INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT
Office of Land Quality
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Title: Use of Chipped Tires in Sewage Systems
Identification Number: WASTE-0058-NPD
Date Originally Effective: November 17, 2005
Dates Revised: None
Other Policies Repealed or Amended: None
Citations Affected: 329 IAC 10-3-1
Brief Description of Subject Matter: Use of waste tire chips in on-site sewage systems.

This non-rule policy document is intended solely as guidance and does not have the effect of law or represent formal Indiana Department of Environmental Management (IDEM) decisions or final actions. This nonrule policy document shall be used in conjunction with applicable laws. It does not replace applicable laws, and if it conflicts with these laws, the laws shall control. This nonrule policy document may be put into effect by IDEM 30 days after presentation to the appropriate board**.** Pursuant to IC 13-14-11.5, this policy will be available for public inspection for at least 45 days prior to presentation to the appropriate board. If the nonrule policy is presented to more than one board, it will be effective 30 days after presentation to the last. IDEM will submit the policy to the Indiana Register for publication. Revisions to the policy will follow the same procedure of presentation to the board and publication.

The purpose of this nonrule policy is to approve the use of chipped tires in on-site sewage (septic) systems when such use is approved by the Indiana State Department of Health (ISDH).

IDEM administers environmental statutes and rules regarding waste tires which contain provisions for disposal of tires, creating funds for clean up of tire dumps, and registration requirements for processors, storers and transporters of waste tires. Approximately six million waste tires are generated each year in Indiana. IDEM estimates that there are an additional 11 million tires stockpiled in Indiana. In general, the majority of Indiana's waste tires are collected for processing, and less than 2% of the tires are reused.

While the regulations do not specifically address beneficial reuses of waste tires, 329 IAC 10-3-1(16) provides that the Commissioner may approve the use of any solid waste for legitimate purposes if it is determined that such use does not pose a threat to public health or the environment. (Traditionally, this has been done on a case by case basis. Without an approval from the Commissioner, waste tires would be fully subject to the above referenced regulations, which do not contain reuse provisions.) The Department has determined that the use of chipped tires in septic systems is a legitimate reuse. The purpose of this document is to provide a generic one-time approval and eliminate the need for case by case approvals from IDEM for the use of chipped tires in on-site septic systems.

Chipped tires are utilized as aggregate in soil absorption fields and perimeter drains in place of more commonly used gravel or crushed stone. The use of chipped tires is not a new or experimental technology and such use is already approved in a number of states. Studies are available which support such use. Experience thus far has demonstrated to the Department's satisfaction that chipped tire aggregate is an effective and environmentally safe alternative to traditional aggregates. Uses in other states have not identified any adverse impacts on ground water and the tire chips provide more surface area for development of micro biota colonies and improved biodegradation of sewage. Some concern with heat build up from oxidation of steel belts within chipped tires can be avoided by limiting the depth of the chipped tires to ten (10) feet.

With this Non-rule Policy Document, the Commissioner is approving the use of chipped waste tires for use as aggregate in on-site sewage systems. Such use is subject to the following conditions:

1. Chipped tires may only be used as aggregate when such use is approved by the ISDH, or approved by a local health department as authorized by ISDH.
2. The chipped tires must be utilized in accordance with the requirements of the ISDH, including size restrictions.
3. Leach fields constructed with chipped tires must not be more than ten (10) feet deep.
4. Any unused chipped waste tires must be managed in accordance with the applicable solid waste rules. Unused chips may be reused at another site or disposed at a permitted municipal solid waste landfill.

Concern has been expressed that the waste tire rules would require a waste tire storage permit if waste tire chips equivalent to 1,000 waste tires, or more, are stored at either a location that was going to utilize the waste tire chips in a septic system or at a waste tire processor that makes shreds for use in septic systems. Under the rules shredded tires that are to be utilized in a septic system would be considered a transformed tire (329 IAC 15-2-12) and therefore not subject to the rule (see 329 IAC 15-1-1(b)(6)). It is important that a waste tire processor be able to demonstrate a market for the commodity in order for the shredded tires to qualify for the exemption from the rule.

IDEM encourages the reuse of waste tires rather than disposal at a landfill. The Department pursuant to 329 IAC 10-3-1-(16)

on a case-by-case basis or through non-rule policy documents when generic approvals are deemed appropriate may approve other legitimate uses of waste tires not addressed here.

If you need additional information, or have questions or concerns, please contact the staff of the Compliance and Response Branch at 317-308-3103. The IDEM toll free telephone number is 1-800-451-6027. Information is also available online at http://www.idem.IN.gov/olq.

DEPARTMENT OF HOMELAND SECURITY
DIVISION OF FIRE AND BUILDING SAFETY

Title: Interpretation of the term "exercise room" for purposes of Table 1003.2.2.2 of the **2003 Indiana Building Code (675 IAC 13-2.4)**
Date: December 1, 2005
Purpose: To assist code enforcement officials, design professionals, and the general public in determining the required number of exits for an "exercise room" for purposes of Table 1003.2.2.2 of the 2003 Indiana Building Code.
Interpretation: The agency interprets "exercise room" to include rooms in which any one or more of the following are located:

Weight machines.
Free weights.
Cardio-vascular workout equipment.
Exercise bicycles.
Platforms used for aerobics.
Equipment such as parallel bars, rings, or other gymnastics equipment.

An exercise room may also be a room without any of the above listed equipment that is used for dance, karate, gymnastics, or similar activities for which the room has no equipment, no spectator seating of any kind, no chairs or tables, and is used exclusively for practice or training. A room that has any of the items listed above and has spectator seating of any kind or chairs or tables is not considered to be an exercise room.

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

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

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

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

The prepayment rate of sales tax on gasoline for the six – (6) month period beginning January 1, 2006, is eleven and two-tenths cents ($0.112) per gallon.

Using the most recent retail price of gasoline available (as required by IC 6-2.5-7-14(b)), the Department has determined the statewide average retail price per gallon of gasoline to be two dollars and six and six tenths cents ($2.066). The most recent retail price of gasoline available was based on data contained in the November 2005 Petroleum Marketing Monthly as published by the Energy Information Agency.

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

Period			Rate Per Gallon
July 1, 1994	to	December 31, 1994	2.9 cents
January 1, 1995	to	June 30, 1995	3.7 cents

July 1, 1995	to	December 31, 1995	3.3 cents
January 1, 1996	to	June 30, 1996	3.3 cents
July 1, 1996	to	December 31, 1996	3.4 cents
January 1, 1997	to	June 30, 1997	4.0 cents
July 1, 1997	to	December 31, 1997	3.9 cents
January 1, 1998	to	June 30, 1998	4.0 cents
July 1, 1998	to	December 31, 1998	2.9 cents
January 1, 1999	to	June 30, 1999	3.0 cents
July 1, 1999	to	December 31, 1999	2.4 cents
January 1, 2000	to	June 30, 2000	3.6 cents
July 1, 2000	to	December 31, 2000	4.6 cents
January 1, 2001	to	June 30, 2001	4.9 cents
July 1, 2001	to	December 31, 2001	4.9 cents
January 1, 2002	to	June 30, 2002	4.9 cents
July 1, 2002	to	December 31, 2002	3.2 cents
January 1, 2003	to	June 30, 2003	5.3 cents
July 1, 2003	to	December 31, 2003	6.6 cents
January 1, 2004	to	June 30, 2004	6.5 cents
July 1, 2004	to	December 31, 2004	6.6 cents
January 1, 2005	to	June 30, 2005	7.6 cents
July 1, 2005	to	December 31, 2005	7.8 cents
January 1, 2006	to	June 30, 2006	11.2 cents

Indiana Department of State Revenue
John Eckart
Commissioner

DEPARTMENT OF STATE REVENUE
DEPARTMENTAL NOTICE #3
NOVEMBER, 2005
INTEREST RATES FOR CALENDAR YEAR 2006

This document does not meet the definition of a "statement" required to be published in the *Indiana Register* under IC 4-22-7-7. However, under IC 6-8.1-10-1(c), the Commissioner is required to establish, on or before November 1 of each year, the applicable interest rates for tax overpayments and underpayments that will take effect for the immediately succeeding calendar year. The purpose of this notice is to inform the public of the interest rates that will be effective for the calendar year beginning January 1, 2006.

The rate of the interest for an excess tax payment is the percentage rounded to the nearest whole number that equals the average investment yield on state money for the state's previous fiscal year, excluding pension fund investments, as published in the Auditor of State's comprehensive annual financial report. Based on this calculation, the rate of interest for an excess tax payment for calendar year 2006 will be two percent (2%).

The rate of interest for an underpayment of tax is the percentage rounded to the nearest whole number that equals two (2) percentage points above the average investment yield on state money for the state's previous fiscal year, excluding pension fund investments, as published in the Auditor of State's comprehensive annual financial report. Based on this calculation, the rate of interest for an underpayment of tax for calendar year 2006 will be four percent (4%).

For taxpayer information, attached is a list of comparable percentages applicable in previous calendar years.

Indiana Department of State Revenue
John Eckart,
Commissioner

Attachment

YEAR	OVERPAYMENTS	DELINQUENT PAYMENTS
1989	10%	10%
1990	10%	10%
1991	10%	10%
1992	8%	8%
1993	7%	7%

1994	7%	7%
1995	4%	6%
1996	5%	7%
1997	5%	7%
1998	5%	7%
1999	5%	7%
2000	5%	7%
2001	6%	8%
2002	6%	8%
2003	4%	6%
2004	2%	4%
2005	1%	3%

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 96-0196 and 02-0001
Corporate Income Tax
For the Years 1991 – 1993 and 1997

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

ISSUE

I. Corporate Income Tax—Computation of NOL

Authority: IC 6-3-2-2.6; IC 6-3-2-12.

Taxpayer protests the Department's computation of Taxpayer's net operating loss. The issue is if the foreign source dividends are deducted in determining the NOL.

II. Corporate Income Tax—Flow through of income reported in K-1s

Authority: 45 IAC 1-1-159.1; IRC § 704.

Taxpayer argues that interest income, capital gains, and other income reported on K-1s is not flow through income; on this basis, it should not be subject to gross income tax.

III. Corporate Income Tax—Industrial Processing Service Income

Authority: IC 6-2.1-5-5(d).

Taxpayer argues that the income that the Department taxed as industrial processing service income is incorrect. Taxpayer argues that title passed from their customer to them and then back to the customers—making it sales in interstate commerce. Additionally, taxpayer argues that regardless if it is industrial processing or not, the income is not taxable because it is income included in the consolidated return. The Department verified that this is true for 1993 and it to be removed as an intercompany elimination. However, the issue is to be decided for 1991 and 1992.

IV. Corporate Income Tax—Forgiveness of Debt

Authority: 45 IAC 1-1-10.

Taxpayer argues that forgiveness of debt taxed for gross income should not be taxed because there was a mortgage on the property.

V. Corporate Income Tax—Penalty

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

Taxpayer objected to the imposition of a 10% penalty on the deficiency assessed.

Resolved Issues

These issues are resolved. They are included in this letter of findings so as to have a record that all outstanding issues for the periods in question have been addressed and resolved.

- **Protest Issues I. and II.—T Ave Co.**

The Department has removed adjustments to Taxpayer's consolidated return relating to T Ave Co. in the existing audits and will refrain from taxing the income of that company through the end of the 2001 tax year. The Department will revisit the issue for all subsequent years.

- **Protest Issues VI. And VII.—B Management**
  The Department has verified that the income from the sale of tangible personal property is low rate income. This makes the double taxation protest moot.
- **Protest Issue VIII.—Specific commission income**
  The Department has verified and has adjusted the assessment.
- **Protest Issues IX and X—Royalty income**
  The Department has verified that the royalty income was properly deducted as intercompany transfers.

STATEMENT OF FACTS

Taxpayer is a multi-tiered organization with subsidiaries and affiliates engaged in two distinct lines of business: a multi-state chemical manufacturing & refining business and an investment real estate partnership.

I. Corporate Income Tax—Computation of NOL

DISCUSSION

Taxpayer protested the computation of the net operating loss deduction, claiming that the computation of loss should include the foreign source dividend deduction. The NOL deduction is calculated using the guidelines in IC 6-3-2-2.6. The foreign source dividend deduction is allowed under IC 6-3-2-12. Foreign source dividend is not included as a deduction in the NOL calculation outlined in IC 6-3-2-2.6. The foreign source dividend deduction is only allowed in computing the current year adjusted gross income and is not allowable when determining the NOL deduction. This issue was addressed and denied in a previous letter of finding issued concerning Taxpayer.

FINDING

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

II. Corporate Income Tax—Flow through of income reported in K-1s

DISCUSSION

Taxpayer objected to the Department's computation of gross income attributable to its distributive shares of partnership income. Taxpayer argues that certain distributive share income items reported on their K-1s should not flow through as taxable gross income. Specifically, Taxpayer objects to the flow through of interest income, capital gain income, and other income. In addition, Taxpayer argues that there is no basis to disallow certain negative flow through items within the separate K-1 items. Taxpayer argues that the only item of flow through should be ordinary income.

45 IAC 1-1-159.1, which was the regulation in force for the audit years in question, states that an amount credited to a corporate partner as its distributive share of partnership income which is derived from sources within Indiana is subject to gross income tax—provided the partnership has not previously paid the gross income tax due. The Department has held, based on the regulation, that net distributive share income is subject to gross income tax. Taxpayer argues that since sections of the regulation only incorporate part of IRC § 704, interest, capital gains, and other income are not part of the flow through income of the partnership distribution. There is no basis to hold that these items are not part of flow through income.

As well, the Department disallowed the negative income items within a particular K-1 from being netted against positive income items to determine the net distributive share. The department determined that this calculation was not appropriate for this K-1 and disallowed the net calculation, leaving the positive distribution for this K-1 as flow through income subject to gross income tax. Taxpayer has failed to adequately rebut the Department's position.

FINDING

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

III. Corporate Income Tax—Industrial Processing Service Income

DISCUSSION

Chemicals were transferred from Taxpayer's chemical subsidiary to Taxpayer's industrial subsidiary. The Department asserted that Taxpayer was acting as an industrial processor. Taxpayer argued that title passed from chemical subsidiary to industrial subsidiary and then back to chemical subsidiary. Taxpayer argued that these receipts are exempt because they are derived in interstate commerce. Taxpayer stated in its protest letter that it objects to the classification of the sale of tangible personal property as an industrial processing service performed in Indiana and subject to Indiana gross income tax. This issue was addressed and denied in a previous letter of finding issued concerning Taxpayer.

In this protest, Taxpayer included an additional argument to their protest—that the income was an intercompany transfer. For tax year 1993, Taxpayer is correct because a consolidated return was filed and the income was eliminated as intercompany. IC 6-2.1-5-5(d) statutorily permitted affiliated corporations to file consolidated returns. This had the accounting effect of eliminating as income receipts transferred between affiliates. But for 1991 and 1992, Taxpayer did not file a consolidated return; therefore, an intercompany elimination of income cannot be performed.

FINDING

For the reasons stated above, Taxpayer is sustained for 1993 and is denied for 1991 and 1992.

IV. Corporate Income Tax—Forgiveness of Debt

DISCUSSION

Taxpayer objects to the Department imposing gross income tax on the conveyance of title to real estate in lieu of foreclosure. Taxpayer argues that forgiveness of debt should not be taxable as there was a mortgage on the property.

This is a constructive receipt of income. Taxpayer owned a piece of property which had a mortgage on it; the mortgage exceeded Taxpayer's cost. When the property was foreclosed, the mortgage was written off. Thus, Taxpayer has a gain for forgiveness of debt in excess of their cost. This is taxable under the guidelines of 45 IAC 1-1-10, which states that constructive receipts are those items of gross income which are not actually received by the taxpayer but which are credited to the taxpayer; constructive receipts include the partial or complete forgiveness of debts; such receipts are required to be reported on the tax return for the tax period in which they are credited.

