with a judicial order or as otherwise provided in this chapter, the department, its employees, former employees, counsel, agents, or any other person may not divulge the amount of tax paid by any taxpayer, terms of a settlement agreement executed between a taxpayer and the department, investigation records, investigation reports, or any other information disclosed by the reports filed under the provisions of the law relating to any of the listed taxes, including required information derived from a federal return, except to:
>
> (1) members and employees of the department;
> (2) the governor;
> (3) the attorney general or any other legal representative of the state in any action in respect to the amount of tax due under the provisions of the law relating to any of the listed taxes; or
> (4) any authorized officers of the United States;
>
> when it is agreed that the information is to be confidential and to be used solely for official purposes.

The General Assembly has also provided Indiana taxpayers with additional protections to prevent the unauthorized disclosure of confidential taxpayer information. Specifically, IC 6-8.1-7-3 states:

> A person who violates the provisions of this chapter commits a Class C misdemeanor. In addition, if the person is an officer or employee of the state, he shall be immediately dismissed from his office or employment.

The Department has promulgated rules reinforcing these statutory proscriptions against the unauthorized disclosure of confidential taxpayer information. *See* 45 IAC 15-7-1 and 45 IAC 15-7-2.

III. STREAMLINED SALES TAX PROJECT

In March 2000, a collection of states joined forces to sponsor a national sales tax initiative—the Streamlined Sales Tax Project ("SSTP"). The SSTP represents an effort on the part of its member states to "simplify and modernize sales and use tax collection and administration." To that end, the Streamlined Sales Tax Implementing States ("SSTIS") crafted model legislation—i.e., the Streamlined Sales and Use Tax Agreement ("Agreement"). Member states were encouraged to adopt legislation conforming to this model.

In 2001, the General Assembly enacted legislation to guide the Department's participation in the Streamlined Sales Tax Project. IC 6-2.5-11-7 established specific disclosure and confidentiality requirements:

> The department shall not enter into the [Streamlined] agreement unless the agreement requires each state to abide by the following requirements:

* * *

(8) CONSUMER PRIVACY. The agreement must require each state to adopt a uniform policy *for certified service providers* that protects the privacy of consumers and maintains the confidentiality of tax information.
IC 6-2.5-11-7(8).

The "certified service provider" referenced in IC 6-2.5-11-7(8) is an "agent of a seller … [employed by the seller to assist in] the collection and remittance of sales and use taxes. As the seller's agent, the certified service provider is liable for sales and use tax due each member state on all sales transactions it processes for the seller…." *See* IC 6-2.5-11-10(a).

The mandate provided by IC 6-2.5-11-7(8) reflects the Department and General Assembly's concerns about the importance of safeguarding confidential information collected from consumers by certified service providers. Section 321 of the Agreement addresses these privacy and confidentiality concerns. Specifically:

- Each member state shall provide public notification to consumers, including their exempt purchasers, of the state's practices relating to the collection, use and retention of personally identifiable information.
- When any personally identifiable information that has been collected and retained is no longer required to ensure the validity of exemptions claimed by reason of a consumer's status or the consumer's intended use of the goods or services purchased, such information shall no longer be retained by the member states.
- When personally identifiable information regarding an individual is retained by or on behalf of a member state, such state shall provide reasonable access by such individual to his or her own information in the state's possession and a right to correct any inaccurately recorded information.
- If anyone other than a member state, or a person authorized by that state's law or the Agreement, seeks to discover personally identifiable information, the state from whom the information is sought should make a reasonable and timely effort to notify the individual of such request.
- This privacy policy is subject to enforcement by member states' attorneys general or other appropriate state government authority.

Streamlined Sales and Use Tax Agreement, "Confidentiality and Privacy Protections under Model 1," Section 321(e) – (i).

Notwithstanding Indiana's participation in the Streamlined Sales Tax Project, Indiana laws and regulations regarding the collection, use, and maintenance of confidential taxpayer information remain fully applicable and binding. Indiana confidentiality provisions are more restrictive with regard to the disclosure of confidential taxpayer information than those mandated by Section 321 of the Agreement. Additionally, the Department will not recognize certified service providers that fail to adopt the Agreement's confidentiality and privacy provisions or engage in business practices that violate state confidentiality and disclosure laws.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #27
July 2005

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

SUBJECT: Seller Registration, Methods of Remittance, Certified Service Providers, and the Taxability Matrix

REFERENCES: IC 6-2.5-1; IC 6-2.5-6-9; IC 6-2.5-11; IC 6-2.5-12; IC 6-2.5-13

I. INTRODUCTION

In March 2000, a collection of states joined forces to sponsor a national sales tax initiative—the Streamlined Sales Tax Project ("SSTP"). The SSTP represents an effort on the part of its member states to "simplify and modernize sales and use tax collection and administration." To that end, the Streamlined Sales Tax Implementing States ("SSTIS") developed the Streamlined Sales and Use Tax Agreement ("Agreement"). Member states were encouraged to adopt legislation conforming to the Agreement.

II. SELLER REGISTRATION

Once the Agreement is implemented, Indiana will participate in a centralized online sales and use tax registration system in cooperation with the other member states. Under this centralized registration system:

A. A seller registering under the Agreement is registered in each of the member states.

B. The member states agree not to require the payment of any registration fees or other charges for a seller to register in a state in which the seller has no legal requirement to register.

C. A written signature from the seller is not required.

D. An agent (CSP) may register a seller under uniform procedures adopted by the member states.

E. A seller may cancel its registration under the system at any time under uniform procedures adopted by the Governing Board. Cancellation does not relieve the seller of its liability for remitting to the proper states any taxes collected.

Additionally, Indiana provides its own online registration system that allows sellers to register for collection of Indiana sales and use taxes. Indiana's online registration form (BT-1 Business Tax Application) may be accessed at the Indiana Department of Revenue's website— http://www.state.in.us/dor/business/register.html.

Regardless of method used to register with the state of Indiana, the seller agrees to collect Indiana sales and use taxes for all taxable sales made into Indiana. ***However, registration and collection of Indiana sales and use taxes does not create nexus with Indiana for state income tax purposes.***

Note: A seller may be registered by an agent. (See IC 6-2.5-11-10(a) regarding certified service providers). ***This agency appointment must be disclosed to the Department in writing at the time of registration.***

III. CERTIFIED SERVICE PROVIDERS

CERTIFIED SERVICE PROVIDER ("CSP") is an **agent** certified under the Agreement to perform all the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases.

CERTIFIED AUTOMATED SYSTEM ("CAS") is software certified under the Agreement used to (1) calculate the tax imposed by each jurisdiction on a transaction, (2) determine the amount of tax to remit to the appropriate state, and (3) maintain a record of the transaction.

IV. METHODS of REMITTANCE

When registering, the seller may select one of the following technology models (i.e., methods of remittance) to remit the Indiana sales and use taxes collected:

A. MODEL 1, wherein a seller selects a CSP as an agent to perform all the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases. A seller that has selected a CSP as its agent to perform all of the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases, is a MODEL 1 SELLER.

B. MODEL 2, wherein a seller selects a CAS to use to calculate the amount of tax due on a transaction. A seller that has selected a CAS to perform all of its sales and use tax functions, but retains responsibility for remitting the tax, is a MODEL 2 SELLER.

C. MODEL 3, wherein a seller utilizes its own proprietary automated sales tax system that has been certified as a CAS. A seller that has sales in at least five member states, has total annual sales revenue of at least five hundred million dollars, has a proprietary system that calculates the amount of tax due each jurisdiction, and has entered into a performance agreement with the member states that establishes a tax performance standard for the seller is a MODEL 3 SELLER.

V. DEFINED TERMS and the TAXABILITY MATRIX

The Agreement provides definitions of terms referenced within the Agreement. These standardized definitions and terms have been incorporated in each member state's conforming legislation. To ensure uniform application by the states of these defined terms, each member state is required to complete a taxability matrix adopted by the project's Governing Board. Each member state's entries in this matrix will be maintained in a downloadable database in a format approved by the Governing Board. A member state shall provide notice of changes in the taxability of the products or services listed in the taxability matrix as required by the Governing Board. Indiana will complete its taxability matrix once an approved format has been adopted by the Governing Board.

Upon implementation, Indiana will relieve CSPs from liability for having charged and collected the incorrect amount of sales or use tax resulting from the seller or CSP relying on data contained in Indiana's taxability matrix.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #28
July 2005

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

SUBJECT: Amnesty Provisions for Sellers Registering to Collect Indiana Sales Tax under the Streamlined Sales Tax Program

I. INTRODUCTION

In March 2000, a collection of states joined forces to sponsor a national sales tax initiative—the Streamlined Sales Tax Project ("SSTP"). The SSTP represents an effort on the part of its member states to "simplify and modernize sales and use tax collection and administration." To that end, the Streamlined Sales Tax Implementing States ("SSTIS") developed the Streamlined Sales and Use Tax Agreement ("Agreement"). Member states were encouraged to adopt legislation conforming to the Agreement.

II. AMNESTY

It is the policy of the Indiana Department of Revenue to provide amnesty for uncollected or unpaid sales or use tax to a seller who registers to pay or to collect and remit applicable sales or use tax on sales made to purchasers in the state in accordance with the terms of the Streamlined Sales Tax Agreement, provided that the seller was not so registered in Indiana in the twelve-month period preceding the effective date of Indiana's participation in the Agreement.

The amnesty will preclude assessment for uncollected or unpaid sales or use tax together with penalty or interest for sales made during the period the seller was not registered in Indiana, provided registration occurs within twelve (12) months of the effective date of Indiana's participation in the Agreement.

The amnesty is not available to a seller with respect to any matter or matters for which the seller received notice of the commencement of an audit and which audit is not yet finally resolved including any related administrative and judicial processes.

The amnesty is not available for sales or use taxes already paid or remitted to the Indiana Department of Revenue or to taxes collected by the seller.

The amnesty is fully effective, absent the seller's fraud or intentional misrepresentation of a material fact, as long as the seller continues registration and continues payment or collection and remittance of applicable sales or use taxes for a period of at least thirty-six months. ***(Each member state shall toll its statute of limitations applicable to asserting a tax liability during the thirty-six month period.)***

The amnesty is applicable only to sales or use taxes due from a seller in its capacity as a seller and not to sales or use tax due from a seller in its capacity as a buyer.

If you have further questions concerning registration under the amnesty provisions of the Agreement, contact the Department at (317) 232-8054.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #29
SALES TAX
JULY 2005
(Replaces Information Bulletin #29 dated January 2004)

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

SUBJECT: Sales of Food

REFERENCES: IC 6-2.5-1-11, IC 6-2.5-1-12, IC 6-2.5-1-16, IC 6-2.5-1-20, IC 6-2.5-1-26, IC 6-2.5-1-28, IC 6-2.5-5-20, IC 6-2.5-5-21, IC 6-2.5-5-21.5, IC 6-2.5-5-22, IC 6-2.5-5-35

INTRODUCTION:

Generally, the sale of food and food ingredients for human consumption is exempt from Indiana sales tax. Primarily, the exemption is limited to the sale of food and food ingredients commonly referred to as "grocery" food. The purpose of this bulletin is to assist Indiana retailers in the proper application of this exemption.

A number of items sold by grocery stores, supermarkets, and similar type businesses are classified in this bulletin under the headings "Non-taxable Food Items" and "Taxable Grocery Items". These examples are for illustrative purposes and are not intended to be all-inclusive.

I. Non-taxable Food Items:

Food is defined as substances, whether in liquid, concentrated, solid, frozen, dried or dehydrated form, that are sold for ingestion or chewing by humans and that are consumed for their taste or nutritional value. The term does not include tobacco, alcoholic beverages, candy, dietary supplements or soft drinks.

The Indiana sales tax does not apply to the sale of food and food ingredients listed below if sold unheated and without eating utensils provided by the seller.

Baby food
Bakery items (including bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, danish, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas)

Baking chocolate (whether liquid, powder, or solid)
Baking soda or other forms of leavening agents
Beverages containing 50% fruit or vegetable juice or containing milk, milk products or milk substitutes
Broths and bouillons (whether liquid, instant, freeze dried, or cubes)
Cereal and cereal products
Cocoa
Coconut (whether whole, shredded, sweetened, processed or raw)
Coffee and coffee substitutes (beans, grounds, freeze dried, bags and instant only)
Condiments
Deli items when sold unheated by weight or volume as a single item
Deli trays that only contain otherwise exempt items
Eggs and egg products or substitutes
Extracts and flavorings intended as a cooking ingredient
Fish and fish products (including all other forms of seafood)
Flour (including wheat, whole wheat, rye, corn, rice, barley, buckwheat, soy or other forms of milled grains or nuts)
Food coloring
Food sold by a seller whose primary NAICS classification is manufacturing in sector 311, except subsector 3118 (bakeries)
Food sold by weight or volume as a single item
Fruit and fruit products (whether fresh, frozen, canned or dehydrated, excludes items on salad bars)
Gelatins (whether powdered or prepared)
Honey
Ice
Ice cream (including toppings and novelties)
Jams and jellies (including marmalades and preserves)
Ketchup
Lard
Marshmallows (including marshmallow crème)
Meat and meat products (whether fresh, frozen, cured, canned, or dehydrated)
Milk and milk products
Mustard
Nuts (including salted, but not chocolate or candy coated nuts)
Oleomargarine
Olive oil
Peanut butter
Pepper
Pickles
Powdered drink mixes (including sweetened)
Relishes
Salad dressings and mixes
Salt
Sauces
Sherbets and sorbets
Shortenings
Soups
Snack chips and pieces (includes potato chips, corn chips, pig skins, pretzels and trail mixes.)
Spices
Sandwich spreads
Sugar, sugar products and sugar substitutes
Syrups (including molasses and dietetic syrups and similar products)
Tea (bags, leaves, or instant only)
Vegetables and vegetable products (whether fresh, frozen, canned or dehydrated, excludes items on salad bars)
Vegetable oils
Water

II. Taxable Grocery Items:

The following grocery items are subject to Indiana sales tax:

Alcoholic beverages
Candy and confections
Chewing gum
Chocolate covered nuts
Cocktail mixes (dry or liquid)
Cooking utensils
Dietary supplements
Liver oils
Lozenges
Over the counter medicines
Paper products
Pet food and supplies
Soap and soap products
Soft drinks
Tobacco and tobacco products
Tonics
Toothpaste and mouthwash
Vending machine sales
Vitamins

Food sold in a heated state or heated by the seller is taxable.

Two (2) or more food ingredients mixed or combined by the seller for sale as a single item are taxable (other than food that is only cut, repackaged, or pasteurized by the seller, and eggs, fish, meat, poultry, and foods containing these raw animal foods requiring cooking by the consumer so as to prevent food borne illness).

Food that is sold with eating utensils, provided by the seller, including plates, knives, forks, spoons, glasses, cups, napkins, or straws is taxable.

A. Candy

Candy is defined as preparations of sugar, honey, or other natural or artificial sweeteners in combination with chocolate, fruits, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. The fact that these preparations contain ingredients, which if purchased separately, are considered exempt, does not exempt these preparations. The term does not include any preparation that contains flour listed on the label or any preparation that requires refrigeration.

Baking chocolate and similar products, which are intended for use in cooking, will be considered exempt food within the meaning of this information bulletin. The method used in packaging, distributing and displaying the product, including the kind and size of container used, will be considered in determining the primary use for which it is sold.

B. Soft Drinks

Soft drinks are defined as nonalcoholic beverages that contain natural or artificial sweeteners. The term does not include beverages that contain milk or milk products, soy, rice, or similar milk substitutes, or greater than fifty percent (50%) vegetable or fruit juice by volume.

C. Dietary Supplements

Sales of dietary supplements are subject to Indiana sales tax. The term "dietary supplements" means any product other than tobacco that:

(1) is intended to supplement the diet;
(2) contains one or more of the following ingredients:
  (a) vitamins,
  (b) minerals,
  (c) herbs or other botanicals,
  (d) amino acids,
  (e) a dietary substance for use by humans to increase the total dietary intake,
  (f) concentrates, metabolites, constituents, extracts or a combination of any of the above ingredients;
(3) is intended for ingestion in tablet, capsule, powder, softgel, gelcap, or liquid form, or, if not intended for ingestion in the above form, is not represented as a conventional food and is not represented for use as a sole item of a meal or of the diet;
(4) is required to be labeled as a dietary supplement, identifiable by the "Supplemental Facts" box found on the label and as required under 21CFR 101.36.

Dietary supplements include products such as Figurines, Carnation Diet Drinks, Slimfast, Slender, and Ensure.

Sales of food prescribed as medically necessary by a physician licensed to practice medicine in Indiana are exempt from the sales tax if dispensed by a registered pharmacist or sold by a licensed physician.

D. Prepared Food

(1) All food sold through a vending machine is subject to sales tax regardless of the type of food sold. The fact that the item qualifies as exempt food if sold in another manner does not make the purchase exempt if sold through a vending machine.

(2) All food items sold with eating utensils provided by the seller are taxable. Food shall be considered to be sold with eating utensils provided by the seller when the food is intended for consumption with the utensils provided. Taxable food therefore includes all food sold by an eating establishment that sells meals, sandwiches, or other food for consumption on or off the premises. Additionally, taxable food includes self-service food such as salad bars or drink islands. The presence of self-service utensils in a facility does not make otherwise exempt food taxable unless it is intended that the food be consumed with those utensils. Further, items provided solely pursuant to sanitary statutes or regulations and not for purposes of consumption do not qualify as utensils.

(3) All food items sold in a heated state are taxable. Food is also taxable if it was heated by the seller and is ready to eat without further cooking by the purchaser.

(4) Where 2 or more food ingredients are mixed or combined by the seller and then sold as a single food item, this item is taxable unless:

(a) the item is both sold in an unheated state by weight or volume as a single item and is sold without eating utensils, e.g., potato salad; or

(b) the item sold represents food that is only cut, repackaged, or pasteurized by the seller, e.g., vegetable trays; or

(c) the item sold contains raw animal foods that require cooking.

(5) Bakery items are not taxable unless they are:

(a) sold through a vending machine; or

(b) sold with eating utensils provided by the seller; or

(c) sold in a heated state.

(6) Food items sold by a seller whose proper primary NAICS classification is 311 food manufacturing (except subsector 3118, bakeries) are not taxable unless they are:

(a) sold through a vending machine; or

(b) sold with eating utensils provided by the seller; or

(d) sold in a heated state.

E. Unitary Transactions

When a taxable item is sold with a non-taxable item for a single price the entire purchase amount is subject to sales tax. If such items are separately priced and charged on the receipt, then only the amount charged for the taxable item is subject to sales tax.

III. Coupons, Redemption Certificates, and Bottle Deposits

Coupons or redemption certificates received by the seller as payment or partial payment of merchandise are considered as cash if such coupons are redeemable to the seller and were not extended by the seller.

Charges for bottle deposits are not subject to sales tax and should be removed from the total on which sales tax is computed. The refund of bottle deposits are not deductible when computing taxable receipts.

IV. Purchases by Retailers

Purchases by the retailer of merchandise for resale and material for non-returnable packaging of merchandise sold is exempt from sales tax.

Gifts and premiums given by a retailer are not purchases for resale and such items are subject to the sales tax when purchased by the retailers. The retailer cannot purchase cash registers, equipment cleaning supplies, cash register tapes, sales tickets and other similar items exempt since the retailer is the final consumer of these items. The retail merchant must pay sales tax on all such items. Sales of merchandise to employees are subject to sales tax on the full final sales price.

V. Registration and Record Keeping Requirements

All grocers and other general merchandise retailers are required to file an application for a registered retail merchant's certificate for each location. Upon application with the Department of Revenue and the payment of a twenty-five dollar ($25.00) fee, a permanent certificate will be issued which must be displayed on the premises at all times.

Indiana retail merchants are required to keep adequate books and records for both taxable and non-taxable sales for a period of three (3) years, plus the current year.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #47
SALES TAX
JULY 2005
(Replaces Information Bulletin #47 dated January 2003)

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

SUBJECT: Auto Rental Excise Tax and Marion County Supplemental Auto Rental Excise Tax

REFERENCES: IC 6-6-9; IC 6-6-9.7

I. Auto Rental Excise Tax

An excise tax known as the auto rental excise tax, is imposed on rentals of passenger motor vehicles and trucks for periods of less than 30 days. The rental of a trailer is not subject to this tax. The tax is equal to 4% of the gross retail income received by the retail merchant. The person renting the vehicle is liable for the tax. The retail merchant is required to collect the tax and remit it to the Department of Revenue. The tax must be separately stated from the amount paid for the rental. Trucks which have a declared gross weight of over 11,000 pounds are exempt. The rental of a passenger motor vehicle or truck by a funeral director is exempt from the auto rental excise tax if the rental is part of the services provided by the director for a funeral.

Example: Mr. X rents a passenger motor vehicle (auto) for 10 days in August and returns the auto; then rents the same auto or another auto for 20 days in September. Both transactions are separate and each is taxable. The rental must be for 30 consecutive days, not 30 total days, in order to be exempt.

A separate return must be filed for each business location. Consolidated reporting is not allowed as each location's tax collections are to be credited to the location's taxing district. A monthly return must be filed even though no tax is due.

II. Marion County Supplemental Auto Rental Excise Tax

Marion County is authorized to impose a supplemental auto rental excise tax on the rental of passenger motor vehicles and trucks in the county for periods of less than thirty (30) days. The tax is imposed at four percent (4%) of the gross retail income derived from the rental.

Trucks exceeding a gross weight of eleven thousand (11,000) pounds are exempt from the tax. The rental of a passenger motor vehicle or truck by a funeral director is exempt from tax if the rental is part of the services provided by the director for a funeral. The temporary rental of a passenger vehicle or truck is exempt if the rental is made or reimbursed under a contract for mechanical breakdown insurance, automobile collision insurance, or provided while repair work is completed.

The original supplemental auto rental excise tax imposed at two percent (2%) expires on December 31, 2027. The additional two percent (2%) rate expires on December 31, 2040. All revenue collected from the tax shall be distributed monthly to the capital improvement board of managers operating in Indianapolis.

The return filed by the retail merchant must separate the amount of taxes collected at each location.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #67
SALES TAX
JULY 2005
(Replaces Bulletin #67 dated January 2003)

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

SUBJECT: Professional Racing Team Engines and Chassis

REFERENCES: IC 6-2.5-5-37

INTRODUCTION:

Transactions involving the purchase, lease or operation of any part of a racing vehicle by professional racing teams in Indiana are exempt from Indiana sales and use tax. This includes replacement and rebuilding parts or components for, and part of, a racing vehicle. Tires and accessories are not eligible for the sales and use tax exemption.

DEFINITIONS:

For purposes of IC 6-2.5-5-37:

Professional Racing Teams are those racing operations qualified to file under the Internal Revenue Code as a for-profit business. To qualify as a trade or business under IRS regulations, a taxpayer must be involved in the activity with continuity and regularity, and the taxpayer's primary purpose for engaging in the activity must be for income or profit. A sporadic activity, a hobby, or an amusement diversion does not qualify.