FINDING

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

V. Corporate Income Tax—Penalty

DISCUSSION

Taxpayer objected to the imposition of a 10% penalty on the deficiency assessed. In the letter of protest submitted to the Department, Taxpayer states, "Due to the fact that the audit of taxable years 1988, 1989, and 1990 was not completed until February 23, 1995, many of the issues related to the audit adjustments for taxable years 1991, 1992, and 1993 were unresolved when the taxpayer prepared its Indiana returns."

According to Department records, the original audit report for 1988 – 1990 was completed on October 19, 1992. The supplemental audit report was completed on February 23, 1995.

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). Taxpayer has not established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

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

DEPARTMENT OF STATE REVENUE

04-980278.LOF

LETTER OF FINDINGS NUMBER: 98-0278
Sales and Use Tax
For The Period: 1994-1996

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

ISSUES

I. Sales/Use Tax: Wheel Loader and Front End Loader

Authority: 45 IAC 15-5-3; North Central Industries, Inc. v. Ind. Dept. of State Revenue, 790 N.E.2d 198, 200 (Ind. Tax Ct. 2003); Department of Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App., First District 1979); Indiana Dept. of State Revenue

v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); 45 IAC 2.2-5-9; 45 IAC 2.2-5 *et seq.*

The taxpayer protests the imposition of tax on a wheel loader and a front-end loader.

II. Sales/Use Tax: Rough Terrain Crane

Authority: 45 IAC 2.2-5-8(h)(1)

The taxpayer protests the taxation of a rough terrain crane.

III. Sales/Use Tax: Calcium Chloride

Authority: IC 6-2.5-5-30; 45 IAC 2.2-5-70

The taxpayer protests the taxation of calcium chloride.

IV. Sales/Use Tax: Computer Equipment

Authority: 45 IAC 2.2-3-4; IC 6-8.1-5-1(b)

The taxpayer protests the taxation of computer equipment and various other items.

V. Sales/Use Tax: Public Transportation

Authority: IC 6-2.5-5-27; Carnahan Grain, Inc. v. Ind. Dept. of State Revenue, 2005 Ind. Tax LEXIS 29 (Ind. Tax Ct. 2005); Department of Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App., First District 1979)

Taxpayer protests that it qualifies for the public transportation exemption.

VI. Tax Administration: Penalty and Interest

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

Taxpayer protests the imposition of the 10% negligence penalty and interest.

STATEMENT OF FACTS

The taxpayer's business involves mining, extraction, production, sale and hauling of sand, gravel and stone. The taxpayer characterizes its business as the processing and selling of "sand, stone, gravel and other similar materials (aggregates)…." The taxpayer's facilities "are primarily quarrying operations where aggregates are extracted, crushed, graded and staged for ultimate sale …." More facts will be provided as needed.

I. Sales/Use Tax: Wheel Loader and Front End Loader

DISCUSSION

Before examining the taxpayer's protest, it should be noted "[t]he burden of proving that a proposed assessment is incorrect rests with the taxpayer.…" 45 IAC 15-5-3. The Indiana Tax Court has also stated: "When a taxpayer claims entitlement to a tax exemption, the taxpayer bears the burden of showing that the terms of the exemption are met." North Central Industries, Inc. v. Ind. Dept. of State Revenue, 790 N.E.2d 198, 200 (Ind. Tax Ct. 2003)(*Citing* Mid-America Energy Resources, Inc. v. Indiana Dept. of State Revenue, 681 N.E.2d 259, 261 (Ind. Tax Ct. 1997)).

Turning to the taxpayer's argument, initially the protest involved three items and the penalty: a wheel loader; a front-end loader; and a rough terrain crane. Although the taxpayer had originally stated that it was protesting the above listed items and was "in agreement with the remainder of the proposed assessment," the taxpayer later expanded the protest. The taxpayer also later disagreed with the "method of sampling" that was used in the audit.

First we will examine the wheel loader and the front-end loader.

Kawasaki Wheel Loader:

The taxpayer states: "This loader is used to place aggregate material into the processing plant at our recycle operation. We believe that the 'production process' begins at the loading of material for processing."

CAT 980G Front End Loader:

Again, quoting the taxpayer: "This loader is also used to place aggregate material into the processing plant at our recycle operation. We believe that the 'production process' begins at the loading of material for processing."

Among the cases that the taxpayer cites to support its position is Department of Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App., First District 1979). Calcar involved a "stone quarry, a hot mix asphalt plant, and a ready mix concrete facility" and various items that Calcar claimed were tax exempt. Id. at 940. The Court of Appeals noted that the trial court found the following:

> That a Caterpillar tractor with *front-end loader*…was used for the purpose of hauling stone in the various stages of production, and that the use of said Caterpillar tractor with *front-end loader* was for the transportation of unfinished work in process in a continuous flow from one production step to another within Calcar's integrated operation. (*Emphasis added*)

Id. at 942. The trial court further found that "the older tractor with front-end loader, for which parts and supplies were purchased" was "used directly to transport unfinished work in process in a continuous flow from one production step to another within Calcar's integrated operations." Id. at 942-3. The Court of Appeals held that "the trial court did not err in finding that the … tractor-loaders were used primarily for the purpose of transporting unfinished work in process from one production step to another." Id. at 943. The Court of Appeals went on to say "the trial court was correct in permitting exemptions for the amounts paid for purchase and repair of these items because they were directly used in direct processing and production." Id. at 943. However, the Court of Appeals in Calcar found that a crane used for "constructing its [Calcar's] asphalt plant" was "[o]bviously, … not a direct use in the direct production of the asphalt" and that a "payloader" that was "used solely for cleaning and maintenance purposes" also was "not a direct use in the direct production or processing of Calcar's products." Id. at 943.

In Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983), the Indiana Supreme Court dealt with "facts very similar" to those in Calcar. The Indiana Supreme Court stated, "We believe that the rationale of the First District in *Calcar* is correct." Id. at 525.

The taxpayer has several locations/facilities. Among those are portable recycling plants, where the Kawasaki Wheel Loader and the CAT 980G Front End Loader are used. At hearing taxpayer stated the recycling plants involve the following: when roads are replaced, the government trucks the broken up road (asphalt/concrete) to the taxpayer's recycling plant to process the broken up road. The broken up road is processed to make concrete again.

The main question is *when* does production begin. For example, under 45 IAC 2.2-5-9 equipment like front-end loaders can be exempt depending on how and when the equipment is used. 45 IAC 2.2-5-9(a) states that, "In general, all purchases of tangible personal property by persons engaged in extraction or mining are taxable. The exemption provided in this regulation extends only to manufacturing machinery, tools, and equipment directly used in mining or extraction." The IAC goes on to illustrate the exempt versus taxable distinction: for example, front-end loaders "used to transport coal from a crusher to a wash plant are exempt" and "[f]ront-end loaders … used to load coal onto trucks, railroad cars, or barges for delivery to customers are taxable." 45 IAC 2.2-5-9(g).

From the facts provided by the taxpayer about the recycling operation, it is not entirely clear whether the road is already broken up by the government, or whether the taxpayer does the breaking up of the road. But neither scenario fulfills the "integrated production process" of the Indiana Administrative Code, since there is not what 45 IAC 2.2-5-9(c)(3) calls [by using coal as its example] a "functional interrelationship of the various steps and the flow of the work in process…." This is seen by the fact that if the government breaks up the road there is no functional interrelationship between the government seeking to break up old road (for whatever purpose) and the taxpayer reclaiming that broken up road. And if the taxpayer breaks up the road for the government, then a *service* is being performed by the taxpayer for the governmental entity. Thus the recycling operation is dissimilar, initially, from the integrated production steps of a quarry. Therefore the Kawasaki Wheel Loader and the CAT 980G Front End Loader are taxable, with, as the auditor put it, "The recycling operation" beginning "when materials are loaded into the plant and ends at the point that the production has altered the item to its completed form."

FINDING

The taxpayer is denied regarding its protest of the Kawasaki Wheel Loader and the CAT 980G Front End Loader.

II. Sales/Use Tax: Rough Terrain Crane

DISCUSSION

The taxpayer describes the "rough terrain crane" thusly: "The proposed assessment appears to be taxing this crane as a repair part or tool. The crane is neither a repair part or tool—it is a necessary piece of equipment used to access the processing plant for making adjustments to production equipment and facilities. This crane is in constant use and should be considered processing equipment." And in another piece of correspondence, "The Crane … was not used for constructing the plant which was already in operation. The crane was used for plant screen changes, plant repair, mobile equipment engine removals and replacements, etc."

45 IAC 2.2-5-8(h)(1) states in part:

Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

(45 IAC 2.2-5-9(h)(1) and 45 IAC 2.2-5-10(h)(1) also have similar language).

The use of a crane for "screen changes" and "plant repair" comes within the ambit of 45 IAC 2.2-5-8(h)(1).

FINDING

The taxpayer is denied regarding its protest of the rough terrain crane.

III. Sales/Use Tax: Calcium Chloride

DISCUSSION

The auditor noted that the taxpayer applied calcium chloride "to road surfaces in plant locations and mines to reduce the airborne dust. The purpose includes the need to comply with standards of government environmental agencies."

The taxpayer states:

The calcium chloride was used in the operation of a facility, namely the quarry. The road beds had to be sprayed with the chloride to meet the government environmental requirements.

And further stated "[t]he calcium required to maintain dust control on the road beds is clearly an essential material consumed in the integrated production process."

Indiana Code 6-2.5-5-30 provides an exemption for environmental quality compliance, which states in part:

Sales of tangible personal property are exempt from the state gross retail tax if:

(1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and

(2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

The Auditor stated that the "calcium chloride is not subject to this exemption because the chemical is not *consumed* in the operation of a device, but continues on the ground to control dust and is dissipated over a period of time after the chemical has been released." (*Emphasis added*).

45 IAC 2.2-5-70(b) states in part that "Consumed," means "the dissipation or expenditure by combustion, use or application…." Thus, from what the Auditor stated, the calcium chloride "dissipates over a period of time" and is not dissipated in the "combustion, use or application."

The calcium chloride does not meet the requirements of the IC 6-2.5-5-30(1) and 45 IAC 2.2-5-70(b).

FINDING

The taxpayer is denied with regards to the calcium chloride.

IV. Sales/Use Tax: Computer Equipment and Various Other Items

DISCUSSION

The taxpayer also challenges the auditor's assessment of computer equipment:

The Agent assessed tax on all computer equipment purchased for use in Indiana. There was no attempt to determine the ultimate use of those computers, many of which are used to operate the crushers, conveyor lines, washers and radial stackers.

The auditor taxed the computer equipment per 45 IAC 2.2-3-4. Under 45 IAC 2.2-5-8, computer equipment can be exempt, but it is a fact-sensitive analysis. Taxpayer has failed to meet the burden of proof (*See* IC 6-8.1-5-1(b)) of demonstrating that the computer equipment is exempt under 45 IAC 2.2-5-8.

The taxpayer argues that the auditor "negotiated various percentages of taxable portions of loaders, supplies used in production, and certain other purchases with plant and quarry personnel after informing them of his interpretation of the administrative rules.…" and "[t]hus, he had a direct influence on the plant personnel's determination of the exempt or taxable portion of the expense items." Taxpayer offers no basis for the numbers and percentages that it offered up to replace those "negotiated" percentages. Additionally, the taxpayer disagreed with the sampling method. The file contains projection methods that were signed and agreed to by the taxpayer at the time of the audit. The taxpayer, at hearing, listed various items that it either agreed or disagreed with the auditor on. The taxpayer then offered proposed taxable percentages for some of the items, but as with the computer equipment, the taxpayer has failed to develop its argument and meet its burden of proof.

FINDING

The taxpayer's protest is denied regarding the computer equipment. The taxpayer is also denied regarding the various items for which the taxpayer offered "new" taxable percentages, and is denied regarding its protest of the sampling method.

V. Sales/Use Tax: Public Transportation

DISCUSSION

Indiana Code 6-2.5-5-27 states that:

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

An Indiana Tax Court case has also recently dealt with IC 6-2.5-5-27. In Carnahan Grain, Inc. v. Ind. Dept. of State Revenue, 2005 Ind. Tax LEXIS 29 (Ind. Tax Ct. 2005), the Indiana Tax Court explained that the Tax Court's prior public transportation case—Panhandle Eastern Pipeline Co. v. Indiana Dept. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001)—"rested entirely on Panhandle's use of the property." Carnahan at *8. The Indiana Tax Court went to hold in Carnahan that "because Carnahan predominantly used the property at issue for transporting agricultural commodities owned by third parties, it is entitled to the public transportation exemption." Carnahan at *11.

Turning to the argument, the auditor states that the taxpayer bought a trucking company "and began using the trucks primarily to haul aggregates that it sold to customers." The auditor noted:

The taxpayer does not qualify for the exemption allowed for property used in public transportation of property because the taxpayer is predominantly transporting property that is owned by the taxpayer until delivery to the customer has been completed.

Taxpayer likewise notes that it "acquired a small fleet of trucks … and since that time has been using these vehicles to transport aggregates products to customers." The taxpayer states:

It is the business', as well as industry, practice to quote the sales price of aggregate products to customers with shipping terms "F.O.B. our Plant." With these terms, the decision of how to transport the product rests with the customer. Generally speaking, it is the customer's option of how product is delivered to his premises—he can arrange his own transportation, using either his own fleet or by hiring a third-party common carrier or by having [Taxpayer] perform these services.

The business' practice since its acquisition of the [Trucking company] assets … has been to charge sales tax to customers on the sales price of the aggregates product at the point of sale (plant). [Taxpayer] added transportation charges when these services were provided and separately stated these fees on the invoice from the sales price of the product.

And finally,

…the typical shipping terms that are customary to the taxpayer and this industry are "F.O.B. origin". Therefore, the title to the goods and risk of the loss pass to the customer while the goods are at the premises of the seller.

The taxpayer relies on Department of Revenue v. Calcar Quarries, Inc. to buttress its argument. In Calcar the Court of Appeals noted:

The State contends that Calcar was not engaged in public transportation but instead was engaged primarily in the service of hauling its own product.

Calcar Quarries, Inc., 394 N.E.2d 939, 941. Calcar, it should be noted, "sold its products F.O.B. Calcar's plant." Id. at 941. The Court of Appeals stated that "[t]he evidence proves that Calcar, … transported property for consideration by highway and satisfied the State's definition of 'public transportation.'" Id. at 941.

The Auditor quotes IC 26-1-2-401: "Unless otherwise *explicitly* agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, …." (*Emphasis added*) However, "F.O.B. Our Plant," amounts to an *explicit* term.

Finally, the taxpayer provided a letter and documents with "two asset listings, one in which the truck division hauled primarily [taxpayer's] sales and the other one in which 80% was public transportation."

FINDING

Taxpayer's protest is sustained.

VI. Tax Administration: Penalty and Interest

DISCUSSION

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

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

Taxpayer argues that the penalty should be abated. The taxpayer notes that it has "practiced a best effort policy and tried to be a compliant taxpayer…." The taxpayer also states that it "paid use tax every quarter…."

Given the fact-sensitive analysis required in reaching the various findings herein, and the taxpayer's efforts to be compliant, the taxpayer is sustained regarding the penalty. Regarding interest, IC 6-8.1-10-1(e) states the Department "may not waive the interest imposed under this section."

FINDING

The taxpayer is sustained regarding the penalty; the taxpayer is denied regarding interest.

DEPARTMENT OF STATE REVENUE

0220010344.LOF

LETTER OF FINDINGS NUMBER: 01-0344
Income Tax
For Tax Year 1995

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

ISSUE

I. Tax Administration—Negligence Penalty

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

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

STATEMENT OF FACTS

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

I. Tax Administration—Negligence Penalty

DISCUSSION

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

If a person:

…

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

…

the person is subject to a penalty.

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

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

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

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

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). As explained in the audit report gross income tax is due on partnership distributions. Taxpayer has not provided an explanation as to why it did not report this distribution. Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010345.LOF

LETTER OF FINDINGS NUMBER: 01-0345
Income Tax
For Tax 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. Tax Administration—Negligence Penalty and Underpayment Penalty

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

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

STATEMENT OF FACTS

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

I. Tax Administration—Negligence Penalty and Underpayment Penalty

DISCUSSION

The Department issued proposed assessments and the ten percent (10%) negligence penalty for the tax years in question, as well as a ten percent (10%) underpayment penalty for a 1998 quarterly estimated tax payment. Taxpayer protests the imposition of both penalties. The Department refers to IC 6-8.1-10-2.1(a), which states in relevant part:

If a person:

…

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

…

the person is subject to a penalty.

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

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

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

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

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). In its protest letter, taxpayer states that it exercised ordinary business care and prudence in filing income tax returns with Indiana. Also in its protest letter, taxpayer states that it was not required to file an estimated quarterly return and so should not have to pay a penalty for failure to file an estimated quarterly return. Since the Department issued assessments for unpaid tax, and taxpayer has not protested the assessments except for the penalties, it stands to reason that taxpayer failed both to exercise reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer and that taxpayer was required to file estimated quarterly returns. Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010346.LOF

LETTER OF FINDINGS NUMBER: 01-0346
Income
For Tax Years 1995-98

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

ISSUES

I. Gross Income Tax—Partnership Distributions

Authority: <u>First National Leasing and Financial Corp. v. Indiana Department of State Revenue</u>, 598 N.E.2d 640 (Ind. Tax 1992); 45 IAC 1.1-1-3; 45 IAC 1.1-2-13; <u>Black's Law Dictionary</u>, 6th Ed., 928 (West Publishing 1990)

Taxpayer protests imposition of gross income tax on partnership distributions.

II. Tax Administration—Non-Filing Penalty

Authority: IC 6-8.1-10-3

Taxpayer protests imposition of a twenty percent (20%) non-filing penalty.

STATEMENT OF FACTS

Taxpayer is a limited partner in a cable television company doing business in Indiana. As the result of an audit, the Indiana Department of State Revenue ("Department") issued proposed assessments for income tax for the tax years 1995 through 1998. Taxpayer disagreed with the proposed assessments and filed a protest. Further facts will be supplied as required.

I. Gross Income Tax—Partnership Distributions

DISCUSSION

Taxpayer protests the proposed gross income tax assessments for the tax years 1995 through 1998. The Department issued the proposed assessments based on income taxpayer received as partnership distributions. Taxpayer states that it had no business situs in Indiana and therefore could not be subject to gross income tax.

In support of its position that taxpayer did have an Indiana business situs, the Department refers to 45 IAC 1.1-1-3, which states in relevant part:

(a) A "business situs" arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile.

(b) A taxpayer may establish a business situs in ways, including, but not limited to, the following:

…

(7) Ownership (in whole or part) of a partnership doing business in Indiana unless the ownership is that of a limited partner who does not participate in the control of the business.

….

In the audit report, the Department notes that taxpayer's corporate officers are the same corporate officers of the general partner and both other limited partners, and that these officers are also officers of the parent corporation which indirectly owns one hundred percent (100%) of the partnership.

The Department states in the audit report that taxpayer does not meet the definition of a limited partner, without providing a citation for the definition. The Department further states that taxpayer acquired the limited partnership interest from an affiliated corporation on paper only. Taxpayer's federal balance sheet as reported on its federal return shows that taxpayer has never had a bank account or owned any assets to invest in return for a partnership interest. The balance sheets on the federal return have never shown any balances in any asset, liability or capital accounts. Taxpayer's asset accounts on the balance sheet have never reflected the ownership of the partnership interest or any of the distributive share of the partnership's income in the taxpayer's capital account.

Taxpayer objects that this is due to errors in record keeping and that no definition for a limited partner appears in Indiana statutes, regulations, or case law. Taxpayer also states that the only place it could find any definition of "limited partner" was in an audit-gram dated after the audit period, and that even if it were to accept this definition, which it does not, the Department could not retroactively impose this definition on taxpayer. While the audit report does not provide a citation for the definition of "limited partner", such a definition is found in Black's Law Dictionary, which defines a "limited partner" as:

A person who has been admitted to a limited partnership as a limited partner in accordance with the partnership agreement. Uniform Partnership Act, § 101. A partner whose liability to third party creditors of the partnership is limited to the amount invested by such partner in the partnership.

Black's Law Dictionary, 6th Ed., 928 (West Publishing 1990)

Also, a "Limited Partnership" is defined as:

Type of partnership comprised of one or more general partners who manage business and who are personally liable for partnership debts, and one or more limited partners who contribute capital and share in profits but who take no part in running business and incur no liability with respect to partnership obligations beyond contribution.

Id.

As explained in the audit report, there was no amount invested by taxpayer for its share of the partnership. As explained in Black's, a "limited partnership" has limited partners who contribute capital. Taxpayer has not demonstrated that it contributed any form of capital. Therefore, taxpayer does not qualify as a limited partner, and 45 IAC 1.1-1-3(b)(7) provides that partnership interests qualify as a business situs. Also, taxpayer has not established that it does not participate in the control of the business.

Taxpayer also refers to First National Leasing and Financial Corp. v. Indiana Department of State Revenue, 598 N.E.2d 640 (Ind. Tax 1992). In that case, First National Leasing leased train derailment equipment to Hulcher Corporation, a wholly owned subsidiary. The equipment was used to place railroad cars and locomotives back on the tracks after a derailment. The lessee had a base in Indiana at which it stored some of the leased equipment. The Court decided that the taxpayer did not owe Indiana income tax on the income from the leases in that case because First National Leasing (taxpayer-lessor) had no control over the equipment. As the Court explained:

The sole activity First National has in Indiana is ownership of equipment that is located in Bluffton independently of any direction, consent, or, often times, knowledge of First National. The critical transaction in this case is the leasing of property. First National executed its leases in Illinois and Texas, not Indiana. The leases were not negotiated in Indiana; and the lease payments are not made or received in Indiana. Consequently, none of First National's activities related to the lease contract itself are conducted in Indiana.

Id., at 644-5.

Regarding whether or not First National had a business situs in Indiana, the Court in First National Leasing explained:

Consequently, although First National owns the equipment that Hulcher leases, locates, and uses in Indiana and elsewhere, the activities related to the lease formation and execution and the purpose of the lease, the use and possession of the equipment are overwhelmingly in quantity and quality activities conducted by Hulcher, not First National. The court therefore finds that First National's ownership of equipment located in Indiana is an activity that is not more than minimal, but is remote and incidental to the lease transaction from which its income is derived. Ownership alone is therefore not the degree of activity contemplated by the Indiana gross income tax statute.

Id., at 645

Taxpayer believes that since it was not involved in the day to day operations of the Indiana cable operations, it holds the same position as First National in First National Leasing.

Taxpayer's position is not the same as First National. First National's income arose from leasing activities over which it had no control. First National's contact with Indiana was not by its own action, but rather by action taken by its lessee. In the instant case, taxpayer's income arises from partnership distributions. Taxpayer's contact with Indiana was entirely by its own action. Taxpayer knew that the partnership's activities were conducted solely within Indiana. The decision in First National Leasing does not support taxpayer's position.

Next, the Department refers to 45 IAC 1.1-2-13, which states in relevant part:

> (a) As used in this section, "partner's distributive share" means the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations before any modifications required by Indiana tax statutes.
>
> (b) An amount credited to a corporate partner as its distributive share of partnership income, which is derived from sources within Indiana is subject to the gross income tax. An amount previously subjected to the gross income tax because it was included in the partner's distributive share but not actually distributed is not subject to the gross income tax again when it is actually distributed.
>
> …

The Department assessed gross income tax on taxpayer's distributive share of partnership income derived from sources within Indiana. This is in accordance with 45 IAC 1.1-2-13(b).

In conclusion, the Indiana tax court's decision in First National Leasing does not support taxpayer's position. Taxpayer is a limited partner as defined in Black's Law Dictionary. The Department properly followed 45 IAC 1.1-2-13(b)(7) in determining that taxpayer had a business situs in Indiana. The Department properly assessed gross income tax on taxpayer's distributive share of partnership income derived from sources within Indiana under 45 IAC 1.1-2-13.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Non-Filing Penalty

DISCUSSION

Taxpayer protests the imposition of a twenty percent (20%) non-filing penalty. Taxpayer states that it acted reasonably and that it did not believe that it was required to file a return. The Department imposed the penalty pursuant to IC 6-8.1-10-3(b), which states:

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

Since the Department prepared taxpayer's return, it imposed the penalty. The only requirements for this penalty are a taxpayer's failure to file a return and the preparation of a return for a taxpayer by the Department. Both of those conditions have been met in this case, therefore the penalty was properly imposed.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010347.LOF

LETTER OF FINDINGS NUMBER: 01-0347
Income
For Tax Years 1995-98

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

ISSUES

I. Gross Income Tax—Partnership Distributions

Authority: First National Leasing and Financial Corp. v. Indiana Department of State Revenue, 598 N.E.2d 640 (Ind. Tax 1992); 45 IAC 1.1-1-3; 45 IAC 1.1-2-13; Black's Law Dictionary, 6th Ed., 928 (West Publishing 1990)

Taxpayer protests imposition of gross income tax on partnership distributions.

II. Tax Administration—Non-Filing Penalty

Authority: IC 6-8.1-10-3

Taxpayer protests imposition of a twenty percent (20%) non-filing penalty.

STATEMENT OF FACTS

Taxpayer is a limited partner in a cable television company doing business in Indiana. As the result of an audit, the Indiana

Department of State Revenue ("Department") issued proposed assessments for income tax for the tax years 1995 through 1998. Taxpayer disagreed with the proposed assessments and filed a protest. Further facts will be supplied as required.

I. Gross Income Tax—Partnership Distributions

DISCUSSION

Taxpayer protests the proposed gross income tax assessments for the tax years 1995 through 1998. The Department issued the proposed assessments based on income taxpayer received as partnership distributions. Taxpayer states that it had no business situs in Indiana and therefore could not be subject to gross income tax.

In support of its position that taxpayer did have an Indiana business situs, the Department refers to 45 IAC 1.1-1-3, which states in relevant part:

> (a) A "business situs" arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile.
> (b) A taxpayer may establish a business situs in ways, including, but not limited to, the following:
> …
> (7) Ownership (in whole or part) of a partnership doing business in Indiana unless the ownership is that of a limited partner who does not participate in the control of the business.
> ….

In the audit report, the Department notes that taxpayer's corporate officers are the same corporate officers of the general partner and both other limited partners, and that these officers are also officers of the parent corporation which indirectly owns one hundred percent (100%) of the partnership.

The Department states in the audit report that taxpayer does not meet the definition of a limited partner, without providing a citation for the definition. The Department further states that taxpayer acquired the limited partnership interest from an affiliated corporation on paper only. Taxpayer's federal balance sheet as reported on its federal return shows that taxpayer has never had a bank account or owned any assets to invest in return for a partnership interest. The balance sheets on the federal return have never shown any balances in any asset, liability or capital accounts. Taxpayer's asset accounts on the balance sheet have never reflected the ownership of the partnership interest or any of the distributive share of the partnership's income in the taxpayer's capital account.

Taxpayer objects that this is due to errors in record keeping and that no definition for a limited partner appears in Indiana statutes, regulations, or case law. Taxpayer also states that the only place it could find any definition of "limited partner" was in an audit-gram dated after the audit period, and that even if it were to accept this definition, which it does not, the Department could not retroactively impose this definition on taxpayer. While the audit report does not provide a citation for the definition of "limited partner", such a definition is found in Black's Law Dictionary, which defines a "limited partner" as:

> A person who has been admitted to a limited partnership as a limited partner in accordance with the partnership agreement. Uniform Partnership Act, § 101. A partner whose liability to third party creditors of the partnership is limited to the amount invested by such partner in the partnership.
> Black's Law Dictionary, 6th Ed., 928 (West Publishing 1990)
> Also, a "Limited Partnership" is defined as:
> Type of partnership comprised of one or more general partners who manage business and who are personally liable for partnership debts, and one or more limited partners who contribute capital and share in profits but who take no part in running business and incur no liability with respect to partnership obligations beyond contribution.
> Id.

As explained in the audit report, there was no amount invested by taxpayer for its share of the partnership. As explained in Black's, a "limited partnership" has limited partners who contribute capital. Taxpayer has not demonstrated that it contributed any form of capital. Therefore, taxpayer does not qualify as a limited partner, and 45 IAC 1.1-1-3(b)(7) provides that partnership interests qualify as a business situs. Also, taxpayer has not established that it does not participate in the control of the business.

Taxpayer also refers to First National Leasing and Financial Corp. v. Indiana Department of State Revenue, 598 N.E.2d 640 (Ind. Tax 1992). In that case, First National Leasing leased train derailment equipment to Hulcher Corporation, a wholly owned subsidiary. The equipment was used to place railroad cars and locomotives back on the tracks after a derailment. The lessee had a base in Indiana at which it stored some of the leased equipment. The Court decided that the taxpayer did not owe Indiana income tax on the income from the leases in that case because First National Leasing (taxpayer-lessor) had no control over the equipment. As the Court explained:

> The sole activity First National has in Indiana is ownership of equipment that is located in Bluffton independently of any direction, consent, or, often times, knowledge of First National. The critical transaction in this case is the leasing of property. First National executed its leases in Illinois and Texas, not Indiana. The leases were not negotiated in Indiana; and the lease payments are not made or received in Indiana. Consequently, none of First National's activities related to the lease contract itself are conducted in Indiana.
> Id., at 644-5.

Regarding whether or not First National had a business situs in Indiana, the Court in First National Leasing explained:

> Consequently, although First National owns the equipment that Hulcher leases, locates, and uses in Indiana and elsewhere, the activities related to the lease formation and execution and the purpose of the lease, the use and possession of the equipment are overwhelmingly in quantity and quality activities conducted by Hulcher, not First National. The court therefore finds that First National's ownership of equipment located in Indiana is an activity that is not more than minimal, but is remote and incidental to the lease transaction from which its income is derived. Ownership alone is therefore not the degree of activity contemplated by the Indiana gross income tax statute.

Id., at 645

Taxpayer believes that since it was not involved in the day to day operations of the Indiana cable operations, it holds the same position as First National in First National Leasing.

Taxpayer's position is not the same as First National. First National's income arose from leasing activities over which it had no control. First National's contact with Indiana was not by its own action, but rather by action taken by its lessee. In the instant case, taxpayer's income arises from partnership distributions. Taxpayer's contact with Indiana was entirely by its own action. Taxpayer knew that the partnership's activities were conducted solely within Indiana. The decision in First National Leasing does not support taxpayer's position.

Next, the Department refers to 45 IAC 1.1-2-13, which states in relevant part:

> (a) As used in this section, "partner's distributive share" means the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations before any modifications required by Indiana tax statutes.
>
> (b) An amount credited to a corporate partner as its distributive share of partnership income, which is derived from sources within Indiana is subject to the gross income tax. An amount previously subjected to the gross income tax because it was included in the partner's distributive share but not actually distributed is not subject to the gross income tax again when it is actually distributed.
>
> …

The Department assessed gross income tax on taxpayer's distributive share of partnership income derived from sources within Indiana. This is in accordance with 45 IAC 1.1-2-13(b).