Engines are engines of vehicles intended for use in competition by the professional racing teams which purchase, lease, or operate the engines.

Chassis are chassis of vehicles intended for use in competition by the professional racing teams which purchase, lease, or operate the chassis. For purposes of this exemption, chassis does not include tires or accessories.

Tires are tires of vehicles intended for use in competition by the professional racing teams which purchase, lease, or operate the tires. Tires include tubes and exclude wheels.

Accessories includes instrumentation, telemetry, consumables and paint.

Chassis, engines, and their components combined are a complete racing vehicle minus the tires and accessories. Therefore, a racing vehicle purchased by a professional racing team is exempt from Indiana sales and use except for the tires and accessories. Tires and accessories purchased by professional racing teams for any purpose are subject to Indiana sales and use tax.

Exemption Procedure

Indiana based racing teams wishing to purchase items exempt pursuant to this exemption must register as a retail merchant with the Department by completing a business tax application (BT-1). A Taxpayer Identification Number (TID#) will be issued which the race team may use on a ST-105 exemption certificate.

A race team not located (based) in Indiana, which is already registered in its home state, may issue an Indiana exemption ST-105 by using its home state business tax identification number.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #91
INCOME TAX
JULY 2005
(Replaces Bulletin #91, dated August 2004)

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

SUBJECT: Biodiesel Tax Credits

REFERENCES: IC 6-3.1-27

INTRODUCTION

SEA 378-2005, amended provisions concerning the biodiesel tax credits. These changes are effective retroactive to January 1, 2005. There are three separate tax credits related to biodiesel. The first is a credit for producing biodiesel; the second credit is for producing blended biodiesel; and the third is for the retail sale of blended biodiesel to an end user. The credits can be applied against the sales tax, the adjusted gross income tax, the financial institutions tax, and the insurance premiums tax.

I. BIODIESEL PRODUCTION TAX CREDIT

Biodiesel is defined as a renewable, biodegradable, mono alkyl ester combustible liquid fuel derived from agricultural plant oils or animal fats that meets American Society for Testing and Materials specification D6751-02 for biodiesel fuel (B100) blend stock distillate fuels.

A taxpayer that has been certified by the Indiana Economic Development Corporation (IEDC), and produces biodiesel at a facility located in Indiana is entitled to a credit against the taxpayer's state tax liability equal to the product of one dollar ($1.00) multiplied by the number of gallons of biodiesel produced by the taxpayer during the taxable year and used to produce blended biodiesel.

The total amount of credits allowed may not exceed three million dollars ($3,000,000) for a taxpayer for all taxable years. This amount may be increased to five million dollars ($5,000,000) with the prior approval of the IEDC.

II. BLENDED BIODIESEL TAX CREDIT

Blended biodiesel is defined as a blend of biodiesel with petroleum diesel, so that the percentage of biodiesel in the blend is at least two percent (2%) (B2 or greater). The term does not include biodiesel (B100).

A taxpayer that has been certified by the IEDC, and produces blended biodiesel at a facility located in Indiana is entitled to a credit against the taxpayer's state tax liability equal to the product of two cents ($.02) multiplied by the number of gallons of blended biodiesel produced at the Indiana facility and blended with Indiana produced biodiesel.

The total amount of credits allowed may not exceed three million dollars ($3,000,000) for all taxpayers and all taxable years.

III. RETAIL SALE OF BLENDED BIODIESEL TAX CREDIT

A taxpayer that is a dealer and distributes at retail blended biodiesel is entitled to a credit against the taxpayer's state tax liability.

The credit allowed is one cent ($.01) multiplied by the number of gallons of blended biodiesel distributed at retail by the taxpayer in a taxable year.

The total amount of credits allowed may not exceed one million dollars ($1,000,000) for all taxpayers and all taxable years. A credit may not be taken for blended biodiesel distributed at retail after December 31, 2006.

IV. APPLICATION FORM AND APPROVAL OF THE TAX CREDIT

Taxpayers desiring to claim one of the three credits must file a claim for credit on Form BD-100 Biodiesel Credit Application which is available at the Department's web site (www.in.gov/dor/taxforms/f&eforms).

Taxpayers desiring to claim the credit for biodiesel production or for blending biodiesel must attach a copy of the certification from the IEDC. Retailers selling to end users are not required to be certified by the IEDC. The claim for credit must be completed by the taxpayer and filed with the Department for approval. The approved claim will be returned to the applicant. A copy of the approved claim and certification from the IEDC must be attached to any tax return on which the credit is taken. The application and claim can be filed on a monthly, quarterly, semi-annual or annual basis depending on which tax type the taxpayer is claiming the credit for and the filing frequency of the return for the type of tax. Failure to submit the approved BD-100 with the tax return will result in the claim being denied by the Department.

V. ADMINISTRATION OF THE TAX CREDITS

Qualifying taxpayers include pass through entities such as S Corporations, partnerships, limited liability companies, and limited liability partnerships. If the pass through entity is entitled to a credit but does not have state tax liability to which the credit can be applied, a shareholder, partner, or member of the pass through entity is entitled to the credit in the same percentage as the person's distributive income to which the person is entitled.

If the credit is applied against the taxpayer's adjusted gross income tax, financial institutions tax, or insurance premiums tax, the credit shall be taken on the annual return filed by the taxpayer. If the credit is to be applied against a taxpayer's sales tax liability, the credit can be taken on a monthly basis. A taxpayer may not take a credit against sales tax collected as a retail merchant, but may take a credit against the use tax due on the taxpayer's taxable purchases.

If the credit claimed exceeds the taxpayer's state tax liability for the taxable year, the taxpayer may carry over the excess credit to the following taxable years. A credit may be carried forward for up to six (6) taxable years following the taxable year in which the taxpayer was first entitled to claim the credit. The taxpayer is not entitled to a refund or carryback of any unused credits.

The total amount of credits allowed for biodiesel production, biodiesel blending, and ethanol production may not exceed twenty million dollars ($20,000,000) for all taxpayers and all taxable years. The IEDC shall determine the maximum amount for each type of credit, but the amount must be at least four million ($4,000,000) for each credit.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN # 92
INCOME TAX
JULY 2005
(Replaces Bulletin #92 dated August 2004)

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

SUBJECT: Individual Earned Income Tax Credit (EITC) Procedures
REFERENCES: IC 6-3-4-8; IC 6-3.1-21
INTRODUCTION:

The Indiana earned income tax credit is effective until December 31, 2011. The statute requires the Department to allow an advance payment of the earned income tax credit through reduced income tax withholdings.

I. CALCULATION OF THE EARNED INCOME CREDIT

An individual is eligible for the Indiana earned income tax credit if the person is eligible for the federal earned income tax credit under Section 32 of the Internal Revenue Code. The Indiana credit amount is equal to six percent (6%) of the amount of federal earned income tax credit that the individual is eligible to receive and claim for the taxable year.

If the credit amount exceeds the taxpayer's actual tax liability for the taxable year, the excess credit shall be refunded to the taxpayer.

II. CALCULATION OF ADVANCE EARNED INCOME CREDIT PAYMENTS

An employee subject to withholding of Indiana adjusted gross income tax may request his/her employer to reduce the amount of adjusted gross income tax withheld as an advance payment of the Indiana earned income tax credit.

To qualify for the advance earned income tax credit payment, the individual must be an Indiana resident, have a federal Form W-5 on file with the employer, and receive federal advance earned income tax credit payments from his/her employer.

To request an Indiana advance earned income tax credit payment, the employee must complete and sign Form WH-5, which the employer is required to maintain for three (3) years after the year that the form is completed by the employee.

The employer shall advance to the employee six percent (6%) of the federal advance earned income tax credit payment, but is not required to advance the credit payment if the amount is less than one dollar ($1) per pay period.

III. REPORTING OF ADVANCE EARNED INCOME TAX PAYMENT AMOUNTS BY THE EMPLOYER

The total amount that the employer advances to all employees shall be reported when the employer remits the Indiana adjusted gross income tax withheld. The advance shall be deducted from the total tax withheld for all employees when calculating the net remittance that the employer is required to remit to the Department.

The total annual amount that the employer advances for the earned income tax credit payments will be reported on the Form WH-3, Annual Withholding Tax Reconciliation Return.

The total amount advanced to individual employees will be shown on the Form W-2 Wage and Tax Statement in the box directly beneath box 19, with 'INADV' directly beneath box 20.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
INFORMATION BULLETIN #93
INCOME TAX
JULY 2005
(Replaces Bulletin #93, dated August 2004)

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

SUBJECT: Ethanol Production Tax Credit
REFERENCES: IC 6-3.1-28
INTRODUCTION

There is a tax credit for ethanol production. The credit can be applied against the sales tax, the adjusted gross income tax, the financial institutions tax, and the insurance premiums tax.

I. ETHANOL PRODUCTION TAX CREDIT

Ethanol is defined as agriculturally derived ethyl alcohol. A taxpayer that produces ethanol at a facility located in Indiana that has the capacity to produce at least forty million (40,000,000) gallons of ethanol a year or which after December 31, 2003 increased its ethanol production capacity by at least forty million (40,000,000) gallons per year, may qualify for the credit.

A taxpayer that produces ethanol is entitled to a credit against the taxpayer's state tax liability equal to the product of twelve and one-half cents ($.125) multiplied by the number of gallons of ethanol produced at the Indiana facility.

The total amount of credits allowed per taxpayer may not exceed a total of three million dollars ($3,000,000) for all taxable years. This total can be increased to five million dollars ($5,000,000) for all taxable years with the prior approval of the Indiana Economic Development Corporation. The total credits awarded for biodiesel production, blended biodiesel production and ethanol production may not exceed twenty million dollars ($20,000,000).

II. ADMINISTRATION OF THE TAX CREDIT

Taxpayers desiring to claim the ethanol production tax credit must file a copy of the Indiana Economic Development Corporation's certificate finding that the taxpayer is eligible for the credit.

III. PASS THROUGH ENTITIES

Qualifying taxpayers include pass through entities such as S Corporations, partnerships, limited liability companies, and limited liability partnerships. If the pass through entity is entitled to a credit, but does not have state tax liability to which the credit can be applied, a shareholder, partner, or member of the pass through entity is entitled to the credit in the same percentage as the person's distributive income to which the person is entitled.

IV. CLAIMING THE CREDIT

If the credit is applied against the taxpayer's adjusted gross income tax, financial institutions tax, or insurance premiums tax, the credit shall be taken on the annual return filed by the taxpayer. If the credit is applied against a taxpayer's sales tax liability, the taxpayer is required to obtain a direct pay permit in accordance with IC 6-2.5-8-9. A taxpayer may not take a credit against sales tax collected as a retail merchant, but may take a credit against use tax due on its taxable purchases.

If the credit claimed exceeds the taxpayer's state tax liability for the taxable year, the taxpayer may carry over the excess to the succeeding taxable years. The taxpayer is not entitled to a refund or carryback of any unused credits.

John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE

04990062.LOF

LETTER OF FINDINGS NUMBER: 99-0062
Sales and Use Tax
For the Tax Period 1995-1997

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

ISSUES

1. Sales and Use Tax- Imposition of Use Tax on Grating

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-3-2 (a), IC 6-2.5-5-2-IC 6-2.5-5-3 (b), 45 IAC 2.2-5-10(c),*Gross IncomeTax Division v.National Bank and Trust Co.,* 79 N.E. 2d 651(Ind. 1948), *Indiana Department of Revenue v. American Dairy of Evansville, Inc.*, 338 N.E. 2d 698, (Ind. App. 1975), *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983).

The taxpayer protests the assessment of use tax on grating.

2. Sales and Use Tax-Imposition of Use Tax on Applied Air System

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-3 (b), 45 IAC 2.2-5-8(c), 45 IAC 2.2-5-8(g).

The taxpayer protests the imposition of use tax on an applied air system.

3. Sales and Use Tax-Imposition of Use Tax on Scale

Authority: IC 6-2.5-5-3 (b), 45 IAC 2.2-5-10(d),

The taxpayer protests the imposition of use tax on a scale.

4. Sales and Use Tax-Refund Items

Authority: IC 6-2.5-3-2(a), IC 6-8.1-9-1(a), IC 6-8.1-5-4.

The taxpayer protests the disallowance of certain refund claims.

5. Sales and Use Tax-Imposition of Use Tax on Decals

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-27,

The taxpayer protests the assessment of use tax on decals.

6. Sales and Use Tax-Imposition of Use Tax on Exhaust and Wall Fans.

Authority: IC 6-2.5-3-2(a), IC 6-2.5-5-3(b), 45 IAC 2.2-5-8(c)(4)(B).

The taxpayer protests the imposition of use tax on exhaust and wall fans.

7. Sales and Use Tax-Imposition of Use Tax on Equipment Purchased from Reeder Heating

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-3 (b).

The taxpayer protests the assessment of use tax on an item purchased from Reeder Heating.

8. Tax Administration-Imposition of 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 that processes food products. After an audit for the tax period 1995-1997, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional use tax, interest, and penalty. The taxpayer agreed with some of the assessed items and protested the remainder of the assessment. A hearing was held and this Letter of Findings results.

1. Sales and Use Tax- Imposition of Use Tax on Grating

DISCUSSION

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

Indiana imposes an excise tax, the use tax, on tangible personal property purchased in a retail transaction and stored, used, or consumed in Indiana if sales tax was not paid at the time of purchase. IC 6-2.5-3-2 (a). In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520*,* (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production.

There are a number of exemptions from the use tax pursuant to the statute. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.,* 79 N.E. 2d 651 (Ind. 1948).

The taxpayer contends that many items, including the bar grating, qualify for exemption pursuant to one of two statutory provisions. First, the items qualify pursuant to the following provisions of IC 6-2.5-5-2 (a):

> Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.
>
> The taxpayer argues that the items could also qualify for exemption pursuant to the following provisions of IC 6-2.5-5-3 (b):
>
> Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining; or finishing of other tangible personal property.

Both exemptions share the basic elements that the item must be "directly used in direct production". Therefore, the Indiana Court of Appeals found in *Indiana Department of Revenue v. American Dairy of Evansville, Inc.*, 338 N.E. 2d 698, (Ind. App. 1975) that the court cases and interpretations of the manufacturing exemption also apply to the agricultural production exemption.

The taxpayer's first protest concern's the department's assessment of use tax on bar grating that is part of the foundation of the tomato dock. The taxpayer contends that this bar grating is part of the exempt equipment used to unload and clean the fresh tomatoes. The bar grating does not, however, have an immediate effect upon the processing of the tomatoes. It would be possible to clean the tomatoes without the bar grating. Rather, the bar grating allows superfluous water, dirt, and cleaning agents to leave the cleaning area. This use does not qualify the bar grating for exemption from the use tax.

FINDING

The taxpayer's protest to the assessment of use tax on the bar grating is denied.

2. Sales and Use Tax-Imposition of Use Tax on Applied Air System

DISCUSSION

The taxpayer also protests the imposition of use tax on an applied air system pursuant to IC 6-2.5-3-2 (a). The taxpayer contends that this system is directly used in the direct production of its product and qualifies for exemption found at IC 6-2.5-5-3 (b).

This air system is used to maintain the temperature in a storage area where cans of product are stored. The taxpayer contends that the air system is necessary to preserve the integrity of the product. Approximately sixty per cent (60%) of the cans stored in the area with the subject air system are unlabeled. If the temperature were to drop too low in the storage area, water would condense on the unlabeled cans, causing the cans to rust. The taxpayer claims that it can not sell rusted cans.

The taxpayer's product is tomatoes and tomato products. The taxpayer packages those products in cans. For the air system to qualify for exemption it must be directly used in the direct production of the tomato products. Pursuant to 45 IAC 2.2-5-8(c) it must have "an immediate effect on the article being produced." This requirement is further described at 45 IAC 2.2-5-8(g), which states:

> "Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax.... The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not in itself mean that the property "has an immediate effect upon the article being produced:. Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

The air system is not functionally interrelated with the processing of tomatoes and tomato products. The air system affects the cans, the packaging of the taxpayer's product rather than the product itself. Anything done to affect the cans is done outside the direct production process of producing tomato products. Since the air system affects the cans rather than the tomato products, it is not directly used in the direct production of tomato products. The air system does not qualify for exemption.

FINDING

The taxpayer's protest is denied.

3. Sales and Use Tax-Imposition of Use Tax on Scale

DISCUSSION

The taxpayer also protests the assessment of use tax pursuant to IC 6-2.5-3-2 (a) on a scale that weighs the produce prior to the cleaning of the tomatoes. Immediately after arriving at the processing facility, the truck loaded with tomatoes drives onto this scale to be weighed. Then the weight of the truck is deducted from the total weight to determine the weight of tomatoes in that delivery. The taxpayer argues that the scale is directly used in the direct production of tomato products and therefore qualifies for exemption from the use tax pursuant to the directly used in direct production manufacturing exemption found at IC 6-2.5-5-3 (b)

To qualify for this exemption, the scale must be used during the production process. The standard for determining the parameters of the direct production process are found at 45 IAC 2.2-5-10(d), which states:

> Pre-processing and post-processing activities. "Direct use" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the processing or refining has altered the item to its completed form, including packaging, if required.
>
> > (1) The production of pharmaceutical items is accomplished by a process which begins with weighing and measuring out appropriate ingredients, continues with combining and otherwise treating the ingredients, and ends with packaging the items. Equipment used to transport raw materials to the manufacturing plant is employed prior to the first operation or activity constituting part of the integrated production process and is taxable. Weighing and measuring equipment and all equipment used as essential and integral part of the subsequent manufacturing steps, through packaging, qualify for exemption.

The taxpayer contends that it uses the subject scale in the same exempt manner as the scale in the example. The department disagrees with the taxpayer's comparison of the subject scale and the scale in the example. The scale in the example combines weighing and measuring in one step, the first step of the production process. Therefore, the use of the scale in the example is integral and essential to the process of manufacturing pharmaceuticals. The taxpayer's scale is not used for specific and precise measurements of ingredients in the taxpayer's production process. It is not an integrated system to weigh and measure. Rather, the subject scale is used to weigh all the tomatoes in the truck prior to the first step in the production process, the cleaning of the tomatoes. The scale does not measure the tomatoes other than determining the gross weight. The taxpayer's use of the scale is more analogous to a scale to weigh the total amount of a chemical raw material at the time of its delivery to the plant prior to the precise weighing and measuring which starts the process of producing pharmaceuticals. A scale used at a pharmaceutical company in the same manner as the taxpayer's scale is used would also be taxable.

FINDING

The taxpayer's protest to the tax assessed on the scale is denied.

4. Sales and Use Tax-Refund Items

DISCUSSION

Pursuant to IC 6-8.1-9-1(a), the taxpayer claimed refunds of use taxes paid on several items. The taxpayer also contended that it presented several items such as pest control and boiler parts to the department for exemption that were not found to be exempt in the final assessment.

The taxpayer filed two separate and frequently overlapping refund claims for the same years as the audit. The taxpayer also had one employee make the original use tax accrual decision and then, in the numerous cases where the deciding employee's supervisor disagreed with the decision, the supervisor would claim a credit against the use tax accrual for a later month. Review of the taxpayer's records indicated that there were numerous items that were claimed more than once and several items where credit was claimed three times.

The taxpayer has the responsibility to keep adequate records to substantiate its claims pursuant to IC 6-8.1-5-4. The taxpayer was unable to offer adequate documentation to sustain its burden of proving that the refunds were improperly denied.

FINDING

The taxpayer's protest is denied.

5. Sales and Use Tax-Imposition of Use Tax on Decals

DISCUSSION

The taxpayer also protests the assessment of use tax on decals applied to trucks owned by a related transportation company.

The decals are placed on the bodies of tractor-trailers belonging to the taxpayer's dedicated common carrier. The decals are colorful, conspicuous, and expensive. They contain pictures, the taxpayer's name and the required common carrier number.

Pursuant to IC 6-2.5-3-2 (a), the use of the decals is subject to use tax unless the use qualifies for a statutory exemption. The taxpayer contends that the use of these decals qualifies for exemption pursuant to the following provisions of IC 6-2.5-5-27:

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

The taxpayer ordered these decals. The invoices indicate that the decals were billed to the taxpayer. The taxpayer's books and records indicate that the taxpayer paid for the decals and charged them to advertising expense. The journal entry indicating that the related transportation corporation later reimbursed the taxpayer for the purchase of the decals does not change the reality that the actual transaction was between the taxpayer and seller of the decals. The taxpayer purchased the decals without paying sales tax on the transaction. The taxpayer used the decals by placing them on the related corporation's trucks and benefited from the advertising and deliveries. The taxpayer did not use or consume the decals in the providing of public transportation for its products. Whether or not the related corporation could purchase the decals exempt is irrelevant. The taxpayer and the related corporation enjoy many benefits by being separate corporations. They must also assume the liabilities associated with being separate corporations. The taxpayer's use of the decals does not qualify for the public transportation exemption.

FINDING

The taxpayer's protest is denied.

6. Sales and Use Tax-Imposition of Use Tax on Exhaust and Wall Fans.

DISCUSSION

The taxpayer also protests the department's assessment of use tax on exhaust and wall fans pursuant to IC 6-2.5-3-2(a). The taxpayer contends that these exhaust and wall fans qualify for the directly used in direct production exemption pursuant to IC 6-2.5-5-3(b).

The exhaust and wall fans are used in various areas where the processing of the product causes significant heat. The taxpayer contends that OSHA requires the fans and the employees could not work without them. Therefore, they qualify for exemption as essential and integral to the production process.

The department disagrees. Pursuant to 45 IAC 2.2-5-8(c)(4)(B), the department has consistently denied the exemption of exhaust and wall fans since they are used for the employees' comfort and well being. They are not integral and essential to the production process.

The taxpayer also protests that one imposition of use tax was actually on a service fee paid to the installer of the fan. Pursuant to the provisions of IC 6-2.5-3-2(a) the use tax is only imposed on the use of tangible personal property, not services except in certain specifically defined instances. The invoice stated that the cost was for "mark-up" on the cost of the equipment. That "mark-up" is part of the fan's price. The use tax is computed on the price of the tangible personal property sold. The taxpayer failed to prove that the imposition was actually on a service associated with installing the fan rather than the cost of the fan. Therefore, the disputed amount of the "mark-up" is taxable.

FINDING

The taxpayer's protest is denied.

7. Sales and Use Tax-Imposition of Use Tax on Air Conditioning System

DISCUSSION

Pursuant to IC 6-2.5-3-2(a), the department assessed use tax on an air conditioning system. The taxpayer contends that this equipment acted as an air filtration system that qualified for the directly used in direct production equipment exemption pursuant to IC 6-2.5-5-3(b).

The equipment was installed in the area where catsup is put into clear plastic bottles. The temperature in this area is not high enough to kill germs. Therefore, the taxpayer argued that it needed to install the air conditioning system to create a clean, aseptic environment to filter out contaminating particles and bacteria.