In conclusion, the Indiana tax court's decision in First National Leasing does not support taxpayer's position. Taxpayer is a limited partner as defined in Black's Law Dictionary. The Department properly followed 45 IAC 1.1-2-13(b)(7) in determining that taxpayer had a business situs in Indiana. The Department properly assessed gross income tax on taxpayer's distributive share of partnership income derived from sources within Indiana under 45 IAC 1.1-2-13.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Non-Filing Penalty

DISCUSSION

Taxpayer protests the imposition of a twenty percent (20%) non-filing penalty. Taxpayer states that it acted reasonably and that it did not believe that it was required to file a return. The Department imposed the penalty pursuant to IC 6-8.1-10-3(b), which states:

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

Since the Department prepared taxpayer's return, it imposed the penalty. The only requirements for this penalty are a taxpayer's failure to file a return and the preparation of a return for a taxpayer by the Department. Both of those conditions have been met in this case, therefore the penalty was properly imposed.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010348.LOF

LETTER OF FINDINGS NUMBER: 01-0348
Income Tax
For Tax Year 1995

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

ISSUE

I. Tax Administration—Negligence Penalty

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

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

STATEMENT OF FACTS

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

I. Tax Administration—Negligence Penalty

DISCUSSION

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

If a person:

…

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

…

the person is subject to a penalty.

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

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

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

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

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). As explained in the audit report, taxpayer deducted capital losses from a partnership in which it was a partner and determined that its partnership distributions were therefore zeroed out. The Department explained that gross income tax is due on partnership distributions and that there is no provision for the deduction of partnership losses from previous years against those partnership distributions. Taxpayer has not provided an explanation as to why it believed it was entitled to such a deduction. Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010350.LOF

LETTER OF FINDINGS NUMBER: 01-0350

Income Tax

For Tax Years 1995-98

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—Partner's Distributive Share

Authority: 45 IAC 1.1-1-5; 45 IAC 1.1-2-13; IRC 704

Taxpayer protests removal of deductions from its partnership distributive share of gross income.

II. Tax Administration—Negligence Penalty

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

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

STATEMENT OF FACTS

Taxpayer is the general partner in a partnership which owns a cable television business operating wholly within Indiana. Taxpayer has no other business activity than owning the partnership interest. As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for gross income tax. The assessments were partially based on the Department's adjustment to include taxpayer's distributive share of partnership income as reported on taxpayer's Federal returns. Taxpayer protests the adjustment. Further facts will be supplied as necessary.

DISCUSSION

I. Gross Income Tax—Partner's Distributive Share

Taxpayer protests the proposed assessments for the tax years in question. The Department adjusted taxpayer's Indiana income to include taxpayer's distributive share of partnership income as taxpayer reported on its Federal returns. Taxpayer had deducted contributions to the partnership from taxpayer's distributive share of partnership income. Taxpayer refers to 45 IAC 1.1-2-13, which states:

(a) As used in this section, "partner's distributive share" means the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations before any modifications required by Indiana tax statutes.

(b) An amount credited to a corporate partner as its distributive share of partnership income, which is derived from sources within Indiana is subject to the gross income tax. An amount previously subjected to the gross income tax because it was included in the partner's distributive share but not actually distributed is not subject to the gross income tax again when it is distributed.

(c) For purposes of this subsection, all income of the partnership shall be considered business income. If a partnership does business in a state besides Indiana, a partner's distributive share of partnership income which is derived from sources within Indiana, for gross income tax purposes, shall be determined by multiplying the partner's distributive share by a fraction. The numerator of the fraction shall be the sum of:

(1) the property factor;

(2) the payroll factor; and

(3) the sales factor;

of the partnership. The denominator of the fraction shall be determined by the number of factors used. The property factor shall be determined under IC 6-3-2-2(c). The payroll factor shall be determined under IC 6-3-2-2(d). The sales factor shall be determined under IC 6-3-2-2(e) and IC 6-3-2-2(f).

(d) The amount credited to a corporate partner as its distributive share of partnership income which is derived from sources in Indiana is taxable at the high rate.

Also, taxpayer refers to 45 IAC 1.1-1-5, which states:

(a) "Constructive receipt" means an item of gross income which is not actually received by a taxpayer but is:

(1) credited to taxpayer;

(2) made available for the taxpayer's withdrawal;

(3) paid to another for the taxpayer's direct benefit; or

(4) income to which the taxpayer is entitled.

(b) The term includes, but is not limited to, the following:

(1) The partial or complete forgiveness of a debt.

(2) Payment of a taxpayer's obligations by a third party for the taxpayer's direct benefit. The assumption of an outstanding lien on equipment sold by the taxpayer is not a payment for the taxpayer's direct benefit.

(3) The sale, by a lender, of property pledged or assigned by the taxpayer as collateral for a loan.

(4) Amounts credited to a partner as its distributive share of partnership income.

(5) The amount of known liabilities discharged as a result of a sale or other disposition of property, and from which the taxpayer receives a direct benefit. For example, if a taxpayer sells a piece of equipment for five hundred thousand dollars, ($500,000) and uses part of the proceeds to pay off a two hundred thousand ($200,000) lien against the pieces of equipment, the amount received by the taxpayer for gross income tax purposes is five hundred thousand dollars ($500,000).

Next, taxpayer states that the Department must, under 45 IAC 1.1-2-13(a), follow Section 704 of the Internal Revenue Code (IRC) to determine the amount of the "partner's distributive share" at issue. Taxpayer refers to IRC subsection 704(d), which states:

A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in a partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

Taxpayer states that this subsection allows for the deduction of losses from previous years against the corporate partner's current distributive share of partnership income, as a carryforward of the loss. That is not what IRC 704(d) provides. IRC 704(d) allows a partner to claim partnership loss and limits the amount of loss which is allowed to be claimed. As the Department explained in its audit report, taxpayer deducted contributions it made to the partnership from its distributive share of partnership income. Taxpayer did not claim partnership losses, which is the focus of IRC 704(d), therefore IRC 704(d) does not support taxpayer's position.

Taxpayer also states that under relevant partnership concepts, an allocation has economic effect only if it affects the amounts the partners will receive over the life of the partnership, and that this is tracked through the partner's capital account. Taxpayer argues that where a negative capital balance exists for one or more partners to a partnership, the income tax concepts embodied in partnership tax law do not evidence a constructive receipt of gross income. Taxpayer fails to cite any Indiana or Federal statute, regulation or case to support this argument.

In conclusion, 45 IAC 1.1-2-13(a) establishes that "partner's distributive share" means the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations before any modifications required by Indiana tax statutes. 45 IAC 1.1-2-13(b) provides that an amount credited to a corporate partner as its distributive share of partnership income, which is derived from sources within Indiana is subject to the gross income tax. Since IRC 704(d) does not provide for the deduction of contributions, as claimed by taxpayer, the Department was correct to remove those deductions from taxpayer's distributive share of partnership income.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty

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

If a person:

…

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

…

the person is subject to a penalty.

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

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

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

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

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

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220010357.LOF

LETTER OF FINDINGS NUMBER: 01-0357
Income Tax
For Tax Year 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.

ISSUE

I. Income Tax—Income From Real Estate Sale

Authority: 45 IAC 1.1-2-4

Taxpayer protests the imposition of income tax on proceeds from the sale of real estate.

STATEMENT OF FACTS

Taxpayer is in the business of renting commercial real estate. Taxpayer has rental property in Indiana and several surrounding states. The property is rented to partnerships all in the same business. Taxpayer sold the property to the partnerships at cost at the end of 1997. Taxpayer filed a final return for 1997 and has been inactive since that time. The Indiana Department of Revenue ("Department") conducted an audit for tax years 1995, 1996 and 1997. As a result of this audit, the Department issued a proposed assessment for gross income tax on the proceeds from the sale of real estate located in Indiana in 1997. Taxpayer protested the assessment. Further facts will be supplied as necessary.

DISCUSSION

Taxpayer owned and sold real estate in Indiana. Taxpayer protested the imposition of gross income tax on the sale of real estate in Indiana. 45 IAC 1.1-2-4(a)(4)(B) explains that taxable gross income from the sale of real estate is subject to the high rate of tax. Since first filing its protest in this matter, taxpayer has decided not to further protest this assessment.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220020274.LOF

LETTER OF FINDINGS NUMBER: 02-0274
Income Tax
For Tax Years 1995-97

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

ISSUES

I. Gross Income—Royalty Income

Authority: Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); Hoosier Energy Rural Electric Cooperative, Inc. v. Indiana Department of State Revenue, 572 N.E.2d 481 (Ind. 1991); IC 6-2.1-3-3; 45 IAC 1-1-51; Aug. 6, 1982, U.S.-Austl. art. 12, paras. 1,2,3, T.I.A.S. 10773

Taxpayer protests imposition of gross income tax on royalties.

II. Adjusted Gross Income—Business/Nonbusiness Income

Authority: The May Department Store Company v. Indiana Department of State Revenue, 749 N.E.2d 651 (Ind. Tax 2001); 45 IAC 3.1-1-29; 45 IAC 3.1-1-30

Taxpayer protests the characterization of income as business income and the imposition of adjusted gross income tax on that income.

III. Adjusted Gross Income—Net Operating Loss

Authority: IC 6-3-2-2; IC 6-3-2-2.6

Taxpayer protests an adjustment to net operating loss calculations.

IV. Tax Administration—Negligence Penalty

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

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

STATEMENT OF FACTS

Taxpayer operates a multi-national business in the metal industry. The business is vertically integrated throughout the metal products industry. As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for income tax for tax years 1996 and 1997, and a proposed refund for tax year 1995. Taxpayer protests some of these assessments as well as the refund. Further facts will be provided as required.

I. Gross Income—Royalty Income

DISCUSSION

Taxpayer protests the Department's assessment of gross income tax on royalty income taxpayer received from the licensing of patented closure systems owned by an Indiana domiciled subsidiary. Some of the licensees are located in other states, while some are located in foreign countries. In the audit report, the Department referred to 45 IAC 1-1-51, which deals with the situs of intangibles and states in relevant part:

The Department applies two tests in determining the taxability of income from intangibles. The term "intangible" or "intangible property" as used in IC 6-2-1-1(m) *[Repealed by P.L. 77-1981, SECTION 22.]*, means and 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.

The first test is what may be termed the "business situs" of the taxpayer or the relationship of the income from the tangible to the business activity of the taxpayer in Indiana. If the intangible or the income derived therefrom forms an integral part of a business regularly conducted at a situs in Indiana, the total gross income derived from the sale, assignment, transfer or exchange of the rights comprising the intangible property, or from the transfer of ownership to another will be required to be reported for taxation under IC 6-2-1-1(m) [*Repealed by P.L. 77-1981, SECTION 22.]* at the higher rate under IC 6-2-1-3(g) *[Repealed by P.L. 77-1981, SECTION 22.]* The test of a "situs" has been defined in Regulation 6-2-1-1(m)(330) *[45 IAC 1-1-49]* and out-of-state business is discussed in Regulation 6-2-1-1(m)(340) *[45 IAC 1-1-50]*).

Therefore, if a taxpayer has a "business situs" in Indiana, as defined by Regulation 6-2-1-1(m)(330) *[45 IAC 1-1-49]*), 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 purposes.

In addition to the case where the owner of the intangible is doing business in Indiana and the intangibles form an integral part of such owner's business conducted at or through his "business situs" in Indiana, a taxpayer may also be liable for gross income tax from intangibles if he is deemed to have established a "commercial domicile" in Indiana. Thus the second test is what may be termed the "commercial domicile" of the taxpayer.

A taxpayer may have many business situses, but has only one commercial domicile. Where that is located must be determined based on all of the facts. Generally speaking, a commercial domicile may be viewed as the location of the majority of all the taxpayer's activities or business. The commercial domicile may also be called the "nerve center" or "corporate center" of all the business functions of the taxpayer.

If a taxpayer's commercial domicile is in Indiana, all of the income from intangibles will be taxed under IC 6-2-1-1(m) *[Repealed by P.L. 77-1981, SECTION 22.]* except that income which may be directly related to an integral part of a business regularly conducted at a "business situs" outside Indiana.

…

The taxability of royalty income from such sources as patents or copyrights is to be determined as other income from intangibles according to the tests outlined previously on the "business situs" of the taxpayer or the "commercial domicile" of the taxpayer.

Examples of transactions in intangibles which are partially or wholly excluded from taxation are:

…

Sales which are totally nontaxable as transactions in interstate commerce

….

Taxpayer protests that the assessment of gross income violates several aspects of the United States Constitution, including the Commerce Clause, the Due Process Clause, the Foreign Commerce Clause, the Import-Export Clause and the Equal Protection Clause. Taxpayer refers to IC 6-2.1-3-3, which states:

Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that income by the United States Constitution.

The Indiana Supreme Court has previously dealt with the interstate sale of intangibles and gross income tax consequences. In Hoosier Energy Rural Electric Cooperative, Inc. v. Indiana Department of State Revenue, 572 N.E.2d 481 (Ind. 1991), the Indiana domiciled and sitused taxpayer had sold its rights to claim certain federal income tax benefits to two out-of-state companies via New York investment bankers. The Department assessed gross income tax on the income from the sale of the rights to the federal tax benefits. The taxpayer protested that there was insufficient nexus to Indiana, that the tax was not fairly apportioned, that the tax discriminated against interstate commerce in favor of local commerce and that the tax was not fairly related to the services provided by Indiana. The court explained:

The intangible which was sold, federal income tax benefits, cannot exist separate and apart from the taxpayer and property which, with the aid of *IRC § 168(f)*, created the intangible. Therefore, the taxation of this sale complies with the first prong of the Complete Auto test.

Id., at 485.

Similarly, in the instant case, the rights to taxpayer's patents were licensed to the out-of-state licensees, but the intangible cannot exist apart from the Indiana domiciled and sitused subsidiary. There is sufficient nexus to Indiana to justify the assessment of gross income tax.

Next, regarding fair apportionment of the tax, the court explains:

A tax by New York does not present a substantial or real risk of taxation in a constitutional sense. A tax by New York would not pass two of the Complete Auto tests. First, a New York tax on this sale of an intangible with a business situs in Indiana would not be fairly related to services provided by New York. Secondly, New York does not have sufficient nexus to the creation of the intangible to be able to tax its sale. Hoosier has not proven that this sale is exposed to any substantial risk of being taxed by New York or any other state. Therefore, we hold that the evidence supports the conclusion that the imposition of the tax at issue meets the apportionment requirement of Complete Auto.

Id., at 485.

In the instant case, a tax by another jurisdiction on the licensing of this intangible would not pass two of the Complete Auto tests. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). Taxpayer's business situs is Indiana and a tax by another jurisdiction would not be fairly related to services provided by the other jurisdiction. As in Hoosier Energy, in this case no other jurisdiction has sufficient nexus to the creation of the intangible to be able to tax its sale.

Next, regarding possible discrimination against interstate commerce, the court in Hoosier Energy explained:

The state gross income tax does not discriminate against interstate commerce in favor of local commerce. As the Tax Court correctly found, there is nothing in the operation of the tax that places a greater burden on out-of-state taxpayers than is placed on in-state taxpayers.

Taxpayer refers to Convention Between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (hereafter "Convention"), Article 12, which states in relevant part:

(1) Royalties from sources in one of the Contracting States, being royalties to which a resident of the other Contracting State is beneficially entitled, may be taxed in that other State.

(2) Such royalties may be taxed in the Contracting State in which they have their source, and according to the law of that State, but the tax so charged shall not exceed 10 percent of the gross amount of the royalties.

(3) Paragraph (2) shall not apply if the person beneficially entitled to the royalties, being a resident of one of the Contracting States, has a permanent establishment in the other Contracting State or performs independent personal services in that other State from a fixed base situated therein, and the property or rights giving rise to the royalties are effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

….

Aug. 6, 1982, U.S.-Austl. art. 12, paras. 1,2,3, T.I.A.S. 10773

Taxpayer believes that this is evidence that, since a foreign jurisdiction may impose withholding taxes on royalties paid to the licensor outside that jurisdiction, the royalties are subject to tax both within and outside the United States. Taxpayer asserts that this situation results in the net tax imposed on foreign royalties being higher than the tax imposed on domestic royalties, resulting in discrimination against foreign commerce. As previously explained, the sources of the royalties are not in the other states or nations, but rather the source is the patents held in Indiana where taxpayer's subsidiary has a business situs and the intangible property sold via the licensing agreements forms an integral part of taxpayer's subsidiary's business activities in Indiana.

Next, addressing the issue of whether or not the tax fairly related to the services provided by the State, the court in Hoosier Energy explained:

Obviously, citizens of the State of Indiana are expected to contribute their fair share of the state tax burden which pays for the multitude of services provided to the citizens by the State. There was no evidence presented to the Tax Court which would in any way show that this tax is not fairly related to the services provided by the State. Therefore, this tax on this sale passes the fourth part of the Complete Auto test.

As previously explained, taxpayer's subsidiary has its business situs in Indiana, is commercially domiciled in Indiana, holds the patents in Indiana, and the licensing agreements subject themselves to Indiana law. The tax is fairly related to the services provided by the State.

In conclusion, the licensing agreements were the sale of intangibles as provided in 45 IAC 1-1-51. The Indiana Supreme Court has addressed the situation of income received from the sale of intangibles by an Indiana sitused and domiciled taxpayer. As explained in Hoosier Energy, since taxpayer's subsidiary is domiciled and sitused in Indiana there is no risk of multiple taxation in this case since taxes imposed by other jurisdictions would not pass the four-part test provided in Complete Auto. Here, there is sufficient nexus with Indiana, the tax is fairly apportioned, the tax does not discriminate against interstate commerce, and the tax is fairly related to services provided by the State.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income—Business/Nonbusiness Income

DISCUSSION

Taxpayer protests imposition of adjusted gross income tax on income it received from the sale of interests it held in three businesses. The sale was part of a restructuring of taxpayer's business. Taxpayer reported the income on its federal return but considered it nonbusiness income and allocated the income to its commercial domicile, the state of Pennsylvania. The Department reclassified the income as business income and imposed adjusted gross income tax according to the apportionment formula. Taxpayer protests the reclassification.

The Department explained that, while there was no Indiana relationship of any of the entities that were sold and all property was located in foreign countries, taxpayer formed the entities and sold them three days later. Also, taxpayer included the entities in taxpayer's consolidated federal filing group. The Department expressed that clearly the intent of the formation of the entities was to sell them. Since the entities were formed to sell the foreign interests, the Department considered the income from the sales to be business income.

In The May Department Store Company v. Indiana Department of State Revenue, 749 N.E.2d 651 (Ind. Tax 2001), the Indiana Tax Court determined that IC 6-3-1-20 provides for both a transactional test and a functional test in determining whether income is business or non-business in nature. Id. at 662-3.

The court looks to 45 IAC 3.1-1-29 and 30 for guidance in determining whether income is business or business income under the transactional test. These regulations state "... the critical element in determining whether income is 'business income' or 'nonbusiness income' is the identification of the transactions and activity which are the elements of a particular trade or business." Id. at 664. 45 IAC 3.1-1-30 lists several factors in making this determination. These include the nature of the taxpayer's trade or business; substantiality of the income derived from activities and relationship of income derived from activities to overall activities; frequency, number or continuity of the activities and transactions; length of time income producing property was owned; and taxpayer's purpose in acquiring and holding the property producing income. In May, the Court found that the transactional test was not met when a retailer sold a retailing division to a competitor because the taxpayer was not in the business of selling entire divisions. Id. at 664.

In the instant case, taxpayer held interests in the three foreign companies and transferred those interests to subsidiary corporations formed for the purpose of holding the interests. Three days later, the newly formed subsidiary corporations sold most of the interests to non-related third parties. The Department considered the three-day ownership indicative of taxpayer's intention to form the companies for the sole purpose of selling them. The Department considered the intent to sell the interests to be business activity.

The court in May, explained that the transactional test requires the identification of the transactions and activity which are the elements of a particular trade or business. Id., at 644. In this case the transactions were the sale of interests in foreign mining operations. Taxpayer has provided sufficient documentation to establish that the mining operations were not part of taxpayer's world-wide metal products operations. One example among many provided is the establishment that the ores mined at the various foreign sites were sold primarily to non-related parties, and the amounts of ore which were bought by taxpayer were paid for at fair market prices. While this alone is insufficient to make taxpayer's case, the extensive documentation provided establishes that such arms-length interactions were standard procedure between taxpayer and the foreign operations.

Taxpayer was in the business of producing metals and metal products. These are the elements of taxpayer's particular trade or business. Taxpayer sold the interests in arms-length foreign mining operations to non-related parties. This is the transaction at issue. Taxpayer here was in the business of producing and selling metal and metal products, not the business of selling ownership of arms-length interests. As provided in May, this does not pass the transactional test.

The functional test focuses on the property being disposed of by the taxpayer. Id. at 664. Specifically the functional test requires examining the relationship of the property at issue with the business operations of the taxpayer. Id. 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. at 664. The court in May defined "integral" as part or constituent component necessary or essential to complete the whole. Id. at 664-5. The court held that May's sale of one of its retailing division was not "necessary or essential" to May's regular trade or business because the sale was executed pursuant to a court order that benefited a competitor and not May. In essence, the court determined that because May was forced to sale the division in order to reduce its competitive advantage, the sale could not be integral to May's business operations. Therefore, the proceeds from the sale were not business income under the functional test.

As previously explained, in this case taxpayer has provided sufficient documentation to establish that it had arms-length relations with the foreign mining operations. The sales of the interests were neither necessary nor essential to complete the whole of taxpayer's whole business. While taxpayer was not forced to sell the interests, as was the case in May, the sales were not integral to taxpayer's operations. Since the sales and purchases of the metals and ores between the foreign interests and taxpayer were conducted at arms-length, taxpayer was not able to integrate the interests into its operations. Indeed, the foreign interests sold the bulk of their goods to non-related parties, which alone would make integration into taxpayer's operations unlikely. Therefore, as provided in May, the sales of the interests do not pass the functional test.

Regarding the Department's concerns that taxpayer formed corporations for the specific purpose of selling the interests, in some circumstances this is a strong indication of business-related activity. However, intention to sell is not an absolute characterization of business income. In May the taxpayer intended to sell its property, yet the Court determined via the transactional test and the functional test that the income was nonbusiness in nature. In the instant case, application of the transactional test and the functional test shows that the income was nonbusiness in nature.

In conclusion, taxpayer has provided extensive and convincing documentation that the foreign interests were not integral components of its business. The sales of the interests were intentional, but this is not the sole determining factor. Under both the transactional test and the functional test, the income from the sales in this case are nonbusiness income and should be allocated to taxpayer's commercial domicile, not apportioned partially to Indiana.

FINDING

Taxpayer's protest is sustained.

III. Adjusted Gross Income—Net Operating Loss

DISCUSSION

Taxpayer protests the reduction of claimed net operating loss via the Department's add back of nonbusiness income and foreign dividends to taxpayer's Indiana adjusted gross income. Taxpayer states that there is no statutory basis for this adjustment. Also, pursuant to a settlement agreement between taxpayer and the Department covering the previous audit period, the amount of net operating loss was increased by several million dollars. Taxpayer wants this increase reflected in the net operating loss credited to it in the instant audit period.

The Department explained its actions in the audit report, which states that for CY 1993, taxpayer incurred a net operating loss. Part of this loss was carried back to CY 1990 in the prior audit. During the instant audit period, the balance of the loss was carried forward to CY 1995 where it was fully utilized. The calculation of the net operating loss for CY 1993 was calculated by including the IND AGI determined per the prior audit. Next all nonbusiness and foreign dividend income was added back. Then the RAR adjustment received for this year was included. This total was then multiplied by the apportionment percentage also determined in the prior audit. For CY 1996, taxpayer incurred a net operating loss. This loss was carried to CY 1995 where it too was fully utilized.

The relevant statute is IC 6-3-2-2.6, which deals with corporate net operating loss and adjusted gross income. IC 6-3-2-2.6 states:

(a) This section applies to a corporation or a nonresident person, for a particular tax year, if the taxpayer's adjusted gross income for that taxable year is reduced because of a deduction allowed under Section 172 of the Internal Revenue Code for a net operating loss. For purposes of section 1 of this chapter, the taxpayer's adjusted gross income, for the particular taxable year, derived from sources within Indiana is the remainder determined under STEP FOUR of the following formula:

STEP ONE: Determine, in the manner prescribed in section 2 of this chapter, the taxpayer's adjusted gross income, for the taxable year, derived from sources within Indiana, as calculated without the deduction for net operating losses provided by Section 172 of the Internal Revenue Code.

STEP TWO: Determine, in the manner prescribed in subsection (b), the amount of the taxpayer's net operating losses that are deductible for the taxable year under Section 172 of the Internal Revenue Code, as adjusted to reflect the modifications required by IC 6-3-1-3.5, and that are derived from sources within Indiana.

STEP THREE: Enter the larger of zero (0) or the amount determined under STEP TWO.

STEP FOUR: Subtract the amount entered under STEP THREE from the amount determined under STEP ONE.

(b) For purposes of STEP TWO of subsection (a), the modifications that are to be applied are those modifications required under IC 6-3-1-3.5 for the same taxable year during which each net operating loss was incurred. In addition, for purposes of STEP TWO of subsection (a), the amount of a taxpayer's net operating losses that are derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's income derived from sources within Indiana is determined, under section 2 of this chapter, for the same taxable year during which each loss was incurred. Also, for purposes of STEP TWO of subsection (a), the following procedures apply:

(1) The taxpayer's net operating loss for a particular taxable year shall be treated as a positive number.

(2) A modification that is to be added to federal adjusted gross income or federal taxable income under IC 6-3-1-3.5 shall be treated as a negative number.

(3) A modification that is to be subtracted from federal adjusted gross income or federal taxable income under IC 6-3-1-3.5 shall be treated as a positive number.

Taxpayer believes that Indiana cannot add back the nonbusiness income and foreign dividends under IC 6-3-2-2.6. Taxpayer states that nonbusiness income is allocated to its commercial domicile, not apportioned to Indiana. Taxpayer also states that Indiana is prohibited from taxing income of a foreign corporation under the apportionment procedures of IC 6-3-2-2(o).

Indiana is not taxing the nonbusiness income or the foreign dividends. These are deductions and exemptions which receive full credit where appropriate. In this case, Indiana has simply added those factors back in order to properly calculate a new deduction.

Taxpayer's approach would result in compounding deductions and exemptions upon one another. Taxpayer has not referenced any statute or regulation which requires the Department to do so. The amount of NOL will be increased as agreed to in the settlement agreement covering the prior audit period.

FINDING

Taxpayer's protest is denied regarding the method of calculating net operating loss and sustained regarding the increased amount of net operating loss as agreed to in the previous settlement agreement.

IV. Tax Administration—Negligence Penalty

DISCUSSION

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

If a person:

…

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

…

the person is subject to a penalty.

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

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

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

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

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). Taxpayer has not established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

01-20020394.LOF

LETTER OF FINDINGS NUMBER: 02-0394
Adjusted Gross Income Tax—Business Income
Penalty—Request for Waiver
For Tax Years 1998 & 1999

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

ISSUES

I. Adjusted Gross Income Tax—Business Income

Authority: IC § 6-8.1-5-1(b); IC § 6-3-2-1(a); IC § 6-3-2-2(a); 45 IAC 3.1-1-25; 45 IAC 3.1-1-29; 45 IAC 3.1-1-38

Taxpayer protested the proposed assessment of Indiana's adjusted gross income tax on income earned from doing business in the state of Indiana.

II. Penalty—Request for Waiver

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

Taxpayer requested a waiver of the 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer, a resident of Michigan, was a retailer of sports trading cards, collectibles, and other memorabilia; he also promoted shows at shopping malls in Indiana and Michigan. Taxpayer solicited participation at the shows from other dealers and arranged for the use of display space within the malls with managers and/or landlords; he also arranged for the necessary insurance coverage for the shows. Taxpayer advertised the shows in local newspapers, prepared flyers and rented tables and chairs needed for the shows from rental companies. Taxpayer then collected rental fees from the dealers attending the shows for use of the tables and chairs. Taxpayer also participated in selling cards and memorabilia at the shows. Taxpayer's retail store was located in Michigan. He was the sole proprietor, and filed schedule C with his federal income tax returns to report all business income and expenses. Taxpayer failed to file Indiana income tax returns for business receipts from Indiana sources for the tax years at issue.

Taxpayer timely protested the proposed assessment. The Department attempted to contact taxpayer regarding facts supporting the protest, but all correspondence was returned unopened with a handwritten message indicating taxpayer had passed away. The file was then sent to the Appeals Section. The Hearing Officer made numerous attempts to contact the Power of Attorney (POA) of record, obtain a new POA form from the apparent new POA, and to contact taxpayer's widow. There were also numerous telephone calls between the Hearing Officer and the apparent new POA, attempting to obtain information to resolve the protest and/or schedule a hearing. The Hearing Officer made one final attempt to contact the apparent POA, giving a date certain by which to respond. The Department has received nothing to date. Additional facts will be supplied as necessary.

I. Adjusted Gross Income Tax—Business Income

DISCUSSION

Taxpayer protested the proposed assessment of Indiana's adjusted gross income tax on business receipts derived from Indiana sources.

Pursuant to IC § 6-8.1-5-1(b), an Indiana Department of Revenue "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." Despite numerous attempts to obtain information from taxpayer, his widow, and two Powers of Attorney (one of record, the other apparent), the Department has not received any information or facts on this protest. Therefore, this Letter of Findings is based on all materials contained in the file, plus all relevant Indiana tax statutes and regulations.

IC § 6-3-2-1(a) imposes the adjusted gross income tax "on that part of the adjusted gross income derived from sources within Indiana of every nonresident person." IC § 6-3-2-2(a)(2) and (3) set forth a nonresident's adjusted gross income tax liability:

(a)With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

(2) income from doing business in this state;

(3) income from a trade or business in this state;

See also, 45 IAC 3.1-1-25.

Taxpayer, during the tax years at issue, received income from renting tables and chairs for use at Indiana sports memorabilia shows, and from selling his own merchandise at these shows. The audit indicates these shows were held at shopping malls in the following Indiana cities: Kokomo, Anderson, Muncie, Marion, Lafayette, and South Bend.

45 IAC 3.1-1-29 defines "business income" as "income from transactions and activity in the regular course of the taxpayer's trade or business." 45 IAC 3.1-1-38 provides in pertinent part:

Sec. 38. Doing Business. For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:

(1) Maintenance of an office or other place of business in the state

(2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods

(3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution

(4) Rendering services to customers in the state

(5) Ownership, rental or operation of a business or of property (real or personal) in the state

(6) Acceptance of orders in the state

(7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income.

Taxpayer's regular trade or business activities in Indiana fall within the strictures of 45 IAC 3.1-1-38. Taxpayer brought merchandise into the state and sold it, rented the tables and chairs and collected fees from other dealers who also sold their merchandise at these sports memorabilia shows. Therefore, any income taxpayer earned from his Indiana activities should have been reported to the state of Indiana via Indiana tax returns.