The taxpayer did not provide sufficient documentation to substantiate its claim that the catsup bottling area was a clean room with all air flowing in and out through the subject air system. Although the system may retard the growth of bacteria, there was no evidence that it meets the standards of an air filtration system for a clean room. The air conditioning system provides for the comfort and well being of the employees. It is subject to the use tax.

FINDING

The taxpayer's protest is denied.

8. Tax Administration-Imposition of 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.

During the tax period, the taxpayer purchased without paying the sales or use tax on many clearly taxable items such as magazine subscriptions, filing cabinets, books, business cards, and office supplies. These breaches of the taxpayer's duty constitute negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990183.LOF

LETTER OF FINDINGS NUMBER: 99-0183
Withholding Tax and Sales Tax
Responsible Officer
For the Tax Period August 1, 1992-December 31, 1994

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 Use and Withholding Tax-Responsible Officer Liability

Authority: IC 6-3-4-8(f), 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 and withholding taxes.

STATEMENT OF FACTS

The taxpayer was an incorporator, shareholder, and officer of a corporation that did not remit the proper amount of sales and withholding taxes to Indiana for the tax period August 1, 1992-December 31, 1994. The taxpayer was personally assessed for the taxes, penalties and interest. The taxpayer protested these assessments and a hearing was scheduled. The taxpayer did not appear for the hearing. This Letter of Findings was based upon the information in the file.

1. Sales and Withholding Tax-Responsible Officer Liability

DISCUSSION

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."

Indiana Department of Revenue assessments are prima facie evidence that the taxes are owed by the taxpayer who has the burden of proving that assessment is incorrect. IC 6-8.1-5-1 (b).

The issue to be determined in this case is whether or not the taxpayer was a person who was responsible for remitting the corporate trust taxes to the Indiana Department of Revenue. The taxpayer failed to appear at the scheduled hearing or send in any documentation other than a personal letter indicating that he did not think he was personally responsible for remitting the corporate trust tax liabilities to the state. This letter is inadequate to overcome the presumption that the tax assessment is correct. Therefore, the taxpayer failed to sustain his burden of proving that the trust taxes were incorrectly assessed against him personally.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01990467.LOF

LETTER OF FINDINGS NUMBER: 99-0467
INDIVIDUAL INCOME TAX
For the years 1996, 1997, and 1998

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

ISSUE

I. Individual Income Tax—Assessment of Unreported Indiana Income

Authority: IC 6-8.1-5-1(b); IC 6-3-2-1(a); IC 6-3-2-2(a).

Taxpayer protests the assessment of income tax on income earned in Indiana.

STATEMENT OF FACTS

Taxpayer, a nonresident, is the sole shareholder of an S-corporation that does landscape architecture and installs plants and construction materials. The business did contract landscaping in Indiana. Taxpayer did not file Indiana income tax returns for the income earned in Indiana during the years at issue. The Department conducted an audit of the business and issued income tax assessments against Taxpayer. Taxpayer filed a protest and a hearing was scheduled for April 12, 2005. Taxpayer was sent a letter by first class United States mail notifying her of the hearing date. Taxpayer did not appear before the Department at the hearing. This letter of findings is written based upon the information contained within the case file.

I. Individual Income Tax—Assessment of Unreported Indiana Income

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 6-3-2-1(a) imposes an income tax on nonresidents on the adjusted gross income derived from sources within Indiana. IC 6-3-2-2(a) defines "adjusted gross income derived from sources within Indiana" to mean and include income from doing business in Indiana as well as income from a trade or profession conducted in Indiana. It also includes compensation for labor or services rendered within Indiana, and income from intangible personal property if the receipt from the intangible is attributable to Indiana. The business in which Taxpayer is a sole shareholder did business in Indiana and earned income in Indiana; it did contract landscaping in Indiana. Taxpayer is required to declare and pay income tax on that Indiana income that passed through to her.

FINDING

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

DEPARTMENT OF STATE REVENUE

02-990468.LOF

LETTER OF FINDINGS NUMBER: 99-0468
Corporate Income Tax
For the Years 1990-1995

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.

ISSUE

I. Gross Income Tax—Calculation of Sales Receipts

Authority: IC 6-8.1-5-1(b); IC 6-8.1-5-1(a); IC 6-2.1-1-2; IC 6-2.1-1-11; IC 6-2.1-1-13; IC 6-2.1-2-2; IC 6-2.1-3-3.

Taxpayer protests the calculation of Indiana sales receipts.

STATEMENT OF FACTS

Taxpayer is a wholly-owned domestic subsidiary of a foreign parent company located outside the United States. Taxpayer is a general trading company whose business is to import and export goods and services among countries around the world. One enterprise operated by Taxpayer is the sale of consumer batteries in the United States and Canada. To facilitate the sale of its batteries, Taxpayer has entered into a consignment agreement with Consignee. Consignee is responsible for the distribution and marketing of the consumer batteries.

Taxpayer purchases batteries from manufacturers in Hong Kong, Korea, and Taiwan; pays the manufacturers; arranges for export, transit, customs clearance, and initial delivery to Consignee. Taxpayer owns warehouses in the United States and Canada.

One of the warehouses is located in Indiana. Consignee uses Taxpayer's warehouses to store and distribute the batteries. Batteries purchased in Hong Kong are delivered to the Indiana warehouse. Batteries purchased in Korea and Taiwan are delivered to Taxpayer's facility in California for packaging.

All delivered batteries are received into Consignee's Inventory Control System for tracking. Consignee is required to submit to Taxpayer various reports tracking inventory, sales, and returns of product. Taxpayer retains title to the batteries until Consignee disposes the inventory—through sales, returns, damage, or loss. Taxpayer records all deliveries of inventory to Consignee as having occurred in Indiana—despite the fact that inventories were delivered to various warehouses throughout the United States and Canada. Consignee is responsible for tracking the ultimate disposal of inventory; all Taxpayer tracks is the delivery of the inventories into the hands of Consignee for marketing and sale.

The Department did an assessment based on the best information available—a BIA assessment. The parties dispute the amount of sales subject to Indiana Gross Income tax. Taxpayer believes that the Department has overstated Taxpayer's Indiana sales. The Department had assessed gross income tax on a proportion of the inventory actually held by the Consignee in the Indiana warehouse. Taxpayer contended that despite the fact that it records all inventories as passing into Consignee's control in Indiana, only a portion of the inventory is disposed in Indiana—making the Gross Income Tax calculation less than all the inventory held by Consignee.

I. Gross Income Tax—Calculation of Sales Receipts

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 6-8.1-5-1(a) permits the Department to make an assessment of taxes based on the best information available. Taxpayer stated at the hearing that documents from nearly 10 years ago related to the sales from it to Consignee have been difficult to obtain, explaining that for its purposes, Taxpayer does not track the domestic movement of the goods; the recording of all inventory passing into the control of Consignee in Indiana is convenient because it allows Taxpayer to record the gross transfer of inventory. The details of distribution are the concern of Consignee. Taxpayer further explained that because title to the goods does not pass from Taxpayer to the customer until sold, the breakout report of sales is the most indicative of its gross income in Indiana.

The gross income tax, which has been repealed, defined gross income as all gross receipts a taxpayer receives. *See* IC 6-2.1-1-2 [repealed]. IC 6-2.1-1-11 [repealed] defined "receives" to mean the possession of income and the payment of a taxpayer's expense. IC 6-2.1-1-13 [repealed], defined "taxable gross income" as the remainder of income after exemptions and deductions. IC 6-2.1-2-2 [repealed] imposed the gross income tax on the entire gross income of a taxpayer who is a resident or domiciliary of Indiana and the taxable gross income derived from activities, businesses, or any other sources within Indiana by a taxpayer who is not a resident or domiciliary of Indiana.

Taxpayer does not contend it owes no gross income tax; the issue is how much it owes. IC 6-2.1-3-3 [repealed] exempted from taxation, income derived from business conducted in interstate commerce. Given that Taxpayer owned warehouses across the United States and Canada, and given that Taxpayer held title of the goods until it was sold to the end consumer, Taxpayer is liable for sales made in Indiana. The issue arises as to the reliability of Taxpayer's documentation of those sales.

Taxpayer conceded that Consignee maintained the documentation of transfers of inventory between the warehouses and the documentation of sales. Because IC 6-8.1-5-1(b) presumes that the Department's assessment is accurate, Taxpayer has the burden to show the inaccuracies of that assessment. Taxpayer stated at the hearing that Consignee maintained a breakout report of the sales made in the different states. At the hearing, Taxpayer presented to the Department a listing of states in which income tax returns were filed and next to the state name was a percent—representing the percentage of national sales made in that state. The worksheet did not list all states in the United States. Only a percentage of sales for each of those states was listed; no supporting documentation to demonstrate how the percentages were calculated was provided to the Department. The worksheet stated that the average percentage of overall sales made to Indiana customers for 1993, 1994, 1995, and 1996 was 3.178%. That average was calculated by Taxpayer from these yearly representations of sales in Indiana: 1993, 3.265%; 1994, 3.394%; 1995, 3.092%; and 1996, 2.959%. Taxpayer states that it had problems receiving records from Consignee to document 1990, 1991, and 1992. The information presented by Taxpayer to the Department has been considered but the Department does not find the evidence to be reliable and credible—because the percentages are mere statements not supported by documents to substantiate the calculations.

The Department did an assessment based on best information available. The audit report calculated an estimated annual turnover of inventory of 3.5 times. Taxpayer agreed at the hearing to the calculation. The audit report calculated estimated sales subject to gross income tax of $7,733,313 for 1993; $6,466,194 for 1994; and $6,058,574 for 1995. Taxpayer agreed at the hearing to those calculations. The assessments were based on the total sales made to Consignee and the breakout percentage of sales made to Indiana customers; the assessment amounts are supported. Taxpayer has not provided credible evidence to rebut the assessment amounts.

FINDING

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

DEPARTMENT OF STATE REVENUE

02-20020450.LOF

LETTER OF FINDINGS NUMBER: 02-0450
ADJUSTED GROSS INCOME TAX PENALTY
For Year 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 – Penalty Waiver

Authority: IC 6-8.1-10-2.1; 45 IAC15-11-2

Taxpayer protests the assessment of penalty related to an audit assessment.

STATEMENT OF FACTS

Taxpayer was assessed adjusted gross income tax as a result of a department audit. The audit was hindered by taxpayer's poor records and taxpayer's refusal to sign for an extension of time for the auditor to complete the audit. As a result of these factors, the auditor prepared a best information available estimate of taxpayer's liability. Taxpayer then requested and cooperated on a supplemental audit that reduced the original assessment, but included a penalty based on taxpayer's poor records and errors in its preparation of its Indiana return. Taxpayer paid the assessment but protested the penalty assessment.

I. Adjusted Gross Income Tax – Penalty Waiver

DISCUSSION

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

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

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

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

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case. 45 IAC 15-11-2.

Taxpayer argues that the penalty should be waived because the company's deficiency was due to reasonable cause and not due to willful neglect. The original audit resulted in a best information available estimate of taxes due because of taxpayer's poor records. The supplemental audit concluded that most of the remaining assessment arose from poor records and errors in taxpayer's preparation of their original returns. Taxpayer has not demonstrated ordinary business care and prudence in carrying out its duties.

FINDINGS

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04-20030201.LOF

LETTER OF FINDINGS: 03-0201
Indiana Gross Retail Tax
For Tax Period July 2002 – September 2002

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

ISSUES

I. Gross Retail Tax—Uncollectible Receivables Deduction

Authority: IC 6-2.5-6-9

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 6-8-10-2.1; 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."

> *A simplified example: Taxpayer sells a used car on credit for <u>$15,000</u>. At the time of sale, taxpayer includes <u>$15,000</u> in its reportable tax base. After making <u>$3,000</u> in payments, the customer defaults. Taxpayer repossesses the used car and "writes off" the remaining account receivable as a bad debt. Assuming the used car (at the time of repossession) has a fair market value of <u>$10,000</u>, taxpayer has "realized" an uncollectible receivable (bad debt) of <u>$2,000</u>. Pursuant to IC 6-2.5-6-9, taxpayer may deduct the <u>$2,000</u> from its reportable tax base.*

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.* 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 provides:

> (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.

Analysis

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 assure 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). 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.

FINDING

Taxpayer's protest is denied.

II. Tax Administration: Negligence Penalty

The Department may impose a ten percent (10%) negligence penalty. IC 6-8-10-2.1 and 45 IAC 15-11-2. Taxpayer's failure to timely file income tax returns, generally, will result in penalty assessment. IC 6-8.1-10-2.1(a)(1). The Department, however, may waive 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

02-20030254.LOF

LETTER OF FINDINGS NUMBER: 03-0254
Adjusted Gross Income Tax
For the Year 1998

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

ISSUES

I. Business / Non-business Classification – Adjusted Gross Income Tax.

Authority: Ind. Code § 6-3-2-2; Ind. Code § 6-3-1-20; Ind. Code § 6-3-1-21; 45 IAC 3.1-1-29; 45 IAC 3.1-1-30; *May Department Store Co. v. Indiana Dept. of State Revenue*, 749 N.E.2d 651, 656 (Ind. Tax 2001); *Hoechst Celanese Corp. v. Franchise Tax Board,* 22 P.3d 324 (Cal. 2001).

Taxpayer protests the Department's assessment of adjusted gross income tax with respect to taxpayer's sales of several businesses.

II. Tax Administration-Limitations on refunds and protests

Authority: Ind. Code § 6-8.1-5-2; Ind. Code § 6-8.1-9-1

Taxpayer's protest was filed within the statutory protest period for federal audit adjustments that taxpayer received, but not within three years of its initial tax return.

STATEMENT OF FACTS

Taxpayer, an out-of-state company, is a business engaged in various media operations. For several years prior to the merger, taxpayer had also owned several Industry A entities, but had been phasing itself out of that business. During Year X, taxpayer acquired another media company, which was engaged in five lines of business, including Industries B and C. Taxpayer had only wished to acquire these lines of business from the media company; however, due to adverse federal tax consequences, taxpayer and media company agreed to allow taxpayer to acquire the stock of the media company. As a result, taxpayer now owned both properties in its two normal lines of business, Industry A in which taxpayer was phasing out its operations, and three lines in which it had no prior experience in management. Thereafter, taxpayer sold its interest in various properties. In the year in question, the properties sold included taxpayer's entire interest in taxpayer's Industry D, in which taxpayer had not previously engaged prior to merger. Taxpayer also disposed of its Industry E operations in two states in which the taxpayer had limited operations, though it kept Industry E operations in a third state. Taxpayer also sold various Industry B operations and sold its remaining Industry A operations. Taxpayer retained the proceeds from all sales or dispositions and did not distribute such proceeds to shareholders.

Initially, taxpayer filed a 1998 return claiming that all of its income was in fact business income. However, taxpayer went through a federal audit which resulted in an increase in income. The Department assessed tax based on these adjustments. However, taxpayer filed a protest to the assessment, and subsequently an amended return. In its protest, taxpayer claimed that the proceeds from the sale of the various properties were non-business income, and therefore allocable to other states for Indiana adjusted gross income tax purposes. This protest was filed within the allowable time for a protest based on federal adjustments, but not for returns generally.

I. Business / Non-business Classification – Adjusted Gross Income Tax

DISCUSSION

In reviewing taxpayer's amended adjusted gross income tax returns, the audit reclassified certain of taxpayer's income. The audit concluded that taxpayer incorrectly classified gains from the sale of several businesses as "non-business income." The audit reclassified all four of these income categories as "business income."

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. Ind. Code § 6-3-2-2(b). In contrast, non-business income is allocated to Indiana or it is allocated to another state. Ind. Code § 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 2001).

Taxpayer's argument, that all four of these income categories are "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. Ind. Code § 6-3-1-20.

"Non-business income," in turn, "means all income other than business income." Ind. Code § 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 Ind. Code § 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* Ind. Code § 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 and 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 of 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*.

A. Industry D

Taxpayer argues that its income from the sale of one of its acquired businesses, a company engaged in Industry D, is considered non-business income and therefore should be subject to allocation rather than apportionment.

With respect to the transactional test, taxpayer's income was not sufficiently recurring to constitute business income within the transactional test stated above. Further, under the functional test, the sale was not of assets which were integral parts of the taxpayer's regular trade or business operations. Taxpayer had only acquired the business as a necessary part of an acquisition of other desired assets.

While the fact that taxpayer did retain the earnings from the sale for its own overall business purposes gives rise to an inference that the income derived from the disposition is actually business income, taxpayer's overall operations did not include Industry D. Accordingly, the income derived from the sale is not business income.

Taxpayer has acknowledged that at least some portion of the gain with respect to the sale was properly allocable to Indiana, as opposed to taxpayer's original return which listed all of the income as allocable to non-Indiana sources. The exact amount is subject to further audit review.

B. Industry A

Taxpayer also argues that the sale of Industry A operations in three large urban markets was non-business income under both the transactional and functional tests. In effect, taxpayer argues that the sale of the Industry A operations does not meet the transactional test because taxpayer's business does not normally consist of the sale of entire lines of business. Further, taxpayer argues that the transaction does not meet the functional test because the Industry A operations were not an integral part of the company's overall enterprise.

With respect to the transactional test, it is unclear whether taxpayer's income was sufficiently recurring to constitute business income within the transactional test stated above. With respect to the functional test, taxpayer voluntarily left Industry A to concentrate on Industries B and C. As such, the sale was a voluntary business decision on the part of the corporation, a refocusing of its overall operations, unlike the forced sale of the division in *May* that the court noted was done to reduce its market concentration in its line of business. Further, the ownership, management and operation of Industry A operations were part of taxpayer's overall enterprise for decades.

Also, taxpayer retained the earnings from the sale of the Industry A operations. The retention of earnings by taxpayer allowed the business to further focus on its main enterprises-Industries B and C. Combined with the other factors above, taxpayer's Industry A operations constituted an integral part of taxpayer's overall business for several years, and accordingly the disposition of that business resulted in business income.

Finally, it its worth noting that in Indiana, as in other states, taxpayer had claimed expenses and depreciation related to these businesses as business expenses, reducing its income apportionable to Indiana. In *Hoechst Celanese Corp. v. Franchise Tax Board,* 22 P.3d 324, (Cal. 2001), a company had established a retirement pension plan for its employees. The company had no rights to the surplus assets until the termination of the pension plan and satisfaction of benefits. *Id.* at 328-329. In 1983, the company had decided to recapture the surplus in order to prevent its use in a potential takeover bid, and accordingly divided the original pension plan and trust into two separate pension plans and trusts, one for active employees and one for retirees. *Id.* at 329. Then, the company purchased annuities to cover the pensions for retired employees, and terminated the trusts. This triggered the reversion of a sizable surplus to the company, which the company maintained in its general fund. *Id.* at 329-330. In deciding that the income in question was business income, the court noted that the pension plan was part of the company's overall strategy in finding and maintaining employees for its business operations. Further, with respect to the income, the court noted that the taxpayer had received a deduction for its pension contributions for all the years. Accordingly, the court noted, the recapture of income resulting from that deduction was equitable in light of the circumstances. *Id.* at 343.

In noting taxpayer's business operations, taxpayer had received the benefit of its Industry A operations to its overall corporate operations for several years, and during those years had received tax deductions apportionable to Indiana for its expenses and depreciation. Accordingly, just as the court in *Hoechst Celanese* had noted that taxpayer's prior treatment of expenses effectively dictated a recapture of those benefits on the same theory when taxpayer realized income, here taxpayer has realized business income on the sale of the assets from which it had derived business deductions.

C. Smaller Industry B Operations

Taxpayer argues that the sales of five smaller Industry B operations in another state, as part of what can best be described as a concentration of its Industry B operations into larger areas, was non-business income within the meaning of Indiana's adjusted gross income statute. Taxpayer argues that the sales of Industry B operations do not meet the transactional test because taxpayer's sales of Industry B operations are unusual events. Further, taxpayer argues that the income is non-business income under the functional test because smaller Industry B operations were not integral to its main business

With respect to the transactional test, it is unclear whether taxpayer's income was sufficiently recurring to constitute business income within the transactional test stated above. Under the functional test, taxpayer's primary line of business is Industry B. Though taxpayer's operations are generally concentrated in larger urban areas, taxpayer has supplied and continues to supply a number of Industry B operations covering smaller population bases. As such, the Industry B operations constituted an integral part of taxpayer's business, and thus their sale constituted business income. Further, the sales were part a voluntary business decision on the part of the corporation, unlike the forced sale of the division in *May* that the court noted was done to reduce its market concentration in its line of business.

Also, taxpayer retained the earnings from the sales of the Industry B operations. The retention of earnings by taxpayer allowed the business to further focus on its main enterprises. Combined with the other factors above, taxpayer's sales of Industry B operations, assets related to its main line of business, is business income.

Further, as with Industry A, taxpayer had claimed expenses and depreciation related to its Industry B operations as business expenses, reducing its income apportionable to Indiana. Accordingly, the sale of those Industry B operations, taxpayer's business assets for which it had apportionable business income and expense treatment under Indiana's tax statutes for many years, is also business income when those assets are sold. *Id.*

D. Industry E

Taxpayer argues that the gain from the disposal of its Industry E operations in two states, acquired in its merger is also non-business income and therefore subject to allocation rather than apportionment. In particular, taxpayer argues that the transactional test was not met because the disposal of the Industry E operations was an extraordinary event Further, taxpayer argues that the disposal of its Industry E operations did not result in business income because the Industry E operations were not essential to taxpayer's main Industry E operations in a third state, and that it was also not part of its main enterprise of Industries B and C.

With respect to the transactional test, taxpayer's income was not sufficiently recurring to constitute business income within the transactional test stated above. Under the functional test, taxpayer's primary businesses were Industries B and C operations. However, in the period from 1995 until its ultimate disposition of its Industry E operations, taxpayer represented that this was part of its regular operations. Further, taxpayer used the proceeds from its various Industry E operations sales to maintain the overall day-to-day operations of the larger corporate whole. To state that the income produced by the sale of a business operated by taxpayer is non-business income, while the deductions for the expenses paid by that same income is business income is an incongruity that the *Hoechst Celanese* court disallowed, and which is properly disallowable here. Accordingly, the gain realized by the taxpayer on this line of business is business income.

FINDING

Taxpayer's protest is sustained with respect to its sale of its Industry D business, subject to audit determination of the amount allocable to Indiana, subject to the discussion in Part II. Taxpayer's protest is denied with respect to its sales of Industry B, A, and E operations.

II. Tax Administration-Limitations on refunds and protests

DISCUSSION

Taxpayer was assessed additional tax based on its federal audit adjustments. When taxpayer received the assessment, it filed a protest and amended return based on a portion of its overall income being non-business income. While the protest and amended return were timely *vis-à-vis* the federal adjustments per Ind. Code § 6-8.1-5-2, they were late with respect to the normal three-year period. *Id.*; Ind. Code § 6-8.1-9-1. In this type of situation, taxpayer cannot claim a refund or offset with respect to its previously-reported income. However, with respect to the additional income that was determined to be due, taxpayer is entitled to treat the items that constituted the additional income as resulting in business or non-business income, and then apportion or allocate the additional income appropriately. For instance, a taxpayer claimed originally that it had $10,000,000 of business income, ten percent (10%) of which actually constituted non-business income. This business/non-business character of this income may not be revisited if the statute of limitations (including extensions) for that year has passed, and the amount of tax due and payable with respect to that return and that income stands as filed. However, if an additional $1,000,000 of income is reportable as the result of federal audit adjustments, $200,000 of which resulted from items that had been treated originally as business income but which actually constituted non-business income, and $800,000 of which resulted from items that constituted business income, the taxpayer or the Department, as appropriate to the fact situation, can treat the $200,000 as non-business income and allocate it to an appropriate jurisdiction, while the $800,000 of business income is apportioned by statute.

FINDING

Taxpayer's protest is further sustained only to the extent that such income in controversy arose from the federal audit adjustments and reportable only there, and denied with respect to the extent that the income was reported on the initial return.

DEPARTMENT OF STATE REVENUE

0220030312.LOF

LETTER OF FINDINGS: 03-0312
Indiana Corporate Income Tax
For Taxpayer's First Short Tax Period of 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.

ISSUE

I. Applicability of the Adjusted Gross Income Tax and Gross Income Tax –Royalty Income from Licensing Taxpayer's Trademarks and Trade Names.

Authority: IC 6-2.1-2-2; IC 6-3-2-2(a); IC 6-3-1-1 et seq.; Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264 (Ind. 1994); Ind. Dept. of State Revenue v. Convenient Industries, 299 N.E.2d 641 (Ind. Ct. App. 1973); Thomas v. Indiana Dep't of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); 45 IAC 1-1-51; 45 IAC 3.1-1-55.

Taxpayer argues that the Department erred when it assessed taxpayer for Indiana corporate income taxes based upon money received from licensing trademarks, trade names, and similar types of intangible assets.

STATEMENT OF FACTS

Taxpayer is an out-state-company which is the holder of trademarks, trade names, and similar intangible assets which are used by taxpayer's parent company and other affiliates. Taxpayer asserts that it has no office, no tangible personal property, and no employees within the state.

During 2003, the Department of Revenue (Department) conducted an audit review of taxpayer's business records. The Department concluded that taxpayer was receiving income from licensing its intellectual property within the state and that taxpayer should have been filing Indiana corporate income tax returns. Accordingly, the Department assessed taxpayer for the unpaid income tax attributable to taxpayer's first short tax period of 1997.

Taxpayer disagreed with the audit report's conclusions on the ground that the intellectual property had not acquired an Indiana business situs. Taxpayer submitted a protest to that effect on July 30, 2003. An administrative hearing was conducted during which taxpayer further explained the basis for its protest. This letter of Findings results.

DISCUSSION

I. Applicability of the Adjusted Gross Income Tax and Gross Income Tax – Royalty Income from Licensing Taxpayer's Trademarks and Trade Names.

Taxpayer owns the rights to certain trade names, trademarks, and other protected identifying features (intellectual property) used to distinguish and market the parent company's fast food restaurants. During the tax period here at issue, taxpayer received royalty income from Indiana restaurants. Taxpayer maintains that the royalty income is not subject to Indiana's corporate income tax scheme because the intellectual property never acquired an Indiana business situs. Instead, taxpayer argues that its only business activity was related to the maintenance, administration, and protection of the intellectual property and that all of this business activity took place at taxpayer's out-of-state location.

Taxpayer does not own or operate fast food restaurants. Instead, taxpayer – by means of its parent corporation – enters into franchise agreements entitling local restaurateurs to operate a local fast food business and to identify that business with taxpayer's intellectual property. The local restaurateurs and taxpayer's parent company (franchisor) enter into a franchise agreement which defines the rights and responsibilities of both parties. Included within the agreement, is a provision granting the franchisee the right to make use of taxpayer's intellectual property.

The franchisor describes itself as the owner of a "system" of restaurant operations marked by "distinctive building designs, advertising signs, specially designed equipment, equipment layout plans, food presentations and formulae, certain business techniques, systems and procedure, and a [franchisor's] operations manual." The franchise agreement provides to the individual franchisee the right to the limited use of taxpayer's intellectual property. That intellectual property is described as consisting of "trademarks, trade names, service marks, logos, insignia, slogans, emblems, symbols, designs and other identifying characteristics...." However, the franchisee is required to "use the trademarks only in a manner expressly approved by Company." The franchisee's rights are "non exclusive, and the Company, in its sole and absolute discretion, [retains] the right to grant other licenses in, to and under the trademarks in addition to those licenses already granted...." The franchisor reserves for itself the right "to develop and license other names and marks on any such terms and conditions as the Company deems appropriate."

The parties' agreement limits the way in which the franchisee may employ the intellectual property. For example, "The franchisee [may] not use the Trademarks in connection with any statement or material which may... be in bad taste or inconsistent with the Company's public image...." The franchisee is precluded from adopting or using a mark, name, or design which "includes or is similar to any of the Company's trademarks, service marks, trade names, logos, insignia, slogans, emblems, symbols, designs, or other identifying characteristics." The franchisee is precluded from making any "additions to, deletions from [or] changes in the Trademarks...."

Upon termination or expiration of the parties' agreement, the franchisee is required to "immediately discontinue the use of the System and Trademarks." In addition, the former franchisee is required to "remove the Trademarks from all buildings, signs, fixtures and furnishings, and alter and paint all buildings and other improvements... a design and color which is basically different from the Company's authorized building design and painting schedule." The former franchisee is required to "change the color of the building," alter the appearance of the building's exterior windows, and replace the building's distinctive "roof with one made of another good quality material and design."

If the former franchisee fails to remove the identifying marks and distinguishing features, the franchisor reserves for itself the "right to enter upon the Restaurant premises... and make or cause such removal, alterations and repainting...."

Upon termination of the agreement, the former franchisee agrees to discontinue using the franchisor's marks and agrees to not thereafter employ any competing mark which might "tend to give the public the impression that the [former] franchisee is or was a licensee or franchisee of, or otherwise associated with, the Company."

It is apparent from the terms of the franchise agreement, that taxpayer zealously guards its intellectual property, is prepared to defend that property from unlicensed interlopers, and that it attaches substantial value to the property. In returns for the rights to make use of the intellectual property, the franchisee agrees to pay the taxpayer a royalty fee based upon a percentage of the franchisee's gross revenues.

The issue is whether the money taxpayer receives from licensing its intellectual property to Indiana franchisees is subject to the state's corporate income tax scheme.

A. Adjusted Gross Income Tax.

Indiana imposes an adjusted gross income tax on income derived from sources within the state. The adjusted gross income tax, IC 6-3-1-1 et seq., is an apportioned tax specifically designed to reach income derived from interstate transactions. Thomas v. Indiana Dep't of State Revenue, 675 N.E.2d 362, 367-68 (Ind. Tax. Ct. 1997); *See also* Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264, 266 n. 4 (Ind. 1994). The legislature has defined "adjusted gross income" as follows:

> (1) income from real or tangible property located in this state; (2) income from doing business in this state; (3) income from a trade or profession conducted in this state; (4) compensation for labor or services rendered within this state; and (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter. IC 6-3-2-2(a).

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

For purposes of Indiana's adjusted gross income tax, it is apparent that taxpayer's intellectual property has acquired a "business situs" within the state. Taxpayer derives income from Indiana franchisees which pay taxpayer for the right to make use of taxpayer's trademarks and trade names in order to sell fast food to Indiana customers at Indiana business locations. Taxpayer may be entirely correct in its assertion that activities associated with the initial development and ongoing administration of the intellectual property take place outside Indiana. However, issues concerning the administration, maintenance, and protection of the intellectual property are finally irrelevant to the tax question here at issue. What is relevant are the royalties taxpayer receives by placing that intellectual property within the state because it is these royalties which represent the "value" of this property. The value attached to the intellectual property does not derive from – however necessary – activities surrounding the administration of the intellectual property outside this state but results from taxpayer's ability to exploit the value of the property within the stream of Indiana commerce and to derive income from its ability to do so. The intellectual property – consisting of words, symbols, color-combinations, decorative elements, and the like – is, standing alone, of no value unless taxpayer takes steps to associate that property with the conduct of a specific business operation. Taxpayer is not paid royalties because it successfully administers the intellectual property at an out-of-state location; taxpayer receives income because it licenses Indiana franchisees to associate that intellectual property with the Indiana franchisees' fast food business.

The terms of the parties' franchise agreement clearly indicate that taxpayer has placed a substantial value on these particular properties. It is, therefore, quite proper that taxpayer take steps to protect the property when it licenses Indiana franchisees to make use of the property within the state. However, the assertion that the intellectual property has not acquired an Indiana business situs is simply without foundation in law or common sense. Indeed, taxpayer's trademarks and trade names have become a ubiquitous part of the Indiana landscape. Taxpayer, having taken calculated steps to "dip its net" into the stream of Indiana commerce and derive Indiana income directly attributable to exploiting its intellectual capital within the state, should not be surprised that the income is subject to Indiana income tax. As the regulation itself states, "'Business situs' is the place at which [the] intangible personal property is employed as capital...." 45 IAC 3.1-1-55. The place at which "value attaches to the [intellectual] property" is within the state of Indiana. Id.

B. Gross Income Tax.

In addition to the adjusted gross income tax, Indiana imposes a tax known as the "gross income tax" on the "taxable gross income" of a taxpayer which is a resident or domiciliary of Indiana and on the taxable gross income from Indiana sources by a taxpayer who is not a resident or domiciliary of Indiana. IC 6-2.1-2-2.

Under the regulation governing the gross income tax, "taxable gross income" includes income that is derived from "intangibles." 45 IAC 1-1-51. The term "intangibles" includes:

> notes, stocks in either foreign or domestic corporations, bonds, debentures, certificates of deposit, accounts receivable, brokerage and trading accounts, bills of sale, conditional sales contracts, chattel mortgages, "trading stamps," final judgments, leases, royalties, certificates of sale, choses in action *and any and all other evidences of similar rights capable of being transferred, acquired or sold.* (*Emphasis added*). Id.

In order for Indiana to impose the gross income tax on income derived from taxpayer's intangibles, the Department must determine that the income is derived from a "business situs" within the state. Id. The regulation states that a taxpayer has established a "business situs" within the state "[i]f the intangible or the income derived therefrom forms an integral part of a business regularly conducted at a situs in Indiana...." Id. Once the taxpayer has established a "business situs" within the state, "and the intangible or the income derived therefrom is connected with that business, either actually or constructively, the gross receipts of those intangibles will be required to be reported for gross income tax purposes." Id.

The income derived from the taxpayer's licensing of its intellectual property within the state, is income derived from a "business situs" within Indiana and is properly subject to the state's gross income tax scheme. The intellectual property is "localized" within the state because the intellectual is integrally related to the fast food restaurants which sell food items labeled, promoted, and marketed using taxpayer's proprietary trademarks and trade names. The income at issue is not derivative of taxpayer's out-of-state activity in developing, managing, and protecting the intellectual property; the value of this intellectual property lies in taxpayer's ability to license the property for use within Indiana, to maintain rigorous control over the use of the property by its franchisees, and to derive the economic benefits attributable to the intangible property's Indiana business situs.

Taxpayer points to court of appeals decision in Ind. Dept. of State Revenue v. Convenient Industries, 299 N.E.2d 641 (Ind. Ct. App. 1973) as supporting the proposition that franchise income, received by out-of-state franchisor/taxpayer, is not subject to the state's gross income tax. However, in Convenient Industries, the plaintiff taxpayer was receiving money because it performed services for its individual franchisees at plaintiff taxpayer's out-of-state location. For example, plaintiff taxpayer performed management and bookkeeping services for the Indiana franchisees. Id. at 643. The plaintiff taxpayer received cash register receipt information, statements for supplies and other documents in each franchisee's 'daily report.'" Id. Having received this information, plaintiff taxpayer "computed and issued checks for the payroll and other obligations of the franchisee, prepared [franchisee's] tax returns, and maintained profit and loss statements and balance sheets for each store." Id. Based upon the information received and analyzed at plaintiff taxpayer's out-of-state location, plaintiff taxpayer thereafter "utilized computer analysis to offer advice to each franchisee regarding ways in which an operation might be made more efficient." Id. The court found that the "bulk of the labor in performances of their contracts with franchisees occurred in Kentucky." Id. at 646. Therefore, the court found that the money plaintiff taxpayer received in the form of "service fee[s]" and "advertising fee[s]" was "not properly the subject of the Indiana Gross Income Tax." Id. at 646.

Taxpayer's circumstances are not analogous to those of plaintiff taxpayer in Convenient Industries. In Convenient Industries, plaintiff taxpayer was receiving money because it was performing management and advertising services, on behalf of its Indiana franchisees, at plaintiff taxpayer's Kentucky location. The court found that the money was not subject to gross income tax because the services were not performed in Indiana. However, what is at issue in taxpayer's own protest is the income specifically derived from licensing intellectual property for use within the state. Certainly, there are particular activities associated with the development, management, and protection of taxpayer's intellectual which are conducted outside Indiana; however, the taxpayer's Indiana restaurant franchisees did not send royalty checks to taxpayer because taxpayer managed intellectual property outside the state. Taxpayer received royalty checks because it licensed Indiana businesses to attract Indiana customers to purchase food consumed in

Indiana. Taxpayer received royalties based upon the franchisees' gross income received in Indiana. The amount of that gross income is directly attributable to taxpayer's success in marketing and labeling itself in distinctive manner readily identifiable by taxpayer's familiar trademarks and trade names. The franchisees' gross income is a measure of the franchisees' success; that success is attributable –in large part – because of the franchisees' identification with the trade names and trademarks; taxpayer's portion of the gross income – in the form of royalties – is subject to Indiana's gross income tax.

Because the intangible intellectual property has acquired a business situs within the state and because the income at issue is "connected with that business, either actually or constructively," the income is subject to the state's gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220030322.LOF

LETTER OF FINDINGS: 03-0322
Indiana Gross Income 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 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 and Installation of Material Handling Equipment – Gross Income Tax.

Authority: U.S. Const. art. I, § 8; IC 6-2.1-2-2; IC 6-2.1-3-3; Indiana Dept. of Revenue v. Brown Boveri Corp., 439 N.E.2d 561 (Ind. 1982); Mueller Brass Co. v. Gross Income Tax Division, Indiana Dept. of Revenue, 265 N.E.2d 704 (Ind. 1971); Indiana Dept. of Revenue v. Surface Combustion Corp., 111 N.E.2d 50 (Ind. 1953); Gross Income Tax Division, State of Indiana v. Fort Pitt Bridge Works, 86 N.E.2d 685 (Ind. 1949); 45 IAC 1-1-120; 45 IAC 1-1-120(1)(c); 45 IAC 1-1-121(b); 45 IAC 1-1-121(d); 45 IAC 1.1-3-3(a); 45 IAC 1.1-3-3(c)(6); 45 IAC 1.1-3-3(d).

Taxpayer argues that it does not owe gross income tax on money received from the sale and installation of material handling equipment sold to Indiana customers because the transactions took place within interstate commerce.

II. Abatement of 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 claims that its failure to pay Indiana gross income tax was attributable to the complexity of the tax issues and that taxpayer exercised reasonable care, caution, and diligence in determining that it did not owe gross income tax.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of manufacturing conveyor systems or "material handling" equipment used by manufacturing companies including companies located in Indiana. The conveyor systems include accumulating conveyors, gravity roller conveyors, belt conveyors, automated storage devices, retrieval systems, and skid systems. Taxpayer states that it manufacturers the conveyors systems at one of its out-of-state locations. Due to the size of the systems, they are shipped to the customer in pieces by means of common carrier where the components are assembled and installed at the customer's location. Taxpayer generally sends one of its "project teams" to the customer's location to supervise the installation pursuant to the parties' sales contract. The project team typically consists of a project manager, field supervisor, and one or more engineers. The project teams are assisted by local union workers.

The Indiana Department of Revenue (Department) conducted an audit review of taxpayer's tax returns and business records. The audit found that taxpayer did not report gross income on the money it received from its Indiana customers. Taxpayer failed to report gross income tax at either the high rate or the low rate. The audit concluded that taxpayer had established an Indiana "business situs" by virtue of the "services provided to their customers" and that taxpayer should have been paying gross income tax on the money it earned from the initial sale and installation of the conveyor systems and the money it earned from the performance of post-installation service and repair work. Following completion of the audit report, the Department sent notices of "Proposed Assessment" for 1998, 1999, and 2000 taxes. The taxpayer disagreed with the audit's conclusions and the proposed assessments. Taxpayer submitted a protest to that effect, an administrative hearing was conducted during which taxpayer further explained the basis for its position, and this Letter of Findings results.

DISCUSSION

I. Money Received from the Sale and Installation of Material Handling Equipment – Gross Income Tax.

Taxpayer is a "material handling specialist" which sells conveyor systems. Taxpayer states the conveyor systems are made of "interchangeable standard stock." The standard stock is manufactured outside of Indiana, delivered by means of common carrier, and assembled and installed at Indiana locations by a team of its own employees who oversee the project and by local union workers. However, there is no indication that a material handling system is ever entirely pre-assembled at taxpayer's out-of-state location. After the conveyor system is installed at the Indiana site, taxpayer provides maintenance, product support, and service.

The conveyor systems are designed to move a variety of items such as newsprint, airline luggage, partially assembled automobiles, and bulk coal. Some of the conveyor systems are designed to move parts and materials before manufacturing occurs. Some of the conveyor systems are designed to transport partially assembled items while manufacturing actually occurs. The conveyor systems vary in design, function, and complexity.

The conveyor system can be as simple as an overhead track on which the load is pushed and maneuvered by hand.

The conveyor system can be an automatic monorail system consisting of switches, overhead sections, and accumulators on which the load is automatically identified and routed along complex paths to different track levels.

The conveyor system can consist of independent tow cars which are computer controlled and automatically routed along tracks embedded in the factory or warehouse floor.

The conveyor system can consist of track-less "automatic guided vehicles" which uses a "sophisticated network of encoded electronic signals" to transport product from one point in the customer's facility to another. Taxpayer states that these particular devices "can be designed to meet the demands of a broad scope of industries including health care, discrete manufacturing, primary metals, and aerospace."

Taxpayer's conveyor systems can be as sophisticated as an entirely integrated storage and retrieval system in which an automatic retrieval device moves through and within a complex, multi-level, densely structured storage facility. The automatic retrieval system locates, identifies, and retrieves a specific item of the customer's inventory and delivers that item to a designated point. The automatic retrievers "utilize state-of-the art software, infrared distance measuring devices and incremental encoders to operate quickly and precisely."

The audit assessed high rate gross income tax on taxpayer's service and installation income. The audit assessed low rate gross income tax on material sales. Taxpayer claims that the sales of the conveyor systems are not subject to gross income tax because the sales occurred in interstate commerce and because the related services are part and parcel of the interstate sales.

Indiana Gross Income Tax (IC 6-2.1-0.6 to 6-2.1-8-7) "is imposed upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident of Indiana." IC 6-2.1-2-2 To assure that only income properly subject to a state tax is assessed Gross Income Tax, IC 6-2.1-3-3 provides that "[g]ross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign county 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 was passed in recognition of the fact that the Commerce Clause requires that Indiana not unduly burden commerce between the states. Therefore, Indiana may not impose a tax that discriminates against interstate commerce in favor of intrastate commerce. "While a state may impose a tax burden that is reasonable in light of the incidence of commercial contact by the taxpayer with [the state], a tax system which may produce a multiple taxation burden is proscribed." Mueller Brass Co. v. Gross Income Tax Division, Indiana Dept. of Revenue, 265 N.E.2d 704, 717 (Ind. 1971).

Taxpayer argues that the Indiana sales in question fell within the protection afforded by the Interstate Commerce Clause which reserves to the federal government the power to "regulate Commerce... among the several states...." U.S. Const. art. I, § 8. More specifically, taxpayer – for the first of the three years at issue – cites to 45 IAC 1-1-120(1)(c) which exempts from the Gross Income Tax certain sales made by non-residents to Indiana customers in which the out-of-state sellers perform installation services intrinsically related to the original sale. In regard to "Nontaxable in-shipments," the regulation states that, "As a general rule, income derived from sales made by nonresident sellers to Indiana buyers is not subject to gross income tax unless the seller was engaged in business activity within the state and such activity was connected with or facilitated the sales." 45 IAC 1-1-120. Specifically, the regulation exempts those sales "made by a nonresident where the product sold is, because of its size or weight, shipped in parts; and the seller, because of his special skill or expertise, assembles or installs the product at the buyer's place of business with no additional services rendered." 45 IAC 1-1-120(1)(c). Taxpayer maintains that Indiana may not tax the money it received during 1998 because that Indiana source income is protected by the Interstate Commerce Clause and falls within the definition of 45 IAC 1-1-120.

The Department promulgated new regulations governing the state's Gross Income Tax. Those new regulations became effective January 1, 1999, and govern taxpayer's 1999 and 2000 Indiana income. Taxpayer maintains that the state may not tax its 1999 and 2000 Indiana income because that money falls within the definition of "Gross income derived from business conducted in interstate commerce...." 45 IAC 1.1-3-3(a). Taxpayer cites to 45 IAC 1.1-3-3(c)(6) in support of its position. That portion of the regulation requires, in part, as follows:

> 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 following examples are situations where a sale is not completed in Indiana prior to or after shipment in interstate commerce... (6) A sale, not otherwise taxable, to an Indiana buyer by a nonresident where the

seller, because of its special skill or expertise, assembles or installs the product at the buyer's place of business without any additional services being rendered. In other words, the services performed are part of the sale and the sale is exempt because it is in interstate commerce.

Taxpayer also cites to Indiana Dept. of Revenue v. Surface Combustion Corp., 111 N.E.2d 50 (Ind. 1953) for support of its contention that the sale of the material handling equipment to its Indiana customers took place within interstate commerce and the proceeds are exempt from the Gross Income Tax. In Surface Combustion, appellee taxpayer was an Ohio based furnace manufacturer. It sold furnaces to an Indiana customer, was assessed Gross Income Tax on the income derived from the sales, and brought an action seeking a refund of those taxes. The court determined that appellee taxpayer had constructed the furnaces at its Ohio facility. Thereafter, appellee taxpayer transported the smaller furnaces to the Indiana customer's site. The larger furnaces were assembled at the Ohio facility, disassembled, and shipped to the Indiana site; alternatively, the larger furnaces were only partially assembled at the Ohio facility before being "knocked down," transported and reassembled at the Indiana customer's site. In all cases, the court found that the "parties contemplated and intended that the furnace... should be shipped and transported from appellee's plant at Toledo, Ohio to the customer's plant in Indiana...." Id. 53.