The audit determined, based on the best information available, taxpayer's adjusted gross income tax liability from taxpayer's federal returns for the tax years at issue because taxpayer had failed to file Indiana tax returns for income earned from conducting sports memorabilia shows in Indiana. Neither taxpayer nor his representatives have supplied any facts to contradict the proposed assessment. While taxpayer is apparently deceased, outstanding tax liabilities remain.

FINDING

Taxpayer's protest concerning the proposed assessment of Indiana's adjusted gross income tax on income earned from doing business in the state of Indiana is denied.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protested the imposition of the 10% negligence penalty on the entire assessment. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due. Taxpayer's representative stated in the Letter of Protest and at the hearing that taxpayer relied on the information obtained from the Indiana Bureau of Motor Vehicles, and that the failure to pay the proper amount of tax was due to that state agency's interpretation of Indiana's statutes, regulations, and case law.

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

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

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

FINDING

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

DEPARTMENT OF STATE REVENUE

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LETTERS OF FINDINGS NUMBERS: 03-0147& 03-0021
Gross Retail Tax-Calculation
Gross Retail Tax-Oil Changes
Withholding Tax-Payment Application
Penalty-Request for Waiver
For Years 1999, 2000, 2001

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

ISSUES

I. Gross Retail Tax—Calculation

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

Taxpayer protests the audit's calculation of gross retail taxes owed on sales of gasoline.

II. Gross Retail Tax—Oil changes

Authority: IC § 6-8.1-5-1(b)

Taxpayer protests the audit's assessment of gross retail tax on items used in oil changes, arguing that the audit's reliance on a single invoice does not support taxpayer's alleged failure to collect and remit the tax.

III. Withholding Tax—Payment application

Authority: IC § 6-8.1-8-1.5; 45 IAC 15-8-1

IV. Penalty—Request for waiver

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

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

STATEMENT OF FACTS

Taxpayer is an Indiana S-corporation, selling gasoline, snacks, beverages, and performing repair work on customers' cars—engines, brakes, shocks, and suspensions. Taxpayer also does oil changes. Additional facts will be supplied as required.

I. Gross Retail Tax—Calculation

DISCUSSION

The audit determined gross retail tax liability in two areas: the calculation of gross retail taxes due on sales of gasoline and the assessment on the sale of parts used during oil changes on customers' vehicles. Taxpayer protested both items as well as a withholding liability payment that taxpayer stated was incorrectly applied. Each protested item will be taken up in order.

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

According to the audit, in connection with the calculation used to arrive at taxpayer's gross retail tax liability for gasoline sales, taxpayer incorrectly claimed a credit of prepaid sales tax on the amount of fuel he sold, not the amount of fuel he purchased. In order to verify the amount of taxpayer's tax liability, the audit completed worksheets that were designed to follow the ST-103MP, the sales tax return required by the Department for entities such as taxpayer. The audit used numbers found in taxpayer's profit and loss statements and verifications of prepaid tax paid at the point of purchase. The audit then determined that the difference was taxable pursuant to 45 IAC 2.2-6-8, **not pursuant** to the rate specified on the ST-103MP. Consequently, taxpayer has incurred a substantial gross retail tax liability for sales during the audit years at issue.

At the hearing on taxpayer's protest, with respect to this issue, taxpayer and his representative walked the hearing officer through how taxpayer figured out his actual tax liability. Taxpayer reconstituted the ST-103MP's, using the audit's own figures and multiplied them by the rate listed on the ST-103MP. In other words, he followed the directions on the form the Department requires for entities such as taxpayer. The audit did not accept taxpayer's reconstituted ST-103MP's.

Taxpayer and his representative stated at the hearing, by way of a complete walk through of a representative sample, and demonstrated, that the figures actually came from the audit worksheets. The Department concludes that taxpayer's reconstituted ST-103MP's, and the tax rate listed on that form, should be accepted, and taxpayer's gross retail tax on the gasoline should be recalculated accordingly.

FINDING

Taxpayer's protest concerning the calculation of gross retail taxes owed on gasoline sales is sustained subject to audit's recalculation.

II. Gross Retail Tax—Oil changes

DISCUSSION

The audit based taxpayer's entire gross retail tax liability on a single invoice which indicated sales tax was not collected on that particular work order. By the time the audit was completed, reviewed, assessments issued, a protest received and reviewed, and a hearing set, taxpayer's limited storage capacity revealed there were no paper invoices for the audit years at issue available to back up taxpayer's protest. Taxpayer keeps paper invoices for a limited period of time in case a customer disputes a particular work order. According to taxpayer, the audit had the opportunity to review computerized invoices during the audit, but chose not to. Taxpayer's storage software periodically purges these files. The audit computed a best information available percentage, "based on a review of similar industries charging the same amount for oil changes," found in an industrial standards textbook; however, the audit did not take into account taxpayer's size, location, or the facility's age. Taxpayer's place of business is decades old, small, out-of-the-way, and nothing like a BP Connect platform/plaza facility. The audit stated no invoices were available to review for the audit years at issue, but that taxpayer had invoices for years prior to the audit years.

It appears that the audit's determination of gross retail tax liability on materials used in oil changes is arbitrary and capricious, based on very little reliable evidence. On the other hand, taxpayer no longer has the documentation to support the lack of liability.

FINDING

Taxpayer's protest concerning the gross retail tax assessment on materials used in oil changes is denied.

III. Withholding Tax—Payment application

DISCUSSION

Taxpayer's protest on this issue focuses on the fact that the payment was applied to two prior, outstanding liabilities. And not to the 1999 withholding liability, the reason taxpayer wrote the check.

Pursuant to IC § 6-8.1-8-1.5, the department applies payments in the following order:

(1) To any penalty owed by the taxpayer.

(2) To any interest owed by the taxpayer.

To the tax liability of the taxpayer.

See also, 45 IAC 15-8-1.

When taxpayer tendered his check to the Department in 2000 to pay the 1999 withholding liability, the Revenue Processing

System showed two older outstanding liabilities. Therefore, pursuant to department policy, the 2000 payment was applied to an open December 1995 Gross Retail Sales Tax liability and to an open 1998 Withholding Tax liability. Therefore, the 1999 withholding tax liability is still open.

FINDING

Taxpayer's protest concerning the perceived misapplication of the 2000 payment for the 1999 withholding tax liability is denied.

IV. Penalty—Request for waiver

DISCUSSION

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

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

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

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

FINDING

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

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 03-0394
Gross Income Tax / Withholding Liability
For 1999, 2000, and 2001

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

I. Withholding Gross Income Tax.

Authority: IC 6-2,1-2-2(a); IC 6-2,1-6-1; 45 IAC 1.1-5-8.

Taxpayer challenges an audit decision requiring it to withhold gross income tax on payments made to certain non-resident contractors.

II. Abatement of the Ten-Percent Negligence Penalty.

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

Taxpayer asks that the Department exercise its discretion to abate the ten-percent negligence penalty on the ground that taxpayer did not act with willful negligence or intentional disregard of Indiana's tax laws.

STATEMENT OF FACTS

Taxpayer operates a network of retail stores selling various types of merchandise. Taxpayer operates approximately 100 retail stores and distribution centers within the state.

The Department of Revenue (Department) conducted a sales and use tax audit review of taxpayer's business records and tax returns. During the course of that audit, a number of payments to vendors were reviewed to determine whether or not the payments were subject to the requirement to withhold Indiana gross income tax. The list of vendors was checked against the Indiana Secretary of State's records to determine if the vendors were registered to conduct business within the state. Thereafter, the taxpayer was provided a list of those vendors for which verification could not be made. Taxpayer was asked to provide documentation demonstrating that the payments to those vendors were not subject to the withholding tax. Taxpayer declined the opportunity to provide that documentation at the time the audit review was conducted.

The audit found that the payments to the non-resident contractors were subject to the withholding requirement. During June of 2004, the Department sent taxpayer notices of "Proposed Assessment." Taxpayer submitted a protest challenging certain aspects of the proposed assessment. Taxpayer declined the opportunity to take part in an administrative hearing or to further explain the basis for its protest. This Letter of Findings results.

DISCUSSION

I. Withholding Gross Income Tax.

Indiana formerly imposed an income tax, known as the gross income tax, upon the receipt of "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a). Except as provided in IC 6-2.1-6-1, each calendar year, each individual, firm organization or governmental agency of any kind which made payments to a nonresident contractor for performance of any contract, except contracts for sale, was required to withhold from such payments the amount of gross income tax owed upon the receipt of those payments. IC 6-2.1-6-1.

The withholding requirement is further clarified at 45 IAC 1.1-5-8, in effect during the tax periods at issue. The regulation states in part as follows:

> For taxable years beginning after December 31, 1993, a withholding agent who is required to withhold gross income tax under IC 6-2.1-6-1 or IC 6-2.1-6-2 is required to file a return and pay the tax withheld to the department on April 20, June 20, September 20, and December 20 of each calendar year. The return shall show the amount withheld from the gross income paid to each taxpayer. (b) The withholding agent is not liable to a taxpayer for any amounts withheld and paid to the department in accordance with this section. (c) Gross income tax should not be withheld on the first one thousand dollars ($1,000) paid to a taxpayer during a taxable year. (d) The amount of gross income tax withheld shall be determined by applying the high rate of tax to the total amount of gross income without any deductions.

The audit review determined that taxpayer did not – but should have – withheld gross income tax on payments made to non-resident contractors during 1999, 2000, and 2001.

During 1999, the audit determined that taxpayer should have withheld gross income tax from payments made to six different contractors. The amount of withholding liability was approximately $68,800.

During 2000, the audit determined that taxpayer should have withheld gross income tax from payments made to four different contractors. The amount of withholding liability was approximately $164,000.

During 2001, the audit determined that taxpayer should have withheld gross income tax from payments made to four different contractors. The amount of withholding liability was approximately $189,600.

A. Withholding Liability.

The total amount of withholding liability for 1999, 2000, and 2001 was approximately $422,400.

In taxpayer's protest letters, taxpayer supplied the Indiana identification numbers for two of the contractors. Taxpayer paid for a portion of the outstanding withholding liability. To the extent that taxpayer has verified that certain of the contractors were registered to do business in Indiana and paid the gross income tax on the payments received from taxpayer, taxpayer's protest of the corresponding assessment is sustained.

To the extent that taxpayer has paid the remaining portion of the outstanding withholding liability, the issue is – of course – moot.

B. Interest.

Taxpayer requests that the interest assessed on the outstanding gross income / withholding liability be abated. IC 6-8.1-10-1(a) states that upon a taxpayer's failure to pay the full amount of tax due, the taxpayer "is subject to interest on the nonpayment." The taxpayer's request for abatement of the interest assessed is unavailing. The interest assessed for late payment under IC 6-8.1-10-1(a) is not subject to the Department's discretionary review. The statute simply states that upon finding a payment deficiency, the taxpayer "*is* subject to interest on the nonpayment." (*Emphasis added*). Absent the statutory or equitable authority to abate the interest properly imposed under IC 6-8.1-10-1(a), the Department must decline the taxpayer's invitation to do so.

FINDING

Taxpayer's protest is denied in part and sustained in part. To the extent that taxpayer has demonstrated that the contractors were registered to conduct business in Indiana, taxpayer's protest is sustained. To the extent taxpayer has paid a portion of the outstanding gross income / withholding liability, the issue is moot. Taxpayer's request to abate the amount of interest attributable to the unpaid gross income / withholding liability, taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Claiming that it exercised "prudence and ordinary care," taxpayer requests that the Department exercise its discretionary authority to abate the ten-percent penalty. Taxpayer claims that expansion of its business "provided new opportunities for employment of Alabama residents." Taxpayer also argues that since conclusion of the audit, it "initiated additional internal controls to promote proper reporting."

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) permits 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...."

During the most recent audit, taxpayer was asked verify that the contractors in question were registered to conduct business in Indiana and to verify that payments to these contractors were not subject to the gross income / withholding requirement; taxpayer declined the opportunity to do so. The gross income tax / withholding issue was addressed in a previous Indiana audit after which a Letter of Finding was issued supporting the Department's position. The Department must conclude that taxpayer's most recent failure to address its gross income / withholding responsibility does not represent the exercise of the "reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." 45 IAC 15-11-2(b).

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBERS: 03-0461; 04-0135; 04-0136
Corporate Income Tax: Accounting Methods
For Tax Years 2000 & 2001

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

ISSUE

I. Corporate Income Tax: Accounting Methods

Authority: IC § 6-3-1-3.5; IC § 6-3-2-2(a)(2); IRS Publication 538; 26 CFR § 1.451-5(b)

Taxpayer protests the audit's assessment of additional taxable corporate income, arguing that deposit amounts taken for items not in taxpayer's inventory were incorrectly included in the audit adjustment.

STATEMENT OF FACTS

Taxpayer, a subchapter S corporation, is a retailer of in-ground spas and hot tubs. Originally, taxpayer protested issues in three separate files. During the telephone hearing, taxpayer indicated two of the three protests had been resolved. Therefore, the sole issue still remaining is the one outlined *supra*: the audit assessment of additional taxable income. When a customer wishes to purchases a spa or hot tub not in taxpayer's inventory, taxpayer accepts an advance payment or deposit, orders the spa or hot tub from the manufacturer, and then delivers and installs the spa or hot tub, whereupon the taxpayer collects the remainder of the money owed. Taxpayer uses the accrual method of accounting in keeping his books, and for income reporting purposes. Additional facts will be supplied as required.

I. Corporate Income Tax: Accounting Methods

DISCUSSION

Taxpayer protests the audit assessment of additional taxable corporate income, arguing that deposit amounts were incorrectly included in the audit adjustment. Taxpayer uses the accrual method of accounting and argues that the deposits are not taxable until delivery is complete and services are performed. Taxpayer supports his argument by stating that since he uses the accrual method of accounting, any deposits customers make on spas and/or hot tubs that are not in his inventory and therefore must be ordered from the manufacturer are not taxable until the items are delivered and installation services are completed. The audit relied on Internal Revenue Service (IRS) Publication 538; the audit report provides in pertinent part:

IRS Publication 538 which states that an amount becomes part of gross income for the year in which all events that fix the merchant's right to receive the income have occurred and the amount owed can be reasonably determined. Under this rule, the amount is reported in gross income when the income amount is due the merchant. In this case the deposits are partial payments of the final agreed upon purchase price of the transaction.

Taxpayer contends that the corporation is reporting income under the accrual method of accounting and that the inclusion of deposits accepted as down payments on noninventory spas and hot tubs should not be included in gross receipts in the year the down payment is accepted because these advance payments are for items taxpayer orders from a manufacturer; they are not inventoried goods. Taxpayer has reported income using the accrual method since 1997; both the state of Indiana and the federal taxation schemes allow taxpayers to use either the cash method of accounting, or the accrual method of accounting; both are correct, and, moreover, legal. Taxpayer's representative sent the auditor a letter setting forth his argument, stating there was no underreporting of income to the state of Indiana; it was merely a question of timing.

IC § 6-3-2-2 defines, at great length, the adjusted gross income tax. Subsection (a)(2) describes the income at issue in this protest: "income from doing business in this state." For purposes of Indiana's adjusted gross income tax, a taxpayer must begin with the federal income tax code's definition of "adjusted gross income," with certain add backs and deductions. *See* IC § 6-3-1-3.5.

IRS Publication 538 defines the accrual method of accounting as one where a taxpayer reports "income in the year earned and [deducts] or [capitalizes] expenses in the year incurred. The purposes of an accrual method of accounting is to match income and expenses in the correct year." The publication goes on to state:

> You generally include an amount as gross income for the tax year in which all events that fix your right to receive the income have occurred and you can determine the amount with reasonable accuracy. Under this rule, you report an amount in your gross income on the earliest of the following dates
>
> - When you receive payment
> - When the income amount is due you
> - When you earn the income

Until the transaction is complete, either through delivery and installation and payment, or default, taxpayer cannot determine income "with reasonable accuracy." Moreover, as the materials cited *supra* support, noninventory goods under the accrual method of accounting and reporting allow taxpayer a choice in the timing of reporting the income.