In Surface Combustion, it was the Indiana customer's responsibility to provide a foundation, plumbing, and electric wiring in preparation for the installation of the furnaces. Id. It was appellee taxpayer's own responsibility to provide the "specially trained factory engineers, supervisors, and workmen to assemble... install, align, and adjust all of [the furnaces] at the customer's plant in order to assure a proper functioning furnace which was necessary to consummate and complete the sale." Id.

In Surface Combustion, the court rejected the Department's contention that it was entitled to levy the Gross Income Tax against appellee taxpayer's income derived from the sale of the furnaces. The court found that, "the tax sought to be recovered was levied upon the gross receipts of appellee from interstate commerce transactions within and without the State of Indiana." Id. at 69. The court concluded that imposition of the tax "directly burdens, and interferes with, the free flow of such commerce between the State of Ohio and the State of Indiana and is invalid as being in conflict with Article I, of § 8 of the Constitution of the United States." Id.

The court found that the "thing" which the Indiana customer purchased from appellee in Ohio, was a "heat treating furnace complete in one functional unit." Id. at 62. In support of that conclusion, the court noted that, "There is no evidence that the furnaces were made, built, fabricated, created or brought into existence in Indiana." Id. The Indiana installation work performed by appellee taxpayer consisted "only in the reassembling and installing the furnaces which had been purchased in the State of Ohio and taken apart for the convenience of shipment." Id. Appellee taxpayer's in-state activity was "intrinsically related to and inherently a part of the sale; and because of their complexity their installation and testing was essential to the making of the sale." Id. The sales of the furnaces were "clearly sales of personal chattels in interstate commerce and the installation and reassembling where required, were inherently a part of, and a necessary incident to, the sale." Id.

Taxpayer also cites to Indiana Dept. of Revenue v. Brown Boveri Corp., 439 N.E.2d 561 (Ind. 1982) in support of the proposition that sales of material handling equipment is not subject to the Gross Income Tax. In Brown Boveri, plaintiff taxpayer was an out-of-state company which had entered into a contract with an Indiana manufacturer for the sale of an induction melting system. The parties' sales agreement was for the "turn-key" delivery of a system that would produce molten iron. "The system was pre-fabricated at [plaintiff taxpayer's] plant, broken down for shipment and reassembled at the [Indiana customer's] plant." Id. at 563. Plaintiff taxpayer conducted certain activities at the Indiana site because it "was necessary for [plaintiff taxpayer] to engage in various activities to guarantee proper planning and coordination of the project." Id. Plaintiff taxpayer's in-state activities "included reassembly of the equipment, removing obsolete equipment, pouring foundations, trenching, and reinforcement of existing structures." Id.

The court disagreed with the Department's argument that plaintiff taxpayer's performance of activities within Indiana removed the transaction from the protection afforded interstate commerce. Id. at 564. The court found that the transaction between plaintiff taxpayer and the Indiana customer was "indeed interstate commerce such that taxation of gross income resulting therefrom [was] prohibited." Id. The transaction was for the "sale of a functioning system for a lump sum," in which "all of the component parts were pre-fabricated outside Indiana, disassembled for shipment, and then reassembled on the job site." Id. Plaintiff taxpayer's local activities did not take the sale of the melting system outside interstate commerce protection because "the local activities of [plaintiff taxpayer] were intrinsically related to and inherently part of the sale in interstate commerce." Id.

In both Brown Boveri and Surface Combustion, the out-of-state taxpayer constructed equipment and then shipped that equipment – either piece-meal or as a complete unit – to the Indiana customer. The court found, in both instances, that the sale of the equipment was interstate in character while taxpayers' in-state activities – installing and testing the equipment – were inherently related to the original out-of-state sale.

Taxpayer's sale of its material handling equipment is not analogous to the transactions described in Brown Boveri and Surface Combustion. In Surface Combustion, the court stated that there was "no evidence that the furnaces were made, built, fabricated, created, or brought into existence in Indiana." Surface Combustion, 111 N.E.2d at 62. While the numerous individual components may have existed outside of Indiana, there is every indication that taxpayer's material handling devices were "made, built, created, [and] brought into existence in Indiana." Brown Boveri, 439 N.E.2d at 563. In Brown Boveri, the court found that, "The system was pre-fabricated at [taxpayer's] plant, broken down for shipment and reassembled at the [Indiana] plant." Id. The taxpayer's own material handling devices were not pre-fabricated outside the state, broken down for shipment, and reassembled at the Indiana customers' steel plant. Instead, the material handling equipment was not brought into existence until taxpayer transported the components to the site and then assembled those components into the device which taxpayer sold to the Indiana customers. Taxpayer's sales of material handling equipment were not interstate transactions with the taxpayer's performance of Indiana installation activities merely incidental to the sale of the material handling equipment. Taxpayer's customers did not buy out-of-state material handling equipment, arrange to have the equipment disassembled and shipped to Indiana, and then reassembled at the customers' site. Taxpayer entered into contracts to perform construction and assembly work in Indiana and thereby subjected itself to Indiana's taxing jurisdiction. Taxpayer's initial construction and completion of the material handling devices occurred in Indiana, and the proceeds are properly subject to the state's Gross Income Tax.

Taxpayer's sales of the material handling equipment are analogous to the activities of appellee manufacturer in Gross Income Tax Division, State of Indiana v. Fort Pitt Bridge Works, 86 N.E.2d 685 (Ind. 1949). In that case, the manufacturer – a Pennsylvania based corporation – arranged for the construction, fabrication, and assembly of certain buildings within the state. The manufacturer "furnished and fabricated the steel and shipped it from its plants in Ohio or Pennsylvania" to the customer's location within Indiana. Id. at 687. Thereafter, a subcontractor received the material and performed all the work necessary for the "construction of the buildings for which the steel was furnished." Id. The manufacturer treated the receipts as not subject to Indiana's Gross Income Tax because, according to the manufacturer, "it had nothing to do with the activity and business conducted in Indiana by [the subcontractor] and that it [was] not liable for tax upon the price paid for the steel and fabrication... because the fabrication occurred outside the state and furnishing the steel was an interstate transaction." Id. at 688. The court disagreed with the manufacturer's contention on the ground that, "A corporation which contracts in the state of its residence to do work in a foreign state subjects itself to the jurisdiction of such foreign state, notwithstanding it employs independent contractors to do the actual work and does no part of the actual work itself." Id. at 689. The manufacturer's income was subject to Indiana's Gross Income Tax because "[the income] was derived from an activity for which it was responsible. It came from its business in Indiana, carried on through the medium of a subcontractor acting independently as to the manner and method, but acting for [the manufacturer] in the accomplishment of the result which it contracted to bring about." Id.

The court rejected the manufacturer's argument that the transaction was interstate in nature because the court did not believe the contract "was a contract of sale with construction work in Indiana as a mere incident." Id. at 691. Even though the component parts were initially manufactured at an out-of-state location, "the transaction as a whole was local in nature and subject to local tax and regulation." Id. The court stated that it had "no hesitance in saying that the State of Indiana [had] the right to apply its gross income tax to business actually transacted within its borders, notwithstanding that interstate commerce, as an incident, may have intervened in at some point in the transaction...." Id. at 692.

Taxpayer manufactured and pre-assembled certain, individual components at its out-of-state location. Other components were purchased from third-party vendors predominantly located outside of Indiana. These components were then delivered by common carrier to the Indiana customer's location. The various component parts were finally assembled and incorporated into the completed material handling device. Taxpayer hired local workmen to perform much of the on-site work. However, "Taxpayer's skill and expertise were required to assemble and install the equipment/systems." To that end, taxpayer sent a project manager, field supervisor, and one or more engineers to oversee the fabrication and installation process. As taxpayer explained, "Taxpayer's engineer(s) were the only person(s) that possessed the knowledge and expertise to supervise the assembly of the component parts into the completed material handling lines."

The taxpayer's 1999 and 2000 transactions fall within the purview of the state's Gross Income Tax scheme as set out in 45 IAC 1-1-121(b) which states that:

> Gross receipts from the performance of construction projects in Indiana are subject to gross income tax. This is true even when the contractor is a nonresident and even when he subcontracts all Indiana work to local businesses and has no other contact with the state except to ship goods manufactured elsewhere into the state for installation by local workmen.

Taxpayer's Indiana activities are not merely "incidental services taking place within the State, which may be tax-exempt as a transaction in interstate commerce." 45 IAC 1-1-121(d). Taxpayer is not merely setting the equipment "on bases or connecting to pipes, supports, etc., provided by the customer." Id. Rather, taxpayer clearly "performs additional services, such as installation, testing, construction, etc." thereby entitling the Department to treat the transaction as an Indiana "construction project" the proceeds of which are properly subject to the state's Gross Income Tax. Id. *See also* 45 IAC 1.1-3-3(d).

Taxpayer designs and builds sophisticated, complex material handling devices. Taxpayer enters into contract with Indiana customers to install the devices at Indiana locations. The devices do not exist until the components and subcomponents are assembled at the Indiana location. The money received from the sale and installation of the devices is subject to the state's gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of Ten-Percent Negligence Penalty.

Taxpayer asks that the "Department waive the imposition of the negligence penalty relating to the Department's audit assessment." Taxpayer does so because it believes that its "failure to pay [Gross Income Tax] does not stem from negligence, but rather from the complexity of the tax issues raised in the audit."

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...."

While the contracts for the sale and installation of the material handling equipment arguably implicated activities related to interstate commerce, taxpayer's determination that it had zero gross income tax liability during the three years falls outside a reasonable definition of "ordinary business care and prudence" and does not warrant abatement of the associated penalties.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220030331.LOF

LETTER OF FINDINGS: 03-0331
Indiana Corporate Income Tax
For Taxpayer's First Short Tax Period of 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.

ISSUE

I. Applicability of the Adjusted Gross Income Tax and Gross Income Tax – Royalty Income from Licensing Taxpayer's Trademarks and Trade Names.

Authority: IC 6-2.1-2-2; IC 6-3-2-2(a); IC 6-3-1-1 et seq.; Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264 (Ind. 1994); Ind. Dept. of State Revenue v. Convenient Industries, 299 N.E.2d 641 (Ind. Ct. App. 1973); Thomas v. Indiana Dep't of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); 45 IAC 1-1-51; 45 IAC 3.1-1-55.

Taxpayer maintains that the money it received from licensing its trademarks and trade names for use within the state is not subject to state income tax. Taxpayer states that the trademarks and trade names (intellectual property) never acquired a business situs within Indiana.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of licensing, operating, and managing fast-food restaurants. It conducts this business by means of various subsidiaries and through local franchisees.

During 2003, the Department of Revenue (Department) conducted an audit review of taxpayer's business records. The Department concluded that taxpayer was receiving income from licensing its intellectual property within the state and that taxpayer should have been filing Indiana corporate income tax returns. Accordingly, the Department assessed taxpayer for the unpaid income tax attributable to the taxpayer's first short tax period of 1997.

Taxpayer disagreed with the audit report's conclusions on the ground that the intellectual property had not acquired an Indiana business situs. Taxpayer submitted a protest to that effect on July 30, 2003. An administrative hearing was conducted during which taxpayer further explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Applicability of the Adjusted Gross Income Tax and Gross Income Tax – Royalty Income from Licensing Taxpayer's Trademarks and Trade Names.

In the audit of taxpayer's business records, the Department concluded that taxpayer was subject to the state's gross income tax and adjusted gross income tax on the ground that taxpayer was licensing the use of intangibles within Indiana. Taxpayer disagrees maintaining that the intangibles – intellectual property consisting of trademarks and trade names – did not have a business situs within Indiana and that the income derived was not subject to the state's corporate income tax scheme. Taxpayer states that it did not own any of the Indiana restaurants and that it had no employees permanently located in Indiana.

Rather than owning the branded restaurants, taxpayer licenses individual franchisees to sell fast food within the state. The parties' agreement grants the individual franchisee the right to use "certain trade names, trademarks and service marks owned by [taxpayer] and to prepare and market the Required Products at the Outlet (and only at the Outlet) in connection with products and services meeting [taxpayer's] quality standards through the use of processes and trade secrets communicated by [taxpayer]." By the terms of the agreement, the parties acknowledge that the taxpayer's "unique system" of preparing fast food is associated with the "trade secrets, standards and specifications designed to maintain a uniform high quality of product, service and national reputation."

The franchisee is required to "strictly comply with the requirements and instructions of [taxpayer] regarding the use of the trademarks, trade names and service marks in connection with the Approved Products and the [franchisee's location]." The Franchisee is granted the right to make use of the intellectual properties but acknowledges that the "goodwill associated with the [taxpayer's] trademarks, service marks and trade names is and will remain the exclusive property of [taxpayer] and that the Franchisee will derive no benefit from such goodwill...."

Upon termination or expiration of the parties' agreement, the franchisee agrees to "immediately discontinue use of all [taxpayer] trademarks, service marks, trade names, trade secrets, and knowhow...." The discontinued franchisee is required to remove "signs, menuboard inserts, point-of-sale material, [colored] stripes, and characteristically designed roof from the Outlet and otherwise change its exterior and interior appearance so that it is no longer confusingly similar to a [licensed restaurant] and no longer bears any of [taxpayer] trademarks, service marks or trade names or designations or marks similar thereto." If – upon termination of the franchisee agreement – the franchisee delays removing the identifying marks, taxpayer reserves the option to do so itself by "entering the premises of the Outlet"

The parties' franchise agreement specifies the food items the franchisee may and may not sell; the agreement gives taxpayer the right to require the franchisee to introduce new food items, specifies the exterior and interior of the restaurant building, and specifies which days of the year the restaurant will be open and which days it will be closed.

In short, taxpayer licenses individual franchisees to operate restaurants subject to the taxpayer's right to control the way in which the restaurants are operated. The franchisee obtains the right to make use of the trademarks and trade names and to enjoy the national reputation which has attached to those intellectual properties. In return, the franchisee pays the taxpayer a royalty fee based upon a percentage of the franchisee's gross revenues.

The issue is whether the income attributable to the licensing of taxpayer's intellectual property is subject to Indiana's corporate income tax scheme. Taxpayer concludes that the income is not subject to the tax because the intellectual property never acquired an Indiana situs. Instead, taxpayer maintains that the only business activity associated with the property is "the maintenance, administration and protection of the trademarks and trade names." Taxpayer states that all of this particular business activity takes place at an out-of-state location.

A. Adjusted Gross Income Tax.

Indiana imposes an adjusted gross income tax on income derived from sources within the state. The adjusted gross income tax, IC 6-3-1-1 et seq., is an apportioned tax specifically designed to reach income derived from interstate transactions. Thomas v. Indiana Dep't of State Revenue, 675 N.E.2d 362, 367-68 (Ind. Tax. Ct. 1997); *See also* Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264, 266 n. 4 (Ind. 1994). The legislature has defined "adjusted gross income" as follows:

> (1) income from real or tangible property located in this state; (2) income from doing business in this state; (3) income from a trade or profession conducted in this state; (4) compensation for labor or services rendered within this state; and (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter. IC 6-3-2-2(a).

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

For purposes of Indiana's adjusted gross income tax, taxpayer's intellectual property has acquired a "business situs" within the state. Taxpayer derives income from Indiana franchisees which pay taxpayer for the right to make use of taxpayer's trademarks and trade names in order to sell fast food to Indiana customers at Indiana business locations. Taxpayer may be entirely correct in its assertion that activities associated with the initial development and ongoing administration of the intellectual property take place outside Indiana. However, issues concerning the administration, maintenance, and protection of the intellectual property are finally irrelevant to the tax question here at issue. What is relevant are the royalties taxpayer receives by placing that intellectual property within the state because it is these royalties which represent the "value" of this property. The value attached to the intellectual property does not derive from – however necessary – activities surrounding the administration of the intellectual property outside this state but results from taxpayer's ability to exploit the value of the property within the stream of Indiana commerce and to derive income from its ability to do so. The intellectual property – consisting of words, symbols, decorative elements, and the like – is, standing alone, of no value unless taxpayer takes steps to associate that property with the conduct of a specific business operation.

Taxpayer is not paid royalties because it successfully administers the intellectual property at an out-of-state location; taxpayer receives income because it licenses Indiana franchisees to associate that intellectual property with the Indiana franchisees' fast food business.

The terms of the parties' franchise agreement clearly indicate that taxpayer has placed a substantial value on these particular properties. It is, therefore, quite proper that taxpayer take steps to protect the property when it licenses Indiana franchisees to make use of the property within the state. However, the assertion that the intellectual property has not acquired an Indiana business situs is simply without foundation in law or common sense. Indeed, taxpayer's trademarks and trade names have become a ubiquitous part of the Indiana landscape. Taxpayer, having taken calculated steps to "dip its net" into the stream of Indiana commerce and derive Indiana income directly attributable to exploiting its intellectual capital within the state, should not be surprised that the income is subject to Indiana income tax. As the regulation itself states, "'Business situs' is the place at which [the] intangible personal property is employed as capital...." 45 IAC 3.1-1-55. The place at which "value attaches to the [intellectual] property" is within the state of Indiana. Id.

B. Gross Income Tax.

In addition to the adjusted gross income tax, Indiana imposes a tax known as the "gross income tax" on the "taxable gross income" of a taxpayer which is a resident or domiciliary of Indiana and on the taxable gross income from Indiana sources by a taxpayer who is not a resident or domiciliary of Indiana. IC 6-2.1-2-2.

Under the regulation governing the gross income tax, "taxable gross income" includes income that is derived from "intangibles." 45 IAC 1-1-51. The term "intangibles" includes:

> notes, stocks in either foreign or domestic corporations, bonds, debentures, certificates of deposit, accounts receivable, brokerage and trading accounts, bills of sale, conditional sales contracts, chattel mortgages, "trading stamps," final judgments, leases, royalties, certificates of sale, choses in action *and any and all other evidences of similar rights capable of being transferred, acquired or sold.* (*Emphasis added*). Id.

In order for Indiana to impose the gross income tax on income derived from taxpayer's intangibles, the Department must determine that the income is derived from a "business situs" within the state. Id. The regulation states that a taxpayer has established a "business situs" within the state "[i]f the intangible or the income derived therefrom forms an integral part of a business regularly conducted at a situs in Indiana...." Id. Once the taxpayer has established a "business situs" within the state, "and the intangible or the income derived therefrom is connected with that business, either actually or constructively, the gross receipts of those intangibles will be required to be reported for gross income tax purposes." Id.

The income derived from the taxpayer's licensing of its intellectual property within the state, is income derived from a "business situs" within Indiana and is properly subject to the state's gross income tax scheme. The intellectual property is "localized" within the state because the intellectual property is integrally related to the fast food restaurants which sell food items labeled, promoted, and marketed using taxpayer's proprietary trademarks and trade names. The income at issue is not derivative of taxpayer's out-of-state activity in developing, managing, and protecting the intellectual property; the value of this intellectual property lies in taxpayer's ability to license the property for use within Indiana, to maintain rigorous control over the use of the property by its franchisees, and to derive the economic benefits attributable to the intangible property's Indiana business situs.

Taxpayer points to the court of appeals decision in Ind. Dept. of State Revenue v. Convenient Industries, 299 N.E.2d 641 (Ind. Ct. App. 1973) as supporting the proposition that franchise income, received by out-of-state franchisor/taxpayer, is not subject to the state's gross income tax. However, in Convenient Industries, the plaintiff taxpayer was receiving money because it performed services for its individual franchisees at plaintiff taxpayer's out-of-state location. For example, plaintiff taxpayer performed management and bookkeeping services for the Indiana franchisees. Id. at 643. The plaintiff taxpayer received cash register receipt information, statements for supplies and other documents in each franchisee's 'daily report.'" Id. Having received this information, plaintiff taxpayer "computed and issued checks for the payroll and other obligations of the franchisee, prepared [franchisee's] tax returns, and maintained profit and loss statements and balance sheets for each store." Id. Based upon the information received and analyzed at plaintiff taxpayer's out-of-state location, plaintiff taxpayer thereafter "utilized computer analysis to offer advice to each franchisee regarding ways in which an operation might be made more efficient." Id. The court found that the "bulk of the labor in performances of their contracts with franchisees occurred in Kentucky." Id. at 646. Therefore, the court found that the money plaintiff taxpayer received in the form of "service fee[s]" and "advertising fee[s]" was "not properly the subject of the Indiana Gross Income Tax." Id. at 646.

Taxpayer's circumstances are not analogous to those of plaintiff taxpayer in Convenient Industries. In Convenient Industries, plaintiff taxpayer was receiving money because it was performing management and advertising services, on behalf of its Indiana franchisees, at plaintiff taxpayer's Kentucky location. The court found that the money was not subject to gross income tax because the services were not performed in Indiana. However, what is at issue in taxpayer's own protest is the income specifically derived from licensing intellectual property for use within the state. Certainly, there are particular activities associated with the development, management, and protection of taxpayer's intellectual which are conducted outside Indiana; however, the taxpayer's Indiana restaurant franchisees did not send royalty checks to taxpayer because taxpayer managed intellectual property outside the state.

Taxpayer received royalty checks because it licensed Indiana businesses to attract Indiana customers to purchase food consumed in Indiana. Taxpayer received royalties based upon the franchisees' gross income received in Indiana. The amount of that gross income is directly attributable to taxpayer's success in marketing and labeling itself in distinctive manner readily identifiable by taxpayer's familiar trademarks and trade names. The franchisees' gross income is a measure of the franchisees' success; that success is attributable –in large part – because of the franchisees' identification with the trade names and trademarks; taxpayer's portion of the gross income – in the form of royalties – is subject to Indiana's gross income tax.

Because the intangible intellectual property has acquired a business situs within the state and because the income at issue is "connected with that business, either actually or constructively," the income is subject to the state's gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0220030332.LOF

LETTER OF FINDINGS: 03-0332
Indiana Corporate Income Tax
For Taxpayer's First Short Tax Period of 1997

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

ISSUES

I. Applicability of the Adjusted Gross Income Tax and Gross Income – Taxpayer's Income from Licensing Trademarks and Trade Names.

Authority: IC 6-2.1-2-2; IC 6-3-2-2(a); IC 6-3-1-1 et seq.; Indiana Dept. of State Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264 (Ind. 1994); Thomas v. Indiana Dep't of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); 45 IAC 1-1-51; 45 IAC 3.1-1-55.

Taxpayer argues that money it received from licensing its trademarks and trade names for use within the state is not subject to state income tax because these intellectual properties do not have an Indiana business situs.

II. Computational Errors.

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

Taxpayer maintains that even if the money received from licensing intellectual property is found to be subject to the state's income tax, the audit report contained computational errors which now require correction.

STATEMENT OF FACTS

Taxpayer is an out-of-state company in the business of operating and managing fast-food restaurants. It conducts this business by means of various subsidiaries and through local franchisees.

During 2003, the Department of Revenue (Department) conducted an audit review of taxpayer's business records. The Department concluded that taxpayer was receiving income from licensing its intellectual property within the state and that taxpayer should have been filing Indiana corporate income tax returns. Accordingly, the Department assessed taxpayer for unpaid income tax attributable to taxpayer's first short tax period of 1997.

Taxpayer disagreed with the conclusions contained within the audit report on the ground that the intellectual property had not acquired an Indiana business situs. Taxpayer submitted a protest to that effect on May 11, 2004. An administrative hearing was conducted during which taxpayer further explained the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Applicability of the Adjusted Gross Income Tax and Gross Income – Taxpayer's Income from Licensing Trademarks and Trade Names.

Following the audit of taxpayer's business records, the Department concluded that taxpayer was subject to the state's gross income tax and adjusted gross income tax on the ground that taxpayer was licensing the use of intangibles within Indiana. Taxpayer disagrees maintaining that the intangibles – intellectual property consisting of trademarks and trade names – did not have a business situs within Indiana and that the income derived was not subject to the state's corporate income tax scheme.

Taxpayer licenses franchisees to sell fast food within the state. As part of the agreement with the individual franchisee, the franchisee is granted the right to use what taxpayer calls its fast food "system." The system includes "distinctive signs, food recipes, uniforms, and various trade secrets and other confidential information...." Taxpayer's "system" is identifiable to Indiana consumers by "certain trademarks, trade names, service marks, symbols, emblems, logos, designs, and other indicia of origin." The parties' franchise agreement collectively describes this identifying property as the "Company's Marks." Although the agreement stipulates that taxpayer continues to retain complete ownership of the "company's marks," the agreement grants the franchisee the right to use the marks in order "to identify for the public the source of the services rendered in accordance with the System and the high standards of quality attendant thereto[.]"

After entering into an agreement with a local franchisee restaurant, taxpayer retains the right to exercise control over the operation of the franchisee's business. Taxpayer retains the right to both prescribe and proscribe the food items sold at the franchise location, requires the franchisee to identify its business as part of the taxpayer's "system" of restaurants," and requires the franchisee adopt a particular, unified menu format. In addition, the taxpayer retains the right to have its "authorized representative... enter upon the premises of Operator's System Restaurants at any reasonable time for the purpose of examining same, conferring with Operator's employees, inspecting and checking operations, food, beverages, furnishings, interior and exterior décor, supplies, fixtures, and equipment, and determining whether the business is being conducted in accordance with [taxpayer's] standards and the terms of [the franchise] agreement."

The parties' franchise agreement circumscribes the individual franchisee's right to use taxpayer's intellectual property. The local franchisee is given the right to use the intellectual property for purposes of identifying the local franchise business as part of taxpayer's "system" of restaurants, but the right to use the identifying intellectual property is limited to the individual franchisee's restaurant and defined territory. The franchisee is not entitled to "license or attempt to license any other person or firm to use [taxpayer's] marks." By the terms of the agreement, the franchisee agrees that "all goodwill arising from operator's use of [taxpayer's] Marks and System inures to [taxpayer]." In addition, the local franchisee agrees to "indemnify [taxpayer] for any damage or expense occasioned by Operator's improper use of said Marks."

In the event that the franchise agreement terminates or is terminated, the local franchisee is required to "remove all identifying architectural superstructure and characteristics from the [franchisee's] building as [taxpayer] may direct in order to effectively distinguish the same from [taxpayer's] building design." In the event that the agreement is terminated, taxpayer retains "the right to enter upon the premises to make or cause to be made such changes at the expense of Operator... which expense Operator agrees to pay on demand."

The terms of the parties' agreement evidence the fact that taxpayer attaches great value to its intellectual property. The agreement expressly states that the elements comprising taxpayer's restaurant system "are unique and distinctive and have been developed at great effort, time, and expense."

In return for the right to make use of taxpayer's "system" and identifying intellectual property, the local franchisee pays taxpayer an initial franchise fee and agrees to pay a monthly service fee ranging between four and four and one-half percent of the franchisee's gross sales.

The issue is whether the income attributable to the licensing of taxpayer's intellectual property is subject to Indiana's corporate income tax scheme. Taxpayer concludes that the income is not subject to the tax because the intellectual property never acquired an Indiana situs. Instead taxpayer maintains that all activity associated with "the maintenance, administration, and protection of the trademarks and trade names... occurred outside the state of Indiana...."

A. Adjusted Gross Income Tax.

Indiana imposes an adjusted gross income tax on income derived from sources within the state. The adjusted gross income tax, IC 6-3-1-1 et seq., is an apportioned tax specifically designed to reach income derived from interstate transactions. Thomas v. Indiana Dep't of State Revenue, 675 N.E.2d 362, 367-68 (Ind. Tax. Ct. 1997); Indiana Dept. of State; *See also* Revenue v. Bethlehem Steel Corp., 639 N.E.2d 264, 266 n. 4 (Ind. 1994). The legislature has defined "adjusted gross income" as follows:

> (1) income from real or tangible property located in this state; (2) income from doing business in this state; (3) income from a trade or profession conducted in this state; (4) compensation for labor or services rendered within this state; and (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter. IC 6-3-2-2(a).

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

For purposes of Indiana's adjusted gross income tax, it is apparent that taxpayer's intellectual property has acquired a "business situs" within the state. Taxpayer derives income from Indiana franchisees which pay taxpayer for the right to make use of taxpayer's trademarks and trade names in order to sell fast food to Indiana customers at Indiana business locations. Taxpayer may be entirely correct in its assertion that activities associated with the initial development and ongoing administration of the intellectual property take place outside Indiana. However, issues concerning the administration, maintenance, and protection of the intellectual property are finally irrelevant to the tax question here at issue. What is relevant are the royalties taxpayer receives by placing that intellectual property within the state because it is these royalties which represent the "value" of this property. The value attached to the intellectual property does not derive from – however necessary – activities surrounding the administration of the intellectual property outside this state but results from taxpayer's ability to exploit the value of the property within the stream of Indiana commerce and to derive income from its ability to do so. The intellectual property – consisting of words, symbols, color-combinations, and the like – is, standing alone, of no value unless taxpayer takes steps to associate that property with the conduct of a specific business operation. Taxpayer is not paid royalties because it successfully administers the intellectual property at an out-of-state location; taxpayer receives income because it licenses Indiana franchisees to associate that intellectual property with the Indiana franchisees' fast food business.

The terms of the parties' franchise agreement clearly indicate that taxpayer has placed a substantial value on these particular properties. It is, therefore, quite proper that taxpayer take steps to protect the property when it licenses Indiana franchisees to make use of the property within the state. However, the assertion that the intellectual property has not acquired an Indiana business situs is simply without foundation in law or common sense. Indeed, taxpayer's trademarks and trade names have become a ubiquitous part of the Indiana landscape. Taxpayer, having taken calculated steps to "dip its net" into the stream of Indiana commerce and derive Indiana income directly attributable to exploiting its intellectual capital within the state, should not be surprised that the income is subject to Indiana income tax. As the regulation itself states, "'Business situs' is the place at which [the] intangible personal property is employed as capital...." 45 IAC 3.1-1-55. The place at which "value attaches to the [intellectual] property" is within the state of Indiana. Id.

B. Gross Income Tax.

In addition to the adjusted gross income tax, Indiana imposes a tax known as the "gross income tax" on the "taxable gross income" of a taxpayer which is a resident or domiciliary of Indiana and on the taxable gross income from Indiana sources by a taxpayer who is not a resident or domiciliary of Indiana. IC 6-2.1-2-2.

Under the regulation governing the gross income tax, "taxable gross income" includes income that is derived from "intangibles." 45 IAC 1-1-51. The term "intangibles" includes:

> notes, stocks in either foreign or domestic corporations, bonds, debentures, certificates of deposit, accounts receivable, brokerage and trading accounts, bills of sale, conditional sales contracts, chattel mortgages, "trading stamps," final judgments, leases, royalties, certificates of sale, choses in action *and any and all other evidences of similar rights capable of being transferred, acquired or sold.* (*Emphasis added*). Id.

In order for Indiana to impose the gross income tax on income derived from taxpayer's intangibles, the Department must determine that the income is derived from a "business situs" within the state. Id. The regulation states that a taxpayer has established a "business situs" within the state "[i]f the intangible or the income derived therefrom forms an integral part of a business regularly conducted at a situs in Indiana...." Id. Once the taxpayer has established a "business situs" within the state, "and the intangible or the income derived therefrom is connected with that business, either actually or constructively, the gross receipts of those intangibles will be required to be reported for gross income tax purposes." Id.

The income derived from the taxpayer's licensing of its intellectual property within the state, is income derived from a "business situs" within Indiana and is properly subject to the state's gross income tax scheme. The intellectual property is "localized" within the state because the intellectual property is integrally related to the fast food restaurants which sell food items labeled, promoted, and marketed using taxpayer's proprietary trademarks and trade names. The income at issue is not derivative of taxpayer's out-of-state activity in developing, managing, and protecting the intellectual property; the value of this intellectual property lies in taxpayer's ability to license the property for use within Indiana, to maintain rigorous control over the use of the property by its franchisees, and to derive the economic benefits attributable to the intangible property's Indiana business situs.

Accordingly, because the intangible intellectual property has acquired a business situs within the state and because the income at issue is "connected with that business, either actually or constructively," the income is subject to the state's gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Computational Errors.

Taxpayer argues that the audit report contains computational errors. For example, taxpayer states that the report's listing of "royalties received from Indiana" sources" represents income received during a 12-month period but that the report itself was intended to cover less than a 12-month period. In addition, taxpayer states that the proposed assessment "includes an adjustment to reverse the net capital loss included in Federal taxable income." Taxpayer states that, in making this adjustment, the audit failed to distinguish properly between "business" and "non-business" income.

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

The administrative hearing process is not the means by which the purported computational errors may be analyzed, corrected, or refuted. Nonetheless, taxpayer has met its burden under IC 6-8.1-5-1(b) of demonstrating that its numerous assertions are neither frivolous nor groundless. Accordingly, the audit division is requested to undertake a supplemental review of the specific claimed errors and make whatever corrections it deems appropriate.

FINDING

Subject to the results of the supplemental audit review, taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220030408.LOF

LETTER OF FINDINGS: 03-0408
Indiana Corporate Income Tax
For Taxpayer's First Short Tax Period of 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.

ISSUE

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

Authority: IC 6-3-2-2(l); IC 6-3-2-2(m); IC 6-8.1-5-1(b).

Taxpayer argues that the Department of Revenue erred in requiring taxpayer – as parent company – to submit a combined income tax return reporting its own income and the income of five related business entities.

STATEMENT OF FACTS

Taxpayer is the out-of-state parent company of a group of subsidiaries which operate fast food restaurants throughout the United States including locations within Indiana. During 2003, the Department of Revenue (Department) conducted an audit review of taxpayer's business records.

Taxpayer owned and managed restaurants located in Indiana and filed income tax returns for the period at issue. However, after conducting the audit review, the Department determined that taxpayer should have been filing a combined return reporting taxpayer's own Indiana income along with the income of five of taxpayer's subsidiaries.

The Department's adjustment resulted in an assessment of additional corporate income tax. Taxpayer disagreed with the Department's reporting methodology and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer further explained the basis for the protest. This Letter of Findings results.

DISCUSSION

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

During the audit review of taxpayer's state income tax returns, the Department concluded that taxpayer should have been filing a combined return reflecting taxpayer's own income and that of its subsidiaries. The audit report indicated that the combined reporting method was necessary "due to the substantial intercompany activities between the group" and "to fairly reflect the income earned from Indiana sources." Specifically, the audit determined that taxpayer should have been filing a combined return reporting its own income along with that of five different related entities. One of these five entities is a "royalty" company which holds title to the intellectual property used to identify and market the group's numerous fast food restaurants. The remaining four entities own restaurants or groups of restaurants in states other than Indiana. In all cases, taxpayer maintains that the five entities do not have nexus with the state.

Taxpayer disagrees with the decision requiring the combined reporting. Specifically, taxpayer argues that taxpayer's original "Indiana corporate income tax return as filed fairly represents [taxpayer's] Indiana income." In addition, taxpayer argues that the filing of the combined return "would lead to a greater distortion of income."

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 concludes that it correctly filed a state tax return reporting only its own Indiana income; the audit concluded that a combined return was the only accurate way to report taxpayer's Indiana income. Taxpayer states that the original return "fairly represents [taxpayer's] Indiana income; the audit report states that only a combined return "fairly reflect[s] the income earned from Indiana sources."

Taxpayer and its various subsidiaries own and operate restaurant chains throughout the United States and Indiana. A certain amount of the income produced by the Indiana restaurants is paid directly one of taxpayer's subsidiaries because the subsidiary purportedly holds title to the intellectual property associated with the Indiana restaurants. That intellectual property was licensed for use within the state. In a separate Letter of Findings, the Department concluded the royalty subsidiary had established an Indiana nexus because licensing the royalty subsidiary's intellectual property to Indiana franchisees produced royalty income subject to the Indiana corporate income tax.

IC 6-8.1-5-1(b) provides 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 assessment is wrong." Given the relationship between taxpayer and the various subsidiaries, the diversion of royalty income obtained from operating the Indiana restaurant chains, and the "substantial intercompany activities between the group," the Department agrees with the audit's conclusion that taxpayer and its subsidiaries should have been filing a combined return in effort to "more fairly" reflect the group's Indiana income.

Pursuant to IC 6-8.1-5-1(b), taxpayer has failed to meet its burden of rebutting the presumption that the original audit decision was correct. Taxpayer has failed to demonstrate that combined filing requirement would distort the amount of income taxpayer received from conducting business within this state.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0320030447P.LOF

LETTER OF FINDINGS NUMBER: 03-0447P
Withholding and Sales Taxes
For the Month of April 2003

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

ISSUES

I. Tax Administration – Penalty

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

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

II. Tax Administration – Interest

Authority: IC 6-8.1-10-1

The taxpayer protests the assessment of interest.

STATEMENT OF FACTS

The taxpayer filed its withholding tax and sales tax returns after their respective due dates for the month of April 2003. Accordingly, the Department assessed a penalty and interest on each of these returns for the taxpayer's failure to timely remit these Indiana trust taxes. In its letter of protest, the taxpayer requested that the penalties and interest be abated due to reasonable cause.

I. Tax Administration – Penalty

The taxpayer protests the imposition of penalty because changes in its computer system made it difficult to issue checks and also hindered the taxpayer from keeping track of due dates. The taxpayer asserts that its payment history prior to April 2003 shows that trust taxes were remitted in a timely manner.

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

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

The Department acknowledges that problems can occur whenever data processing systems are updated. However, the possibility of such problems should have been anticipated by the taxpayer; procedures should have been in place to assure that tax obligations were timely paid.

The taxpayer has not established that its failure to timely pay the full amount of tax due was due to reasonable cause and not due to negligence.

FINDING

The taxpayer's protest is denied.

II. Tax Administration – Interest

The Department does not have the authority to waive interest.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220040001.LOF

LETTER OF FINDINGS NUMBER: 04-0001
Corporate Income Tax
For the Tax Year Ended January 29, 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. Gross Income Tax- Combined Return

Authority: IC 6-8.1-5-1 (b), IC 6-2.1-2-2, IC 6-2.1-5-2, IC 6-2.1-5-5(b) and (d). The taxpayer protests the department's combination of its income tax returns with the income tax returns of related corporations.

STATEMENT OF FACTS

The taxpayer is a corporation with several related and subsidiary corporations that are engaged in retail sales primarily of clothing. The Indiana Department of Revenue (department) audited the taxpayer and its related corporations for the tax year ended January 29, 2000. During the course of the audit, the department determined that the taxpayer and its related corporations' individual corporate tax returns did not properly reflect the entities' income. Therefore, the department combined the returns for gross income tax purposes. The combination of the returns resulted in a gross income tax liability for the taxpayer. The department issued an assessment for the gross income tax, interest, and penalty. The taxpayer protested the assessment. A hearing was held and this Letter of Findings results.

1. Gross Income Tax-Combined Return

DISCUSSION

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

Indiana imposes a gross income tax on Indiana gross income of nonresident businesses. IC 6-2.1-2-2. All taxpayers are required to file annual returns pursuant to IC 6-2.1-5-2. Taxpayers are allowed to elect to file a consolidated return pursuant to the provisions of IC 6-2.1-5-5(b) and (d) as follows:

(b) Corporate members of an affiliated group that are incorporated in the state of Indiana or are authorized to do business in the state of Indiana may file a consolidated gross income tax return.

(d) An affiliated group must elect at the time it files its first annual return whether or not it will file a consolidated gross income tax return or whether each corporate member of the group will file a separate gross income tax return. After this election is made, the group must file gross income tax returns in the same manner as the group's first annual return is filed, unless the department allows the group to change the manner in which it files gross income tax returns.

Affiliated corporations are allowed to choose to file gross income tax returns on a consolidated basis. Indiana law does not allow corporations to report their Indiana gross income on a combined basis. Similarly, the department may not require corporations to report their Indiana gross income on a combined basis.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220040002.LOF

LETTER OF FINDINGS NUMBER: 04-0002
Corporate Income Tax
For the Tax Year Ended January 29, 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. Gross Income Tax - Combined Return

Authority: IC 6-8.1-5-1 (b), IC 6-2.1-2-2, IC 6-2.1-5-2, IC 6-2.1-5-5(b) and (d). The taxpayer protests the department's combination of its income tax returns with the income tax returns of related corporations.

STATEMENT OF FACTS

The taxpayer is a holding corporation. The Indiana Department of Revenue (department) audited the taxpayer and its related corporations for the tax year ended January 29, 2000. During the course of the audit, the department determined that the taxpayer and its related corporations' individual corporate tax returns did not properly reflect the entities' income. Therefore, the department combined the returns for gross income tax purposes. The combination of the returns resulted in a gross income tax liability for the taxpayer. The department issued an assessment for the gross income tax, interest, and penalty. The taxpayer protested the assessment. A hearing was held and this Letter of Findings results.

1. Gross Income Tax - Combined Return

DISCUSSION

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

Indiana imposes a gross income tax on Indiana gross income of nonresident businesses. IC 6-2.1-2-2. All taxpayers are required to file annual returns pursuant to IC 6-2.1-5-2. Taxpayers are allowed to elect to file a consolidated return pursuant to the provisions of IC 6-2.1-5-5(b) and (d) as follows:

> (b) Corporate members of an affiliated group that are incorporated in the state of Indiana or are authorized to do business in the state of Indiana may file a consolidated gross income tax return.
> (d) An affiliated group must elect at the time it files its first annual return whether or not it will file a consolidated gross income tax return or whether each corporate member of the group will file a separate gross income tax return. After this election is made, the group must file gross income tax returns in the same manner as the group's first annual return is filed, unless the department allows the group to change the manner in which it files gross income tax returns.

Affiliated corporations are allowed to choose to file gross income tax returns on a consolidated basis. Indiana law does not allow corporations to report their Indiana gross income on a combined basis. Similarly, the department may not require corporations to report their Indiana gross income on a combined basis.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420040037.LOF

LETTER OF FINDINGS NUMBER: 04-0037
Sales Tax
For the 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.

ISSUE

I. Sales Tax—Assessment; Rental of Ceremonial Caskets

Authority: IC 6-8.1-5-1(b); IC 6-2.5-2-1; IC 6-2.5-4-10(a); 45 IAC 2.2-4-27(d)(3)(B); Mason Metals v. Dept of State Revenue, 590 N.E.2d 672 (Ind. Tax 1992); **Sales Tax Information Bulletin #49**, December 1997.

Taxpayer protests the assessment of sales tax on the rental of ceremonial caskets to clients who desired public viewing of the deceased before the cremation of the body.

II. Sales Tax—Assessment; Calculation of the deficiency amount

Taxpayer protests the calculation of sales tax due on one particular contract used in a 19 contract sample employed to calculate the sales tax assessment.

III. Tax Administration—Negligence Penalty and Interest

Authority: IC 6-8.1-10-2.1(a)(3); IC 6-8.1-10-2.1(b); IC 6-8.1-10-1(a); IC 6-8.1-10-1(e); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer protests the imposition of a 10% negligence penalty and the assessment of interest on the sales tax deficiency.

STATEMENT OF FACTS

Taxpayer owns and operates funeral homes in Indiana. Taxpayer was examined by the Department for calendar years 2000, 2001, and 2002. An assessment for sales tax deficiencies was issued as a result of the audit examination. Taxpayer protested the assessment for sales tax due on the rental of ceremonial caskets rented to clients who desired public viewing of the deceased before the cremation of the body. Additional facts will be discussed below.

I. Sales Tax—Assessment; Rental of Ceremonial Caskets

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). Indiana retail transactions are subject to the imposition of an excise tax—known as the state gross retail tax. IC 6-2.5-2-1. Under IC 6-2.5-4-10(a), a person is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person.

A ceremonial casket is used in funeral services where the client desires a viewing prior to the cremation of the deceased. A viewing is not required prior to cremation; a direct cremation can occur—in which the deceased is cremated without a public viewing of the body. Viewings are the prerogative of a client. State law does require that a cremated body be placed in an alternative container for cremation. An alternative container can be a cardboard box or a pine box. The box merely is a container that allows the body to be handled and transported. For viewings, clients choose to have the deceased presented in a ceremonial casket, which is rented for the services and then is returned to the funeral home.

Taxpayer forwards 45 IAC 2.2-4-27(d)(3)(B) to support its argument that the rental of a ceremonial casket is a sales tax exempt transaction. The regulation states:

> The rental of tangible personal property together with an operator as part of a contract to perform a specific job in a manner to be determined by the owner of the property or the operator shall be considered the performance of a service rather than a rental or lease provided the lessee cannot exercise control over such property and operator.

Taxpayer argues that because Indiana law allows only a licensed funeral director to perform a funeral service, the funeral director acts as the operator of the ceremonial casket—precluding the lessee from exercising control over the property and operator. While a novel argument, it is not persuasive. The regulation is written to address the rental of heavy equipment that is used by the operator of the equipment in a manner determined by the operator—not by the person paying for the rental. An example would be where a person hires a contractor for a project and in order for the contractor to complete the project, the contractor rents a piece of heavy equipment. The person does not control the property and the operator; the contractor controls the equipment and the operator in the fulfillment of the project.

Taxpayer compares itself to a contractor hired for a project. A ceremonial casket is not a piece of heavy equipment that requires an operator in order for the function and the use of the ceremonial casket to be fulfilled. Understandably, the alternative container with the body of the deceased will need to be placed inside the ceremonial casket, and this is done by the funeral home providing the services. There are no mechanisms, buttons, knobs, controls, wheels, or the like of a ceremonial casket that need to be controlled by an operator. A ceremonial casket is a decorative container with a lid. Taxpayer places the body into the casket and removes the body from the casket. Taxpayer moves the casket into place for services, and opens and closes the lid as needed. All this is done at the request and direction of the client. While the client does not stand over Taxpayer as the tasks are done, the client does tell Taxpayer which body to place into the casket, where to place the casket, and when to remove the body from the casket. While Taxpayer facilitates the accomplishing of all this—suggesting the best method of execution—the client controls the use of the ceremonial casket. Taxpayer fulfills providing services and disposition of the body in the manner directed by the client. The client is the one who chooses whether to have a viewing. And to accomplish this, the client rents a ceremonial casket and then tells Taxpayer how to fulfill the client's viewing expectations. The client rents and controls the casket; Taxpayer is the agent who fulfills the requests.