FINDING

Taxpayer's protest concerning the audit assessment of additional taxable corporate income, based on the accrual method of accounting for noninventoried goods, is sustained.

DEPARTMENT OF STATE REVENUE

0220040001.SLOF

SUPPLEMENTAL 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.

ISSUES

I. Adjusted Gross Income Tax-Combined Return

Authority: IC 6-3-2-2(m), IC 6-3-2-2(p), IC 6-8.1-5-1(b).

The taxpayer protests the combination of the taxpayer's Indiana adjusted gross income tax returns with affiliated corporations.

II. Adjusted Gross Income Tax- Foreign Source Dividend Deduction

Authority: IC 6-3-2-2.2(g).

The taxpayer protests the amount of the foreign source dividend deduction.

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. As a result of the audit, the department assessed additional gross income tax, adjusted gross income tax, interest and penalty against the taxpayer. A hearing was held and a Letter of Findings was issued on April 28, 2005. That Letter of Findings dealt with the gross income tax issues but not the adjusted gross income tax issues. A rehearing was requested and granted. Pursuant to the taxpayer's request, this Supplemental Letter of Findings is based on the documentation in the file.

I. Adjusted Gross Income Tax-Combined Return

DISCUSSION

In the audit, the department forced the taxpayer and its related corporations to file a combined Indiana adjusted gross income tax return instead of separate Indiana adjusted gross income tax returns pursuant to IC 6-3-2-2(m). The taxpayer protests this forced combination.

The taxpayer argues that pursuant to IC 6-3-2-2(p), the department cannot force combined Indiana adjusted gross income tax reporting unless the taxpayer's adjusted gross income cannot otherwise be fairly reflected. The taxpayer contends that since all of the transactions between the taxpayers and its affiliates were at arms length rates, the separate adjusted gross income tax returns properly and fairly reflect the taxpayer's Indiana adjusted gross income and tax liability.

Pursuant to IC 6-8.1-5-1(b), all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. In this case, the taxpayer made allegations but offered no evidence to support those statements. Therefore, the taxpayer did not sustain its burden of proving that the department improperly combined the Indiana adjusted gross income tax returns.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax- Foreign Source Dividend Deduction

DISCUSSION

The taxpayer contends that even if combination of Indiana adjusted gross income tax returns is allowed, an error was made in the calculation of the combined Indiana adjusted gross income tax. Specifically, the taxpayer contends that the department allowed less than the full amount of the foreign source dividend deduction under IC 6-3-2-1.1(g).

At the time of the audit, the taxpayer did not provide the department with a copy of the Consolidated Federal 1120 return, Schedule C. Consequently the department used the "Proforma" Federal 1120, Schedule C return which was provided. This proforma schedule did not include all of the companies included in the Unitary Group as determined by the department. Based on the information available at the time of the audit, the department allowed a deduction for Foreign Gross Up in the amount of $43,099,169 and a deduction for Foreign Dividend Expense in the amount of $58,754,225. On March 10, 2005, the taxpayer submitted a copy of the Consolidated Federal 1120, Schedule C to the department.

Upon review of the submitted documentation, the department finds that the correct amount of Gross Up which should be deducted is $48,049,662 (instead of $43,099,169). The correct amount of the Foreign Dividend Deduction which should be deducted is $197,106,158 (instead of $58,754,225).

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220040002.SLOF

SUPPLEMENTAL 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.

ISSUES

I. Adjusted Gross Income Tax-Combined Return

Authority: IC 6-3-2-2(m), IC 6-3-2-2(p), IC 6-8.1-5-1(b).

The taxpayer protests the combination of the taxpayer's Indiana adjusted gross income tax returns with affiliated corporations.

II. Adjusted Gross Income Tax- Foreign Source Dividend Deduction

Authority: IC 6-3-2-2.2(g).

The taxpayer protests the amount of the foreign source dividend deduction.

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. As a result of the audit, the department assessed additional gross income tax, adjusted gross income tax, interest and penalty against the taxpayer. A hearing was held and a Letter of Findings was issued on April 28, 2005. That Letter of Findings dealt with the gross income tax issues but not the adjusted gross income tax issues. A rehearing was requested and granted. Pursuant to the taxpayer's request, this Supplemental Letter of Findings is based on the documentation in the file.

I. Adjusted Gross Income Tax-Combined Return

DISCUSSION

In the audit, the department forced the taxpayer and its related corporations to file a combined Indiana adjusted gross income tax return instead of separate Indiana adjusted gross income tax returns pursuant to IC 6-3-2-2(m). The taxpayer protests this forced combination.

The taxpayer argues that pursuant to IC 6-3-2-2(p), the department cannot force combined Indiana adjusted gross income tax reporting unless the taxpayer's adjusted gross income cannot otherwise be fairly reflected. The taxpayer contends that since all of the transactions between the taxpayers and its affiliates were at arms length rates, the separate adjusted gross income tax returns properly and fairly reflect the taxpayer's Indiana adjusted gross income and tax liability.

Pursuant to IC 6-8.1-5-1(b), all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. In this case, the taxpayer made allegations but offered no evidence to support those statements. Therefore, the taxpayer did not sustain its burden of proving that the department improperly combined the Indiana adjusted gross income tax returns.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax- Foreign Source Dividend Deduction

DISCUSSION

The taxpayer contends that even if combination of Indiana adjusted gross income tax returns is allowed, an error was made in the calculation of the combined Indiana adjusted gross income tax. Specifically, the taxpayer contends that the department allowed less than the full amount of the foreign source dividend deduction under IC 6-3-2-1.1(g).

At the time of the audit, the taxpayer did not provide the department with a copy of the Consolidated Federal 1120 return, Schedule C. Consequently the department used the "Proforma" Federal 1120, Schedule C return which was provided. This proforma schedule did not include all of the companies included in the Unitary Group as determined by the department. Based on the information available at the time of the audit, the department allowed a deduction for Foreign Gross Up in the amount of $43,099,169 and a deduction for Foreign Dividend Expense in the amount of $58,754,225. On March 10, 2005, the taxpayer submitted a copy of the Consolidated Federal 1120, Schedule C to the department.

Upon review of the submitted documentation, the department finds that the correct amount of Gross Up which should be deducted is $48,049,662 (instead of $43,099,169). The correct amount of the Foreign Dividend Deduction which should be deducted is $197,106,158 (instead of $58,754,225).

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

042004004.LOF

LETTER OF FINDINGS NUMBER: 04-0004
Use Tax for the Years 2000 - 2002

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

ISSUE

I. Use Tax—Equipment used to provide services

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

Taxpayer protests the imposition of use tax upon the purchase of two infrared thermal cameras used to inspect new construction buildings.

II. Adjustments to the audit assessment

Taxpayer requests the Department to review the adjustments made to the assessments to be certain that the items that were agreed to come off the assessment have been removed.

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

STATEMENT OF FACTS

Taxpayer inspects completed new construction buildings. The Department audited Taxpayer and issued use tax assessments. Taxpayer protested and the file was transferred to Protest Review. During protest review, Taxpayer provided documentation to rebut some of the audit items and the Department found adequate basis to remove these audit items. However, the use tax assessment remained concerning the purchase of two infrared thermal cameras used to inspect new construction buildings. Taxpayer requested a hearing to argue that the two cameras were exempt from the imposition of sales and use tax.

I. Use Tax—Equipment used to provide services

DISCUSSION

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

Taxpayer came to the protest hearing forwarding legal arguments that its purchase and use of two infrared thermal cameras were exempt from sales and use tax under IC 6-2.5-5 *et seq*. However, the specific exemption statutes named by Taxpayer apply to operations engaged in producing tangible personal property. Taxpayer stated that it provides inspection services and does not produce any tangible personal property eligible under the exemption provisions in 6-2.5-5 *et seq*. After a discussion at the hearing with Taxpayer, Taxpayer withdrew its protest position, stating that it recognized there are no exemption statutes that apply to support its protest concerning the two cameras.

FINDING

Because Taxpayer withdrew its protest and conceded that use tax is due, this protest issue is moot; the use tax assessment on the two infrared thermal cameras is upheld.

II. Adjustments to the audit assessment

DISCUSSION

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

Taxpayer was audited and an assessment was issued. Taxpayer protested the assessment and the file went to Protest Review. A representative of the Department reviewed the documentation submitted by Taxpayer. Based upon the sufficiency of the evidence, the Department agreed to remove several items from the assessment. A supplemental audit report was issued. At the hearing, Taxpayer stated that it recently had received assessment notices that did not fully reflect the agreed adjustments. Taxpayer requested that the Department adjust the assessment to accurately reflect the remaining tax liability.

At the hearing, Taxpayer did concede that the assessments for use tax for magazine subscriptions and trade show items were taxable.

FINDING

The file is returned to Audit for it to determine whether the items agreed to be removed from the audit assessment actually have been removed. Audit is to confirm that the outstanding liabilities are correctly billed.

DEPARTMENT OF STATE REVENUE

0120040111.LOF

LETTER OF FINDINGS NUMBER: 04-0111 AGI
ADJUSTED GROSS INCOME TAX
FOR TAX PERIOD: 2002

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

ISSUES

Adjusted Gross Income Tax: Imposition

Authority: IC 6-3-2-1 (a), IC 6-3-2-2 (a), *State Election Board v. Evan Bayh*, 521 N.E.2d 1212, (Ind. 1988).

The taxpayers protest the imposition of the adjusted gross income tax.

STATEMENT OF FACTS

The taxpayers are a married couple who were assessed Indiana adjusted gross income tax, penalty and interest for the year 2002. They protested the assessment and a hearing was held by telephone. This Letter of Findings results.

Adjusted Gross Income Tax: Imposition

DISCUSSION

Indiana imposes an adjusted gross income tax pursuant to the following provisions of IC 6-3-2-1 (a):

> Each taxable year, a tax at the rate of three and four-tenths percent (3.4%) of adjusted gross income is imposed upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person.

The department assessed adjusted gross income tax on the taxpayers' income as an Indiana resident. The taxpayers contends that they earned the income as a nonresident of Indiana and is not subject to the imposition of the tax. The issue to be determined is whether or not the taxpayers were Indiana residents for purposes of Indiana adjusted gross income taxation during the 2002 tax year.

For purposes of adjusted gross income tax, IC 6-3-1-12 defines the term "resident" as "any individual who was domiciled in this state during the taxable year." In accordance with this definition, the taxpayer would be considered an Indiana resident and subject to tax on income earned during the period when he was domiciled in Indiana.

Indiana tax assessments are presumed to be correct and taxpayers bear the burden of proving that any particular assessment is incorrect. IC 6-8.1-5-1 (b).

The Indiana Supreme Court considered the issue of the meaning of domicile in *State Election Board v. Evan Bayh*, 521 N.E.2d 1212, (Ind. 1988). In that case, Mr. Bayh desired to run for governor of the state. Pursuant to public discussion concerning whether Mr. Bayh met the residency requirements for governor, Mr. Bayh sought a declaratory judgment determining that he met the residency requirement. The Indiana Supreme Court affirmed the trial court's decision that the standard for residency was whether or not Mr. Bayh had an Indiana domicile. It also held that Mr. Bayh was domiciled in Indiana.

Domicile in Indiana is defined as "the place where a person has his true, fixed, permanent home and principal establishment, and to which place he has, whenever he is absent, the intention of returning." *State Election Board* at page 1317. Once established, a person's domicile is presumed to continue until the person's actions provide adequate evidence that along with moving to another jurisdiction, the person intends to establish a domicile in the new residence. Whether or not the person has successfully established a new domicile is a question of fact to be determined by the trier of fact. *Id.* at 1317. Some of the facts considered were that Mr. Bayh paid in-state tuition at Indiana University, out-of -state tuition at the University of Virginia law school and voted in the elections in Vigo County, Indiana. He also registered for the draft from Indiana. The Supreme Court considered these acts adequate evidence to prove that Mr. Bayh intended to return to Indiana and retain his Indiana domicile even though he had lived outside the state for several years.

The taxpayers contend that they moved from Indiana in 1999 and purchased property in Florida in 1999. The taxpayers kept their Indiana drivers' licenses until they replaced them with Florida licenses in late 2002. They also obtained Florida voters' registration cards in late 2002. The totality of these actions and failures to act do not clearly evidence that the taxpayers intended to change their domicile to Florida until late 2002.

The taxpayers did not meet his burden of proving that their changed his domicile from Indiana to Florida.

FINDING

The taxpayers' protest is denied.

DEPARTMENT OF STATE REVENUE

0320040117.LOF

LETTER OF FINDINGS NUMBER: 04-0117
Withholding Tax
Responsible Officer
For the Tax Period 1993-2000

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(g).

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

STATEMENT OF FACTS

The taxpayer was the vice president of a corporation that did not remit the proper amount of withholding taxes to Indiana for the period 1993-2000. 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 held and this Letter of Findings results.

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(g), which provides that "In the case of a corporate or partnership employer, every officer, employee, or member of such employer, who, as such officer, employee, or member is under a duty to deduct and remit such taxes shall be personally liable for such taxes, penalties, and interest."

The taxpayer produced substantial documentation that he was not involved in the financial aspects of the corporation and had no duty to collect and remit the withholding taxes to the state. Therefore, he is not personally responsible for the payment of the corporate withholding taxes.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0220040180P.LOF

LETTER OF FINDINGS NUMBER: 04-0180P
Income Tax
For the Short Period ending March 26, 2002

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late payment of a short period income tax return for the period ending March 26, 2002.

The taxpayer is an out-of-state company.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the late penalty should be abated as the taxpayer did not have the information available at the election date to file the income tax return, and, the taxpayer has a good compliance record.

The taxpayer was acquired by another corporation in the tax year in question. At the time of the acquisition, the taxpayer did not know if the acquisition would be a stock transfer, or, an asset transfer. In the event the transfer was an asset transfer (Section 338(h)(10)), the taxpayer would have to file a short period income tax return. On July 15, 2002, the taxpayer paid an extension payment in the event the taxpayer decided to do an asset election at a later date. Later, the taxpayer actually decided to do an asset transfer and it took several months for the taxpayer to determine the tax liability. The tax liability was paid three weeks after the election date (due date) and deemed three weeks late.

The Department points out that the taxpayer knew at least by November 9, 2002, that an asset election would be made. The Department feels that the taxpayer had plenty of time (over one month), in which to properly calculate the tax liability. On this point, the Department feels the taxpayer fails to establish reasonable cause.

With regard to the compliance history, the taxpayer has had several late filings. The Department feels the taxpayer fails to establish reasonable cause on this point.

The regulation which controls penalty is 45 IAC 15-11-2(b) which states, "Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to 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

0220040181P.LOF

LETTER OF FINDINGS NUMBER: 04-0181P
Income Tax
For the Short Period ending March 26, 2002

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

ISSUE

I. Tax Administration – Penalty

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

The taxpayer protests the late penalty.

STATEMENT OF FACTS

The late penalty was assessed on the late payment of a short period income tax return for the period ending March 26, 2002. The taxpayer is an out-of-state company.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the late penalty should be abated as the taxpayer unexpectedly switched from a stock election to an asset sale on the election date of December 15, 2002. This switching of the election caused the taxpayer to be required to file a short period return for the period ending March 26, 2002. As the taxpayer did not have the information available, the short period income tax return was filed and paid late.

The Department points out the taxpayer stated in Hearing that a payment of $300,000 was made on July 15, 2002 in the event the taxpayer decided to do an asset election. The Department feels that if the taxpayer was contemplating the asset election five months in advance of the election date, the taxpayer should have had the necessary information to file the income tax return on the election date.