Taxpayer cites Mason Metals v. Dept of State Revenue, 590 N.E.2d 672 (Ind. Tax 1992), to support its position that it is an operator who controls the ceremonial casket. In Mason Metals, a corporation engaged in the recycling and manufacturing of tin products entered into agreements in which a company provided a semi-tractor and a driver to haul the corporation's semi-trailers. The Tax Court held that the corporation's transactions with the company were not leases subject to sales and use tax. The decision noted that—in general—sales and use tax does not apply to the provision of transportation services. Taxpayer is not providing transportation services by way of the ceremonial casket. The casket is a container. Transportation services are provided by other means. The Tax Court determined in Mason Metals that the corporation did not have possession and control of the semi-tractor; the corporation had no control over the routes taken by the drivers in getting to their destinations and semi-tractor was not used exclusively to haul the corporation's products. The clients of Taxpayer control where the ceremonial casket is to be taken and placed. As well, during the rental period, the casket is exclusively used to contain the body of the deceased. But the most striking distinction between the facts of the Mason Metals case and the facts of this tax protest is the disparity between a semi-tractor, which provides locomotion, and a casket, which is a container. If a comparison is to be made, the ceremonial caskets are more akin to the semi-trailer—which hold the contents.

Finally, **Sales Tax Information Bulletin #49**, December 1997, lists on page 2 sales taxable items and exempt items. The exempt items include transportation services, such as: funeral cars, family cars, and flower cars. Applying this to Mason Metals, the car used to transport the ceremonial casket is the analog to the semi-tractor. It is what provides the locomotion to transport the casket. Taxable items listed in the Bulletin include: caskets and cremation caskets. The Department has placed Taxpayer on notice—by way of the Bulletin—that ceremonial caskets are a taxable product supplied in a funeral service.

FINDING

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

II. Sales Tax—Assessment; Calculation of the deficiency amount

DISCUSSION

At the hearing, Taxpayer presented the hearing officer with a copy of a contract used by the Department in a 19 contract, 2 month sample used in the audit to determine the sales tax due. Taxpayer stated that the Department incorrectly calculated the sales tax due on the contract. Taxpayer explained that the contract listed the prices of the services and products supplied to that client—but that a discount was taken off the total cost. Taxpayer presented the hearing officer with a copy of the contract and the billing statement. Neither the contract nor the billing statement indicated to which items of the billing the discount was applied. Taxpayer presented an analysis sheet that separated out what Taxpayer wished to represent as to the items to which the discount was applied. But this analysis was produced after the fact for the purposes of the hearing. It does not have indicia of reliability because nothing on the original contract or billing supports the breakout of the charges as to which the discount was applied.

FINDING

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

III. Tax Administration—Negligence Penalty and Interest

DISCUSSION

When the Department issued the assessments of sales tax, it imposed a 10% negligence penalty, as well as interest, for the tax years in question. Taxpayer protests the imposition of the penalty and the assessment of interest. IC 6-8.1-10-2.1(a)(3) states that if a person is examined by the Department and incurs a deficiency that is due to negligence, the person is subject to a penalty. In general, the penalty is 10%. *See* IC 6-8.1-10-2.1(b). 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 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 thus was subject to a penalty under IC 6-8.1-10-2.1(a). In its protest letter, Taxpayer requested a waiver of penalties and interest—but provided no documentation of reasonable cause. No affirmative explanation was provided to the Department in the letter. At the hearing, Taxpayer provided no affirmative explanation of reasonable cause. 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).

IC 6-8.1-10-1(a) states that a taxpayer is liable for interest on unpaid taxes. IC 6-8.1-10-1(e) states that the statutorily imposed interest may not be waived by the Department.

FINDING

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

DEPARTMENT OF STATE REVENUE

0320040220P.LOF

LETTER OF FINDINGS NUMBER: 04-0220P
Withholding Tax
For the Calendar Year 2003

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late payment of a calendar year withholding tax return for the year 2003.

The taxpayer is an out-of-state company.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the late penalty be abated as the taxpayer did not have the information needed to pay the tax by the due date.

The taxpayer sold an Indiana property during the 2003 year. The taxpayer completed an IRS Section 1031 Exchange in early March 2004 for the property sold in 2003. The 1031 computation resulted in the taxpayer not having the information available to compute the annual withholding until late March 2004, where upon, the taxpayer filed and paid the 2003 withholding three weeks past the due date.

The Department points out the taxpayer could have paid an estimate at the March 15th due date and then applied for a refund when the withholding 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

0420040279.LOF

LETTER OF FINDINGS NUMBER: 04-0279
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

1. Sales and Use Tax- Imposition of Use Tax on Sanitation Supplies and Equipment

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-3-2 (a), IC 6-2.5-3-2 (b), IC 6-2.5-5-2 (a), IC 6-2.5-5-3, 45 IAC 2.2-5-10(c), *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind.1983), *Gross Income Tax Division v. National Bank and Trust Co.,* 79 N.E. 2d 651 (Ind. 1948), *Indiana Department of Revenue v. American Dairy of Evansville, Inc.*, 338 N.E.2d 698, (Ind. App. 1975).

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

2. Sales and Use Tax-Imposition of Use Tax on Floor Coating

Authority: IC 6-2.5-3-2 (b), IC 6-2.5-3-2 (a), IC 6-2.5-5-3.

The taxpayer protests the imposition of use tax on floor coating.

3. Sales and Use Tax-Imposition of Use Tax on Vinegar Holding Tanks

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

The taxpayer protests the imposition of tax on vinegar holding tanks.

4. Tax Administration-Imposition of 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 that processes food products. After an audit for the tax period 1999-2001, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional use tax, interest, and penalty. The taxpayer agreed with some of the assessed items and protested the remainder of the assessment. A hearing was held and this Letter of Findings results.

1. Sales and Use Tax-Imposition of Use Tax on Sanitation Supplies and Equipment.

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 an 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). In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) further describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production.

There are a number of exemptions from the use tax pursuant to the statute. All exemptions must be strictly construed against the party claiming the exemption. *Gross Income Tax Division v. National Bank and Trust Co.,* 79 N.E. 2d 651 (Ind. 1948).

The taxpayer contends that many items, including the sanitation supplies and equipment, qualify for exemption pursuant to one of two statutory provisions. First, the taxpayer argues that the items qualify pursuant to the following provisions of IC 6-2.5-5-2 (a):

> Transactions involving agricultural machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, extraction, harvesting, or processing of agricultural commodities.

The taxpayer argues that the items could also qualify for exemption pursuant to the following provisions of IC 6-2.5-5-3 (b):

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

Both exemptions share the basic elements that the item must be "directly used in direct production". Therefore, the Indiana Court of Appeals found in *Indiana Department of Revenue v. American Dairy of Evansville, Inc.*, 338 N.E. 2d 698, (Ind. App. 1975) that the court cases and interpretations of the manufacturing exemption also apply to the agricultural production exemption.

The taxpayer protests the assessment of use tax on raincoats, aprons, overalls, sleeves, gloves, boots, and helmets. The taxpayer closes down the processing line for cleaning. While the processing line is closed down, the taxpayer's employees wear the protested items to protect themselves from the caustic cleaning solutions.

American Dairy of Evansville, Inc. (supra) dealt specifically with the taxability of cleaning compounds and supplies at a facility producing food products for human consumption. The Court found that the cleaning compounds used to maintain a clean processing area as required by the Indiana State Board of Health were directly used in direct production and therefore qualified for exemption. However, the Court reached a different conclusion on the taxability of cleaning equipment such as sponges, scouring pads, towels, and mops. The Court found that these items were too far removed from the production process to satisfy the double direct requirement of the exemption.

The sanitation items involved in this protest are even further removed from the production process than American Dairy's sponges, scouring pads, towels, and mops. Therefore, they do not qualify for exemption.

FINDING

The taxpayer's protest is denied.

2. Sales and Use Tax-Imposition of Use Tax on Floor Coating

DISCUSSION

The taxpayer also protests the assessment pursuant to IC 6-2.5-3-2 (a) of use tax on a floor coating. The taxpayer contends that this floor coating qualifies for the manufacturing exemption pursuant to IC 6-2.5-5-3 (b). This is a special urethane slurry coating used in the filler room where product is placed into jars and cans. The coating is designed to keep food particles from penetrating into any floor cracks where bacteria could grow.

The floor coating producer's sales brochure indicates that the floor coating is designed "to increase abrasion and chemical resistance while improving cleanability" and protect against moisture penetration. These functions do not directly affect the direct production of the taxpayer's product. Rather, the flooring is removed from the process in much the same way as the taxable cleaning supplies such as mops and scouring pads.

FINDING

The taxpayer's protest is denied.

3. Sales and Use Tax-Imposition of Use Tax on Vinegar Holding Tanks

DISCUSSION

The taxpayer also protests the assessment of use tax pursuant to IC 6-2.5-3-2 (a) on vinegar holding tanks. The taxpayer argues that the vinegar tanks qualify for exemption from the use tax pursuant to IC 6-2.5-5-3 (b), which states:

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

Pursuant to 45 IAC 2.2-5-8(c) equipment must have "an immediate effect on the article being produced" to qualify for the exemption. This requirement is defined at 45 IAC 2.2-5-8(g) as follows:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are exempt from tax.... The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not in itself mean that the property "has an immediate effect upon the article being produced:. Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

To qualify for this exemption, the vinegar tanks must be used during the production process. The standard for determining the parameters of the direct production process are found at 45 IAC 2.2-5-10(d) as follows:

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

The vinegar storage tanks hold enough vinegar for about eighteen (18) hours of production. They are constantly being refilled. They are located immediately outside the cook room and are connected to the cooking kettles with piping. The flow meters on the tanks control the number of gallons introduced to each cooking kettle.

The vinegar storage tanks store vinegar, a raw material for the processing of tomatoes. They do not have an immediate effect on the product. Although it is essential that there be tanks to hold the vinegar prior to the production process, they are not part of the taxpayer's integrated production process. Therefore, they do not qualify for the exemption.

FINDING

The taxpayer's protest is denied.

4. Tax Administration-Imposition of 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.

During the tax period, the taxpayer purchased without paying the sales or use tax on many clearly taxable items such as first aid supplies, file cabinets, oil dri, polo shirts, and office supplies. These breaches of the taxpayer's duty constitute negligence.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420050001.LOF

LETTER OF FINDINGS NUMBER: 05-0001
SALES TAX
For 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.

ISSUE

I. Sales and Use Tax—Like Kind Exchange; Trade in Allowance on the Purchase of an Aircraft

Authority: IC 6-8.1-5-1(b); IC 6-2.5-3-2; IC 6-6-6.5-2; IC 6-2.5-3-6(d)(2); IC 6-2.5-5-24(a)(6); IC 6-2.5-1-6; *Black's Law Dictionary*, Seventh Edition.

Taxpayer protests the denial of the trade in allowance on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased New Aircraft and sold Old Aircraft using a qualified intermediary to facilitate an IRC § 1031 like-kind exchange. Taxpayer sought to avoid the triggering of capital gain. Taxpayer purchased New Aircraft for $1.4 million from New Seller using Intermediary and sold Old Aircraft to Old Buyer for $997,975 using Intermediary. Intermediary was paid $1,000 to handle the transaction and $402,025 to cover the difference in price between the selling price of Old Aircraft and the purchase price of New Aircraft. Intermediary is not an aircraft dealer—but specializes in structuring transactions to facilitate an IRC § 1031 like kind exchange so as to avoid the triggering of the capital gains tax—which is an income tax. The title to New Aircraft was not transferred from Intermediary to Taxpayer, but was transferred from New Seller to Taxpayer. The title to Old Aircraft was not transferred from Taxpayer to Intermediary, but was transferred from Taxpayer to Old Buyer.

Taxpayer registered New Aircraft with the Department and paid the sales and use tax on $402,025—the difference between what Taxpayer claims is the purchase price of $1.4 million and the "trade in" value of $975,975. The Department billed Taxpayer for the whole purchase price of New Aircraft—stating there was no like kind exchange and thus no application of a trade in allowance.

Taxpayer filed a protest; a hearing was held; this letter of findings is issued.

I. Sales and Use Tax—Like Kind Exchange; Trade in Allowance on the Purchase of an Aircraft

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). Indiana imposes an excise tax, known as the use tax on the storage, use, or consumption of an aircraft if the aircraft:

(1) is acquired in a transaction that is an isolated or occasional sale; and

(2) is required to be titled, licensed, or registered by this state for use in Indiana.

See IC 6-2.5-3-2. Taxpayer acquired New Aircraft in an isolated sale and the aircraft is required to be registering in Indiana for use. IC 6-6-6.5-2 requires an Indiana resident who owns an aircraft to register the aircraft with the Department within 31 days after the purchase date. IC 6-2.5-3-6(d)(2) requires a taxpayer to pay the use tax due on aircraft to the Department at the time the taxpayer registers the aircraft—if the sales tax was not paid at the time of purchase. Because Taxpayer purchased New Aircraft in an isolated sale, Indiana sales tax was not collected—and thus use tax is due. IC 6-2.5-5-24(a)(6) grants an exemption to the sales and use tax due for those amounts representing a reciprocal exchange for tangible personal property of like kind. A "like kind exchange" is defined in IC 6-2.5-1-6.

(a) "Like kind exchange" means the reciprocal exchange of personal property between two (2) persons, when:

(1) the property exchanged is of the same kind or character, regardless of grade or quality; and

(2) the persons exchanging the property both own the property prior to the exchange.

(b) A "like kind exchange" may be a part of a transaction involving additional consideration other than the exchanged property.

(c) Notwithstanding subsection (a), a "like kind exchange" does not occur when:

(1) the transaction involves more than two (2) persons; or

(2) one (1) party to the transaction, through agreement or negotiation with the second party, acquires personal property for the primary purpose of exchanging that property for like kind property held by the second party.

To be a like kind exchange, several requirements must be met. The exchange must not involve more than two parties. In this case, these are the parties involved: Taxpayer, Intermediary, New Seller, and Old Buyer. There are four parties. Taxpayer exchanged consideration with Intermediary, but exchanged titles with New Seller and Old Buyer. The word *reciprocal* is defined in *Black's Law Dictionary*, Seventh Edition as *mutual* and *bilateral*. IC 6-2.5-1-6(c)(1) excludes Taxpayer's transaction as a like kind exchange. Additionally, Taxpayer admitted both at the hearing and in documentation submitted to the Department that the transactions were executed through an intermediary so as to secure a qualified IRC § 1031 like kind exchange for income tax purposes. Indiana sales and use tax code does not reference back to IRC § 1031. What is defined and qualifies as a like kind exchange in IRC § 1031 for federal income tax purposes and what is defined and qualifies for a like kind exchange in IC 6-2.5-1-6 for Indiana sales and use tax purposes are not the same. Income tax and sales & use tax are two different types of taxes—each with their own statutes, regulations, and definitions.

Taxpayer did not engage in a reciprocal like kind exchange for sales and use tax purposes. No offset for a "trade in" exists. Use tax is to be paid on the whole purchase price of New Aircraft.

FINDING

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

DEPARTMENT OF STATE REVENUE

0120050046.LOF

LETTER OF FINDINGS: 05-0046
Individual Adjusted Gross Income Tax
For 1999 and 2000

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

ISSUES

I. Imposition of the State's Individual Income Tax by Reference to Taxpayers' Federal Adjusted Gross Income.

Authority: Ind. Const. art. I, § 25; Ind. Const. art. IV, § 1; Ind. Const. art. X, § 8; IC 6-3-1-3.5; Ind. Dept. of Envtl. Management v. Chemical Waste Management, Inc., 643 N.E.2d 331 (Ind. 1994); Campbell v. Heiss, 53 N.E.2d 634 (Ind. 1944); Bissell Carpet Sweeper Co. v. Shane Co., 143 N.E.2d 415 (Ind. 1957).

Taxpayers argue that imposition of the Indiana income tax by reference to the federal income tax law is a violation of the Indiana constitution.

II. Sufficiency of Taxpayers' Indiana Tax Return.

Authority: IC 6-3-1-3.5; United States v. Kimball, 896 F.2d 1218 (9th Cir. 1990); United States v. Long, 618 F.2d 74 (9th Cir. 1980); Cooper Industries, Inc. v. Indiana Dept. of State Revenue, 673 N.E.2d 1209 (Ind. Tax Ct. 1996); 45 IAC 3.1-1-1.

Taxpayers maintain that their Indiana tax returns were not "frivolous."

III. Definition of "Income" for Purposes of Imposing the State's Individual Income Tax.

Authority: U.S. Const. amend. XVI; Ind. Const. art X, § 8; IC 6-3-1-3.5 et seq.; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; I.R.C. § 61; New York v. Graves, 300 U.S. 308 (1937); Burnet v. Harmel, 287 U.S. 103 (1932); Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926); Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921); Eisner v. Macomber, 252 U.S. 189 (1920); United States v. Connor, 898 F.2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F.2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F.2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F.2d 1328 (7th Cir. 1984); United States v. Romero, 640 F.2d 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)

Taxpayers claim that any money they received during 1999 and 2000 was not subject to the state's adjusted gross income tax. Taxpayers argue that only corporate income is subject to income tax.

STATEMENT OF FACTS

Taxpayers are Indiana residents who filed state income tax returns for 1999 and 2000. The Department of Revenue (Department) adjusted the taxpayers' returns based on income information contained on the taxpayers' W-2 forms. As a result, the Department sent taxpayers notices of "Proposed Assessment."

Taxpayers disagreed with the Department's conclusion and assessments. Taxpayers submitted a protest letter to that effect. The protest letter challenged the Department's conclusions. The taxpayers also challenged adjustments made for 1996, 1997, 1998, and 2001; however, the taxpayers' challenges of those latter adjustments had been addressed in three Letters of Finding previously issued by the Department.

Upon assignment to the Hearing Officer, taxpayers were notified of their opportunity to take part in an administrative hearing and to further explain the basis for their protest. Taxpayers chose not to respond. Taxpayers were notified a second time and provided a second opportunity to schedule the hearing. Taxpayers again chose not to respond despite their own initial written "demand" for just such a hearing. Consequently, this Letter of Findings was written based entirely upon taxpayers' original protest letter.

DISCUSSION

I. Imposition of the State's Individual Income Tax by Reference to Taxpayers' Federal Adjusted Gross Income.

Taxpayers argue that the proposed assessments represent a "blatant violation of the Indiana Constitution...." because "[n]owhere in the Indiana Constitution did the people of this State give any power or authority to the federal government to make laws exclusively for those living in Indiana." According to taxpayers, the Department's attempt to hold them accountable to a state law based upon a federal statute (whose specific provisions had never been incorporated into the laws of Indiana) "obviously represents an illegal and unconstitutional delegation of legislative authority by the Indiana legislature to the U.S. Congress which is specially barred by the Indiana Constitution."

Taxpayers states that if the Department attempts to enforce against them a federal law, they will seek punitive damages from the Department and will take the matter up with the Indiana Supreme Court.

In effect, taxpayers argue that the Indiana Constitution does not permit references to another taxing jurisdiction's own laws; because taxpayers are now faced with just such an improper reference to federal law – such as that found within IC 6-3-1-3.5 – the taxpayers' compliance with the state tax law is not required.

Because taxpayers did not take part in an administrative hearing and because taxpayers did not provide a more detailed explanation of their state constitutional argument, the Department must assume that taxpayers' based their argument on Ind. Const. art. I, § 25 which states that, "No law shall be passed, the taking effect of which shall be made to depend upon any authority, except as provided in this Constitution." This section of the state constitution is intended to place a limit on "the legislative activity of the General Assembly." Ind. Dept. of Envtl. Management v. Chemical Waste Management, Inc., 643 N.E.2d 331, 341 (Ind. 1994).

The Indiana Constitution vests legislative authority in the Indiana General Assembly. "The Legislative authority of the State shall be vested in a General Assembly, which shall consist of a Senate and a House of Representatives. The style of every law shall be: 'Be it enacted by the General Assembly of the State of Indiana': and no law shall be enacted, except by bill." Ind. Const. art. IV, § 1. Taxpayers are correct in their assertion that, under Ind. Const. art. I, § 25 and Ind. Const. art. IV, § 1, the Indiana General Assembly may not delegate either its authority or its exclusive responsibility for performing legislative functions. "The power to legislate or to exercise a legislative function cannot be delegated to a non-governmental agency or person. Nor can the Legislature delegate its law-making power to a governmental officer, board, bureau or commission." Bissell Carpet Sweeper Co. v. Shane Co., 143 N.E.2d 415, 419 (Ind. 1957) (Internal citations omitted).

On its face, taxpayers' contention appears to have merit. The Indiana General Assembly may not delegate to the federal government the Assembly's own responsibility for defining or enforcing the state's adjusted gross income tax scheme. Neither may the Assembly's authority to implement such a scheme be obtained under federal law. However, the cross-references to the Internal Revenue Code – such as I.R.C. § 62 cited within IC 6-3-1-3.5 – do not delegate the Assembly's taxing authority to the federal government. The Assembly did not turn over its taxing authority to the federal government. The Assembly did not obtain its taxing authority from the federal government. Ind. Const. art. X, § 8 unambiguously states that, "The general assembly may levy and collect a tax upon income from whatever source derived, at such rates, *in such manner*, and with such exemptions as may be prescribed by law." (*Emphasis added*). The Indiana Code provisions containing references to the I.R.C. reflect merely the legislature's independent decision to employ the federal tax calculation as the starting point for determining Indiana's adjusted gross income tax. "It is well settled that a legislative body may enact a law, the operation of which depends upon the existence of a stipulated condition." Campbell v. Heiss, 53 N.E.2d 634, 636 (Ind. 1944). The state legislature has retained its independent authority to define and enforce the state's own income tax plan. That the Indiana General Assembly has retained exclusive authority to stake out the parameters of the state's adjusted gross income tax scheme, is evidenced by the Assembly's regular decisions to periodically reenact IC 6-3-1-3.5 the latest of which occurred in 2004. Whether the General Assembly should have avoided references to the Internal Revenue Code, drafted original statutory provisions mirroring the Internal Revenue Code, and then require every Indiana taxpayer to recalculate his or her taxable income, is an issue beyond the scope of this Letter of Findings and is irrelevant to determining taxpayer's existing tax liability. It is enough to say that the General Assembly acted entirely within its authority in employing the federal adjusted gross income as the jumping off point for calculating the individual taxpayer's Indiana adjusted gross income. It is no different than if the General Assembly simply adopted federal guidelines for state road construction or if the General Assembly adopted Illinois procedures for removing underground fuel tanks. The federal government did not decide that Indiana residents should pay a state income tax; the General Assembly did.

FINDING

Taxpayers' protest is denied.

II. Sufficiency of Taxpayers' Indiana Tax Return.

Taxpayers have set out various arguments in support of their belief that they were not liable for Indiana income tax for income received during 1999 and 2000. One of their arguments is based upon the undisputed fact that they reported "0" income on their corresponding federal returns. According to taxpayers, they were thereafter – under penalty of law – obliged to report the identical amount ("0") on their state return. In support of their argument taxpayers have reported a copy of their 2000 federal return and, indeed, it is apparent that taxpayers reported "0" on their federal return.

It is also not disputed that the Indiana tax return for the tax year 2000 employs federal adjusted gross income as the starting point for determining a taxpayer's state individual income tax liability. Line one of the IT-40 state form requires the taxpayer to "Enter your Federal adjusted gross income from your Federal return (see page 9)."

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

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

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

Taxpayers' contention – that they were compelled by force of law to declare "0" as Indiana adjusted gross income because they declared "0" on his federal return – is meritless. The Indiana statute is unambiguous. Indiana adjusted gross income begins with federal taxable income as defined by I.R.C. § 62, not 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. The Indiana tax form simply instructs a taxpayer to put which number inside of which box. Those directions notwithstanding, a taxpayer is nonetheless required to actually perform the calculations necessary to determine his Indiana adjusted gross income tax liability.

Taxpayers have cited to various cases in support of the proposition that they are in full compliance with the tax laws simply by placing a "0" on their tax return. Taxpayers cite to United States v. Long, 618 F.2d 74 (9th Cir. 1980) and United States V. Kimball, 896 F.2d 1218 (9th Cir. 1990). However, neither case supports the fanciful notion that a taxpayer has fulfilled his obligations by merely placing a "0" on the form. Rather, in the cited cases, the defendants were being criminally prosecuted for *failing to file* an income tax return. *See* 26 U.S.C.S. § 7203. In the Long case, the court found that "A return containing false of misleading figures is still a return." Long, 618 F.2d at 76. The cases cited by the taxpayers are entirely irrelevant to taxpayers' underlying argument that they do not have to pay income tax. Taxpayers are not being criminally prosecuted for failure to file a return because it is clear that taxpayers *did* file an Indiana tax return for 1999 and 2000. Rather, the issue is whether the taxpayers owe adjusted gross income tax because the numbers written on the returns were the wrong numbers.

Taxpayers reported receiving zero income for 1999 and 2000. Fanciful semantics aside, they reported their income incorrectly, and they now owe income tax for those years.

FINDING

Taxpayers' protest is denied.

III. Definition of "Income" for Purposes of Imposing the State's Individual Income Tax.

Taxpayers argue that "wages" for services do not constitute taxable income. Taxpayers believe that only corporate profits are subject to federal or state income tax. Since taxpayer's did not obtain "corporate profits" during 1999 and 2000, they maintain that they do not owe state income tax.

Taxpayers' argument is that – for purposes of determining income tax liability – "income" can only be derivative of corporate activity. Therefore, as individual Indiana residents who by definition did not receive "corporate" income, taxpayers are not subject to the adjusted gross income tax because the ordinary income received by individuals is not "taxable income."

Taxpayers have offered a number of Supreme Court cases which purportedly support taxpayers' basic contention. Taxpayers cites to Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921) for the proposition that income tax can only be levied against corporate gains. In that case, the Court held that the when a provision in a will created a trust, the increase of the value of the trust resulted in taxable "income" under the provisions of the U.S. Const. amend. XVI. Id. In arriving at that decision, the Court stated that "the word [income] must be given the same meaning and content in the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of [the] court." Id. 519.

Taxpayers also cite to Eisner v. Macomber, 252 U.S. 189 (1920), a case in which the Court addressed the issue of whether the U.S. Const. amend. XVI permitted the government to tax a taxpayer's stock dividends resulting from a corporation's accumulated profits. The Court found that the stock dividend did not involve the realization of a taxable gain but that the corporation's accumulated profits were simply capitalized or retained as surplus. Id. at 211. In effect, the taxpayer in Eisner had not yet realized a gain severed from and independent of the corporations' assets. Id. at 211-12. In reaching that decision, the Court stated that income is the "gain derived from capital, from labor, or from both combined." Id. at 201.

Taxpayers read Merchant's Loan and Eisner together with certain other cases – Burnet v. Harmel, 287 U.S. 103 (1932); Bowers v. Kerbaugh-Empire Co., 271 U.S. 170 (1926) – as supporting their contention that the individual income tax can only be assessed against corporate gain. Taxpayers base their conclusion on selected case citations which, when taken together, purportedly limits the definition of "taxable income" to the definition originally established under the Corporation Excise Tax Act of 1909 and the Revenue Act of 1924. The conclusion that only a "corporation" can earn "corporate income" is not particularly startling. However, even setting aside questions concerning the soundness of taxpayers' legal analysis, taxpayers' review of corporate income tax cases is entirely irrelevant.

Taxpayers' legal argument stands for nothing more than that a legal argument can be advanced which will support any legal conclusion no matter how far-fetched. Taxpayers cite cases in which the Court was asked to determine what constituted *corporate income* under the corporate income and excise taxes in effect at the time the Court reached its conclusion. In each of the cases cited by taxpayers, the Court was asked to determine if certain income was subject to the federal corporate income tax law. Not one of the cases cited by taxpayers addresses the issue of whether the wages received by an individual are subject to federal income tax. It is sufficient to say that the cases simply do not get the taxpayers where they want to go.

The United States Supreme has clearly stated that the wages of individual citizens may be subjected to an adjusted gross income tax. In New York v. Graves, 300 U.S. 308 (1937), Justice Stone stated "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized." Id. at 312.

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

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

As set out in the Indiana Constitution, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art X, § 8. The Indiana General Assembly exercised its constitutional prerogative by imposing an adjusted gross income tax on individuals and corporations. IC 6-3-1-3.5 et seq. In doing so, the General Assembly defined an individual subject to the adjusted gross income tax as a "natural born person, whether married or unmarried, adult or minor." IC 6-3-1-9.

Taxpayers are of the opinion that with the right combination of "legal arguments," they can render themselves immune from federal and state tax liability. There is not one single federal or state court case which supports such a notion. Wishful thinking aside, given that taxpayers received gross income (I.R.C. § 61) during 1999 and 2000, are "individual[s]" under IC 6-3-1-9, were residents of Indiana for the years 1999 and 2000 (IC 6-3-1-12), and are "taxpayer[s]" as defined within (IC 6-3-1-15), the statutes imposing the Indiana individual income tax apply with full force to taxpayers' 1999 and 2000 income.

FINDING

Taxpayers' protest is denied.

DEPARTMENT OF STATE REVENUE

0120050054P.LOF

LETTER OF FINDINGS NUMBER: 05-0054P
Income Tax
For the Calendar Year 2003

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late payment of a calendar year individual income tax return for the year 2003.

The taxpayer is an individual residing in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the penalty be abated as the error was the fault of the taxpayer's accountant.

The Department points out the accountant is an agent of the taxpayer, and therefore the taxpayer is liable for the actions of the accountant. "Generally, a principal who controls or has the right to control the physical conduct of his agent in the performance of a service is an employer upon whom liability for the torts of the agent may be imposed." Dague v. Fort Wayne Newspapers, 647 NE 2nd 1138 (Ind. Ct. App.) (1995).

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

0120050055.LOF

LETTER OF FINDINGS: 05-0055
Indiana Individual Income Tax
For 2001

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

ISSUES

I. Sufficiency of Proposed Assessment Notice.

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

Taxpayer argues that the notice of proposed tax assessment was insufficient and that he requires a "verified bill" before he will consider paying the assessment.

II. Administrative Due Process.

Authority: U.S. Const. amend. V; U.S. Const. amend. XIV; JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW (5th ed. 1995).

Taxpayer claims that issuance of the proposed assessment constituted a denial of administrative due process.

III. Unapportioned State Income Tax.

Authority: U.S. Const. art. I, § 2, cl. 3; U.S. Const. art. I, § 8, cl. 1; U.S. Const. amend. XVI; Ind. Const. art. X, § 8; IC 6-3-1-3.5 et seq.; United States v. Collins, 920 F.2d 619 (10th Cir. 1990); Lovell v. United States, 755 F.2d 517 (7th Cir. 1984).

Taxpayer maintains that Indiana is not entitled to impose or collect an unapportioned state income.

STATEMENT OF FACTS

Taxpayer is an Indiana resident who did not file state income tax returns for several tax periods. Based upon information forwarded by the IRS, the Department of Revenue (Department) determined that taxpayer should have paid state income tax for 2001.

Therefore, the Department sent taxpayer a notice of "Proposed Assessment" dated September 13, 2004. Taxpayer disagreed with the Department's decision and sent the Department a protest to that effect. Taxpayer was offered the opportunity to further explain the basis for his protest during an administrative hearing. Taxpayer declined the opportunity to do so. As a result, this Letter of Findings is based on taxpayer's original protest letter and upon the supplemental correspondence directed to the Hearing Officer.

DISCUSSION

I. Sufficiency of Proposed Assessment Notice.

Taxpayer objects to the notice of "Proposed Assessment." In place of the notice the Department first sent to the taxpayer, taxpayer claims that he is entitled to a "verified bill" signed under penalty of perjury.

IC 6-8.1-5-1(a) in part 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 taxes on the basis of the best information available to the department." (*Emphasis added*). IC 6-8.1-5-1(b) in part states that, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid."

The Department sent taxpayer the notice of "Proposed Assessment" because it had obtained information indicating that taxpayer received taxable income during 2001. The notice was based upon information received from the IRS. That information constituted "the best information available to the department." IC 6-8.1-5-1(a).

There is no indication that the Department did anything less than was required under the law when it sent taxpayer the notice of "Proposed Assessment" in which the Department indicated that taxpayer owed 2001 income taxes. There is nothing in IC 6-8.1-5-1 which requires the Department to send taxpayer a "verified bill" or that the notice be signed under penalty of perjury. Taxpayer has unilaterally imposed upon the Department a procedural and substantive requirement that is not required under the law.

FINDING

Taxpayer's protest is denied.

II. Administrative Due Process.

Taxpayer believes that his constitutional guarantee of due process was given short shrift by the Department. Taxpayer suggests that this denial of "meaningful due process of law and notification of my Administrative Due Process Rights...." would potentially subject the Department to a "Federal Civil Rights and other Tort Actions for violation of Constitutional Rights."

Both the Fifth and Fourteenth Amendments prohibit governmental actions which would deprive "any person of life, liberty or property without due process of law." U.S. Const. amend. V; U.S. Const. amend. XIV. "The essential guarantee of the due process clause is that of fairness. The procedure must be fundamentally fair to the individual in the resolution of the factual and legal basis for government actions which deprive him of life, liberty or property." JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW p. 561 (5th ed. 1995).

After taxpayer sent his initial protest letter dated September 28, 2004, taxpayer was sent a letter from the Department dated February 4, 2005, indicating that it had received taxpayer's letter and that the "Department [would] review the protest as soon as possible and [would] contact him." Taxpayer responded with a letter dated February 18 indicating that he was not "arguing anything," that he was not "objecting to the law," and that he was "willing to pay any debt [he] lawfully owe[d]." Nonetheless, taxpayer's challenge of the assessment was assigned to a Hearing Officer. The Hearing Officer sent taxpayer a letter dated February 23 offering taxpayer the opportunity to further explain his position at an administrative hearing. Taxpayer was offered the choice of conducting the hearing by telephone or in person. Taxpayer was offered the opportunity to choose a date and time for the hearing. Taxpayer responded with a letter dated February 26 stating the he was currently involved in unrelated litigation and again offered to pay "any debit [he] lawfully owed" as soon as he was sent a "certified bill and also a jury or bench judgment...." The hearing officer responded in a letter dated March 1 stating that the litigation in which taxpayer was then involved was "irrelevant to the notice of proposed assessment originally issued on September 13, 2004." Taxpayer was asked to schedule and take part in an administrative hearing. Taxpayer responded with a letter dated March 3, 2004 in which taxpayer again objected to the proposed assessment, raised additional objections, but failed to respond to the offer to take part in an administrative hearing. The Hearing Officer answered in a letter dated March 9. In this letter, the offer to schedule an administrative hearing was repeated. However, taxpayer was cautioned that if he waived the right to an administrative hearing, the Letter of Findings would be prepared and would be "based upon the written information currently before [the Hearing Officer]." Taxpayer failed to respond, and the Letter of Findings was drafted on April 8, 2005.

The taxpayer has failed to demonstrate that he was in any way denied his right to due process. To the contrary, taxpayer declined to take part in an administrative hearing in which he would have been provided the opportunity to explain the basis for his challenge of the proposed assessment. Contrary to the taxpayer's unfounded assertion, taxpayer was provided a full and fair opportunity to air his grievances; taxpayer received all the administrative due process that he was owed.

FINDING

III. Unapportioned State Income Tax.

Taxpayer maintains that the Indiana is without authority to levy an unapportioned state income tax.

Taxpayer apparently refers to the provisions of the Constitution granting powers of taxation to the Congress. U.S. Const. art.

I, § 2, cl. 3 states that, "Representatives and direct Taxes shall be apportioned among the several states which may be included within this Union, according to their respective Numbers...." U.S. Const. art. I, § 8, cl. 1, states that, "The Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States." However, the Sixteenth Amendment permitted imposition of a federal income tax without apportionment among the states. "The Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." U.S. Const. amend. XVI.

Since the Sixteenth Amendment was ratified in 1913, the courts have implicitly and explicitly recognized that the Amendment authorizes a non-apportioned direct income tax on United States citizens and that federal tax laws are valid. In United States v. Collins, 920 F.2d 619 (10th Cir. 1990), *cert denied*, 500 U.S. 920 (1991), the court cited to Brushaber v. Union Pacific R.R., 240 U.S. 1 (1916) and noted that the United States Supreme Court has recognized that the "sixteenth amendment authorizes a direct nonapportioned tax upon United States citizens throughout the nation." Collins, 920 F.2d at 629.

In Lovell v. United States, 755 F.2d 517 (7th Cir. 1984), the court rejected the plaintiffs' argument that the Constitution prohibited the imposition of a direct, unapportioned income tax and concluded that "there is absolutely no doubt that the legal contentions advanced by the plaintiffs are frivolous; indeed, plaintiffs' arguments are patently absurd." Id. at 519.

However, taxpayer's argument touches on Indiana's right to levy a state income tax, but it is somewhat difficult to understand taxpayer's argument that a state tax must be "apportioned" among the residents of that state. The Indiana Constitution simply states that, "The general assembly may levy and collect a tax upon income from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art. X, § 8. The Indiana General Assembly has exercised its constitutional prerogative by imposing a state adjusted gross income tax on individuals and corporations. IC 6-3-1-3.5 et seq.

Taxpayer has advanced a number of other legal arguments including the assertion that Indiana taxes are founded in contract and that he did not sign a contract with the state, that Indiana does not possess the authority to collect federal reserve notes, and that the Department has not satisfactorily proved taxpayer's identity. These and taxpayer's remaining arguments are frivolous and the Department will not expend further resources addressing them.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0320050056P.LOF

LETTER OF FINDINGS NUMBER: 05-0056P
Withholding Tax
For the Calendar Year 2003

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late payment of an annual withholding tax return for the calendar year 2003.

The taxpayer is an in-state company.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the late penalty be abated as the taxpayer paid the liability in good faith before the Department contacted the taxpayer concerning the liability.

The taxpayer reorganized from a sole proprietorship to a Professional Corporation (P.C.) in 2003. The taxpayer registered for a new withholding account on December 29, 2003. The taxpayer's payroll provider told the taxpayer to send the 2003 withholding payment to the bank and the bank would send the payment to the Department of Revenue. The taxpayer did so and sent a check for $40,831.16 to the bank. However, the bank sent the $40,831.16 check to the IRS. As it turns out, the bank does not procedurally send withholding payments to the Department of Revenue. The taxpayer had received erroneous information from the taxpayer's payroll provider concerning the remittance of the withholding payment.

In May 2004, the taxpayer received a $41,167.09 check from the IRS where the IRS stated the check was an overpayment of the federal withholding account. At the time, the taxpayer did not understand the $41,167.09 check. The taxpayer did not figure out that the Department of Revenue had not received its withholding payment until October 2004. In October 2004, the taxpayer sent the $41,167.09 IRS check to the Department for payment of the 2003 withholding liability.

With regard to the Department contacting the taxpayer, the Department is not obliged to contact the taxpayer for an unfilled tax period. When the taxpayer files a return, the Department has three years in which to contact the taxpayer.

With regard to timeliness, the Department did not receive payment until October 2004. This payment is seven months after the due date, and, five months after the IRS informed the taxpayer of a payment problem.

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

0320050077.LOF

LETTER OF FINDINGS NUMBER: 05-0077
Withholding Tax
Responsible Officer
For the Tax Period September, 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 the president of a corporation that did not remit the proper amount of withholding taxes for the tax period September, 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. A hearing was scheduled. The taxpayer did not appear.

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 was the president of the corporation. She had the ultimate responsibility for all of the corporation's financial affairs. Therefore, she is personally responsible for the payment of the corporate withholding taxes.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01980577.LOF

SUPPLEMENTAL LETTER OF FINDINGS: 98-0577
Indiana Adjusted Gross Income Tax
For 1995

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

ISSUE

I. Net Operating Losses – Adjusted Gross Income Tax.

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

Taxpayer repeats her argument that she did not owe Indiana adjusted gross income tax for 1995 because she was entitled to carry forward a net operating loss from previous years.

STATEMENT OF FACTS

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

Following taxpayer's initial protest, the Department issued a Letter of Findings (LOF) denying taxpayer's claim. Taxpayer again protested and supplied additional information purporting to verify the net operating loss. This Supplemental Letter of Findings results.

DISCUSSION

I. Net Operating Losses – Adjusted Gross Income Tax.

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

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

The original LOF agreed with the Department's original decision. As stated in the original LOF, "What is missing is any sort of explanation as to the manner in which the $200,000 was originally incurred or how that loss was calculated."

After the LOF was issued, taxpayer supplied information indicating that the original losses were attributable to periodic crop losses caused by flooding. Taxpayer explained that crop insurance paid for some but not all of the losses.

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." Taxpayer has met her burden of establishing the factual predicate upon which the original NOL was claimed.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE
Revenue Ruling #2005-02IT
May 16, 2005

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

ISSUE

Corporate Adjusted Gross Income Tax—Sourcing Business Receipts

Authority: IC 6-3-2-1; IC 6-3-2-2; 45 IAC 3.1-1-37; 45 IAC 3.1-1-55.

Taxpayer requests the Department to rule on the sourcing of business receipts.

1. For purposes of computing the sales factor and sourcing the receipts of Taxpayer's commissions received in the sale of

insurance coverage policies, is Taxpayer able to apportion based on the location of where the insurance policies are executed, hand delivered, and loss prevention services are rendered?

2. For purposes of computing the sales factor and sourcing all the receipts of Taxpayer's claim management fees, is Taxpayer able to apportion based on the location where the claim report is rendered to the insured?

STATEMENT OF FACTS

Taxpayer is an Indiana corporation that specializes in marketing and writing property and casualty insurance. Taxpayer does business and files income tax returns in Indiana and other states. Taxpayer's subsidiaries both are Indiana domiciled; they are licensed and sell insurance policies in all fifty states and all Canadian provinces.

DISCUSSION

IC 6-3-2-1 imposes on every corporation an income tax upon the adjusted gross income derived from sources within Indiana. For adjusted gross income tax purposes, a corporation must apportion its business income derived from sources within and without Indiana. *See*, IC 6-3-2-2. 45 IAC 3.1-1-37 states that business income is apportioned to Indiana based on the 3-factor formula named in IC 6-3-2-2(b). Business income derived from sources within Indiana is determined by multiplying all business income by a fraction; the numerator of the fraction is the property factor plus the payroll factor plus twice the sales factor; the denominator of the fraction is four. *Id.*

45 IAC 3.1-1-55, **Attribution of sales to state**, interprets IC 6-3-2-2. The regulation states that gross receipts from transactions other than sales of tangible personal property are included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within Indiana. If the income producing activity is performed within and without Indiana, those receipts are attributed to Indiana based on whether or not the receipts constitute a principal source of income. *Id*. Income producing activity is deemed performed at the situs of real, tangible, and intangible personal property or the place where personal services are rendered. *Id*. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed). *Id*.

Commission Revenue on Sale of Insurance Policies

Taxpayer states that the performance of services for customers across the United States are split between Indiana and the resident state of the insured. Taxpayer's employees travel into the various states and execute an insurance coverage application in the resident state of the insured. Prior to a quote being provided, Taxpayer's employees perform loss prevention services, which occurs in the home office located in the state of the prospective customer. Subsequent to the execution of the sale and loss prevention services, the insurance policy is underwritten in Taxpayer's Indiana office. Once the policy is underwritten, it is delivered to the insured in their home state. Taxpayer receives a commission for the solicitation and execution of the sale.

Taxpayer's commission revenue constitutes a principal source of business income, therefore Taxpayer's commission revenue is sourced in this manner. Services are rendered both within and without Indiana, 45 IAC 3.1-1-55(e) states that the gross business income receipts shall be attributed to Indiana based upon the ratio which the total property and payroll factors in Indiana bears to the total of the property and payroll factors everywhere for the tax period.

Management Fee Revenue

Taxpayer serves as a third-party administrator for many customers of self-insurance policies sold by one of its subsidiaries. Using its employees located in Indiana, Taxpayer provides services to process insurance claims for self-insurance customers. Taxpayer's employees supervise the handling and settlement of these claims, including hiring outside adjustors and attorneys. As well, Taxpayer's employees conduct many claim processing services, such as inspection, interviews, and documentation of insurance claims in the resident state of the insured or in the state where the accident occurred. Following the services rendered by the adjustors and attorneys, Taxpayer issues a claim report to the self-insured to the policy holder's resident state. A claims management fee is charged to each policyholder selecting Taxpayer as its third-party administrator. The fee is paid directly to taxpayer by the policyholder.

Taxpayer's management fee revenue constitutes a principal source of business income, therefore Taxpayer's management fee revenue is sourced in this manner. Services are rendered both within and without Indiana. 45 IAC 3.1-1-55(e) states that the gross business income receipts shall be attributed to Indiana based upon the ratio which the total property and payroll factors in Indiana bears to the total of the property and payroll factors everywhere for the tax period.

RULING

The Department rules that the commission revenue and the management fee revenue is earned for services rendered both within and without Indiana. The gross business income receipts shall be attributed to Indiana based upon the ratio which the total property and payroll factors in Indiana bears to the total of the property and payroll factors everywhere for the tax period as the receipts constitute a principal source of business income.

CAVEAT

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

Indiana Department of State Revenue