The regulation which controls penalty is 45 IAC 15-11-2(b) which states, "Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to 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

0420040186.LOF

LETTER OF FINDINGS NUMBER: 04-0186
Sales and Withholding Tax
Responsible Officer
For the Tax Period 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

1. Sales and Withholding Tax-Responsible Officer Liability

Authority: IC 6-2.5-9-3, IC 6-3-4-8(g), IC 6-8.1-5-1(b), Indiana Department of Revenue v. Safayan, 654 N.E. 2d 279 (Ind.1995).

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

STATEMENT OF FACTS

The Indiana Department of Revenue, hereinafter referred to as the "department," assessed sales taxes, withholding taxes, interest, and penalty against the taxpayer as a responsible officer of a corporation that did not properly remit said taxes during the tax 1995 tax year. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Sales and Withholding Tax-Responsible Officer Liability

DISCUSSION

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

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

An individual who:

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

(2) has a duty to remit state gross retail or use taxes to the department;

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

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

Pursuant to Indiana Department of Revenue v. Safayan 654 N.E. 2d 279 (Ind.1995) any officer, employee, or other person who has the authority to see that they are paid has the statutory duty to remit sales and withholding taxes to the state.

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

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420040197.LOF

LETTER OF FINDINGS NUMBER: 04-0197
Use Tax
For the Periods 2000 - 2002

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

ISSUE

I. Sales and Use Tax—Production exemption

Authority: IC 6-8.1-5-1(b); IC 6-2.5-3-2; IC 6-2.5-3-4; IC 6-2.5-3-5; IC 6-2.5-5; IC 6-2.5-5-3(b); Indiana Dept. of Revenue v. Interstate Warehousing, Inc., 783 N.E.2d 248, 250 (Ind. 2003).

Taxpayer protests the assessment of use tax due on items Taxpayer asserts are used in production.

STATEMENT OF FACTS

Taxpayer manufactures and sells pharmaceutical products. The Department conducted an audit of Taxpayer and assessed use tax due on items that were purchased exempt from sales tax, but upon which the auditor found use tax should have been paid. Taxpayer filed a protest and a hearing was held.

I. Sales and Use Tax—Production exemption

DISCUSSION

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

Taxpayer purchased a pump to pump water from the ground. Taxpayer is on a well and uses the water to make products as well as for general purposes. Taxpayer asserts that pumping the water from the ground is an integral part of manufacturing. The auditor determined that the pump was used in pre-production.

IC 6-2.5-3-2 imposes an excise tax, commonly called the use tax, on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction. Credit against the use tax due is given for sales tax that already has been paid. *See* IC 6-2.5-3-4 and IC 6-2.5-3-5.

Exemptions to sales and use tax exist. *See, generally,* IC 6-2.5-5. The Indiana Supreme Court has stated that it is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted; as such, a taxpayer has the burden of establishing its entitlement to an exemption. Indiana Dept. of Revenue v. Interstate Warehousing, Inc., 783 N.E.2d 248, 250 (Ind. 2003). IC 6-2.5-5-3(b) states that transactions involving manufacturing machinery, tools, and equipment are exempt from the sales and use tax if the person acquiring the property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. The pump brings water from the ground to a pressure tank and the water then is distributed throughout the building for general purpose uses as well as in manufactured products. The pump is not used to distribute water within the manufacturing process, but before the manufacturing process. For this reason, the purchase of the pump was not exempt from sales and use tax.

Taxpayer also subscribed to United States Pharmacopoeia (USP)—a book that provides standardized test methods for the most common and widely used raw materials. Taxpayer stated that the testing of raw materials is essential and mandated; for this reason the subscription should not be taxed. However, because USP contains the specifications for testing raw materials when received and before combination with other ingredients or processes, the USP book was used before the manufacturing process. For this reason, the purchase of the subscription was not exempt from sales and use tax.

Taxpayer also had purchased lab supplies and materials and did not pay sales or use tax on those transactions. During the audit, Taxpayer and the auditor agreed that 70% of the lab supplies were used in an exempt manner and 30% of the lab supplies were used in a taxable manner. Taxpayer later asserted that the lab supplies and materials were used in production. At the hearing, Taxpayer returned to the original determination agreement.

FINDING

For the reasons stated above, Taxpayer's protest of the taxability of the well pump and the USP subscription is denied; use tax is due. In accord with the audit agreement, 70% of the lab supplies and materials are not taxable and 30% are taxable.

DEPARTMENT OF STATE REVENUE

04-20040253.LOF

LETTER OF FINDINGS NUMBER: 04-0253
Gross Retail & Use Taxes
For Years 2001 & 2002

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

ISSUES

I. Gross Retail and Use Taxes—Motorcycles

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-4; IC § 6-2.5-3-6; IC § 6-2.5-3-7; IC § 6-2.5-4-1; IC § 6-2.5-5-15; 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-3-4; 45 IAC 2.2-4-1; 45 IAC 2.2-5-21; 45 IAC 2.2-1-1

Taxpayer protests the assessment of the state's gross retail tax on out-of-state sales of ATV's and/or motorcycles, arguing that since the Indiana Bureau of Motor Vehicles stated no gross retail tax was owed because the vehicles were not to be licensed in Indiana, these transactions were exempt.

II. Penalty—Request for Waiver

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

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

STATEMENT OF FACTS

Taxpayer is a dealer of Polaris, Suzuki, and Kawasaki all-terrain vehicles (ATV's) and motorcycles. Taxpayer also sells parts and sundries, and services all makes and models of motorcycles. Taxpayer's sales are both retail and wholesale. The transactions at issue concern sales to out-of-state customers who came into Indiana, purchased the vehicles, and then took them out-of-state for registration and licensing in their home states. There is also an issue concerning the proper exemption certificates that taxpayer needed to support the exemption claim. Additional facts will be supplied as required.

I. Gross Retail and Use Tax—Motorcycles

DISCUSSION

Taxpayer protests the proposed assessment of use tax on sales of ATV's and motorcycles where out-of-state customers came into Indiana, purchased the vehicles, and then took them out-of-state for registration and licensing. Taxpayer alleges that Indiana's Bureau of Motor Vehicles informed taxpayer's representative that since the vehicles at issue were off-road, they did not require registration and licensing by the State of Indiana, and therefore taxpayer was not required to collect and remit the state's gross retail tax on these transactions.

The audit argues that taxpayer incorrectly assumed these retail transactions were exempt based on the Bureau's representations, and, moreover, the ST-105's submitted as proof of exemption would not be accepted because taxpayer should have used properly executed ST-137's its exemption claim. The audit's argument is therefore two-fold: these transactions are not exempt; even if they were exempt, taxpayer used an incorrect exemption certificate form to support the claim for exemption. As stated in the audit report:

The taxpayer feels that the ATV's sold for use outside Indiana should be exempt from the Indiana gross retail tax under... motor vehicles transported to a destination outside Indiana.

The auditor was informed by the taxpayer that the taxpayer asked the license branch in... if the ATVs sold for use outside of Indiana are subject to the gross retail tax. Per the taxpayer, the license branch informed the taxpayer that these sales are not subject to the gross retail tax.

The taxpayer did not have any exemption certificates on file for the ATV's sold for use outside of Indiana. The auditor gave taxpayer's accountant,..., Form ST-137 (Certificate of Exemption for Out-of-State Delivery of Motor Vehicle, etc.) to obtain for the ATVs sold for use outside Indiana. The next day the taxpayer contacted the auditor about the Form ST-137 stating that this form would not be appropriate since the ATVs do not have to be licensed or registered. The taxpayer was informed since the ATVs do not have to be licensed or registered there are no exemption certificates for the ATVs sold for use outside of Indiana and the taxpayer would be liable for the gross retail tax on these ATV's.

At the final conference with the taxpayer's accountant, the taxpayer had obtained five Form ST-105 from their out-of-state customers. The taxpayer was informed that these would not be acceptable.

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

The issues in this case are whether gross retail taxes were due on these transactions, collected and remitted to the State of Indiana, or if the transactions were exempt. If the transactions were not exempt, taxpayer remains liable for the uncollected and unremitted gross retail tax.

45 IAC 2.2-1-(c) provides in pertinent part:

The state gross retail tax is imposed on retail transactions made in Indiana... The first category is described as transactions of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-1.

45 IAC 2.2-4-1(a) provides in pertinent part:

Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail....

See also, IC § 6-2.5-4-1.

IC § 6-2.5-5-15 provides in pertinent part:

Transactions involving motor vehicles, trailers, watercraft, and aircraft are exempt from the state gross retail tax, if:

(1) upon receiving delivery of the motor vehicle, trailer, watercraft, or aircraft, the person immediately transports it to a destination outside Indiana;

(2) the motor vehicle, trailer, watercraft, or aircraft is to be titled or registered for use in another state; and

(3) the motor vehicle, trailer, watercraft, or aircraft is not to be titled or registered for use in Indiana.

45 IAC 2.2-5-21 provides in pertinent part:

The state gross retail tax shall not apply to sales of motor vehicles, trailers, and aircrafts, delivered in Indiana for immediate transportation to a destination outside of Indiana and for licensing or registration for use in another state, and not to be licensed or registered in Indiana.

Based on the statutes and regulations cited *supra*, taxpayer's transactions of licensed vehicles were retail transactions exempt by both statute and regulation from the imposition of Indiana's gross retail tax. The cited language is clear and unambiguous. Both the ST-105 and ST-137 require signatures signed "under penalty of perjury." The ST-137 requires a bit more information, but the information is sufficient to support an exemption claim in this instance.

FINDING

Taxpayer's protest, concerning the assessment of gross retail tax on out-of-state sales where the tangible personal property was immediately moved and licensed outside the state, is sustained. If the vehicles were not licensed out-of-state, the exemption does not apply, and the applicable tax is owed to the Department.

II. Penalty—Request for waiver

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty on the entire assessment. Taxpayer argues that it had reasonable cause for failing to pay the appropriate amount of tax due. Taxpayer's representative stated in the Letter of Protest and at the hearing that taxpayer relied on the information obtained from the Indiana Bureau of Motor Vehicles, and that the failure to pay the proper amount of tax was due to that state agency's interpretation of Indiana's statutes, regulations, and case law.

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

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

Taxpayer has set forth a basis whereby the Department could conclude taxpayer exercised the degree of care statutorily imposed upon an ordinarily reasonable taxpayer. Therefore, given the totality of all the circumstances, waiver of the penalty on that part of the assessment that was successfully protested is appropriate in this particular instance. The penalty remains on that part of the assessment that was unsuccessfully protested.

DEPARTMENT OF STATE REVENUE

0420040373.LOF

LETTER OF FINDINGS NUMBER: 04-0373
Sales and Use Tax
For Tax Years 2004

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

ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); IC 6-2.5-5-8; Horn v. Commissioner of Internal Revenue, 968 f.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft, but did not pay sales tax on the purchase. Taxpayer claimed that the purchase was exempt from sales tax because the aircraft was to be used for rental or leasing to others. The Indiana Department of Revenue ("Department") conducted an investigation regarding the rental or leasing of the aircraft and determined that there was insufficient evidence to support the claim of rental or leasing as the use of the aircraft. As a result of this investigation, the Department denied the claim for exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer protests the assessment. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer purchased an aircraft and claimed a sales tax exemption. The Department compared a non-related aircraft rental company's rate for the same type of aircraft, to the rate taxpayer charged for its aircraft. The rental rate was far below the market rate. Also, the same individual signed the rental agreement as both lessor and lessee. The Department determined that taxpayer was not renting the aircraft and denied the exemption. Taxpayer protests the denial.

Taxpayer states that it qualifies for the rental exemption found in IC 6-2.5-5-8(b), which states:

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

Taxpayer states that the Department has provided no evidence that it has statutory or regulatory authority to require arm's-length pricing. Taxpayer also states that it consulted an aircraft consultant who agreed with its rental rate. Taxpayer states that the Department can not invalidate a business restructuring due to the presence of a tax benefit. Taxpayer also states that, in the event the

Department finds that it does have authority to impose arm's-length pricing in rental rates, the only remedy is to modify the rates and not to invalidate the claim for exemption. Taxpayer has provided no documentation in support of its position.

Taxpayer is incorrect on all counts. The rental exemption provided in IC 6-2.5-5-8(b) plainly states that the person claiming the exemption must resell, rent or lease the property in the ordinary course of its business. From all evidence available to the Department, taxpayer is not in the business of renting aircraft. Taxpayer has provided no documentation of any business activity at all, beyond the lease agreement signed as lessor and lessee by the same individual, let alone sufficient documentation to establish that it rented the aircraft in its ordinary course of business. Taxpayer has not even provided documentation that any rental payments were made at its generously low rental rate. Taxpayer has not provided any documentation that the rental rate is common or even in on the low end of going market rates.

Regarding taxpayer's claim that there is no authority for the Department to impose arm's-length pricing for the rental rates, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction". The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

Finally, taxpayer's claims that the Department can not invalidate a business restructuring due to a tax benefit and that the only remedy is to modify the rental rate are evidence that taxpayer fundamentally misunderstands the Department's actions. The Department is not invalidating a business restructuring. It simply determined that a taxpayer was not eligible for a claimed exemption. There is no need to modify a rental rate here. Taxpayer claimed an exemption for which it was not eligible and the Department disallowed the exemption. A sale occurred and sales tax was due but not paid. It's that simple.

In conclusion, the Department denied taxpayer's claim for exemption because taxpayer did not qualify for the exemption provided in IC 6-2.5-5-8(b). The Department was not attempting to invalidate taxpayer's business restructuring, but was merely denying an invalid claim for exemption. All evidence available to the Department shows that this was a "sham transaction" and the Department was correct to deny the claim for exemption.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420040421.LOF

LETTER OF FINDINGS NUMBER: 04-0421
Use Tax
For Years 2001, 2002, 2003

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

ISSUE

I. Use Tax—Agricultural exemptions

Authority: IC § 6-8.1-5-1(b); IC § 6-2.5-2-1; IC § 6-2.5-5-1; IC § 6-2.5-5-2; IC § 6-3-1-3.5(a); 45 IAC 15-5-3(8); 45 IAC 2.2-2-1; 45 IAC 2.2-2-2; 45 IAC 2.2-5-1; 45 IAC 2.2-5-2; 45 IAC 2.2-5-3; 45 IAC 2.2-5-4; 45 IAC 2.2-5-6; 26 U.S.C. § 62; 26 U.S.C. § 165; 26 U.S.C. § 183

Taxpayer protests the assessment of use tax on items used in producing agricultural commodities, specifically alpaca fleece, based on the audit's determination that taxpayer's alpaca ranch was a "hobby," not a business engaged in for profit.

STATEMENT OF FACTS

Taxpayer owns and operates an alpaca ranch. At the time of the audit, taxpayer had seventeen alpacas, weighing between 125-200 pounds each and each producing approximately four pounds of fleece per year. Taxpayer breeds the animals to increase the size of the herd, a process known as "alpaca compounding," keeping progeny instead of selling the babies for profit. Once taxpayer's herd gets to the size he wishes to maintain, he will start selling animals. As of the date of the hearing, six of his breeding females were expecting foals to be delivered any day. Breeders show their animals at various places; values depend on breeding lineage, quality of fleece and color, and any unique physical features in the animals' physical appearance, fleece, or progeny.

Taxpayer, in business since 1998, is a member of an alpaca owners association, attending fairs and festivals since 2001. The co-op takes in fleece from the members, cleans it, and turns the fleece into blankets, throws, and various items of clothing. Members purchase the items at wholesale and sell them at retail at fairs and festivals. Taxpayer did not register as a retail merchant with the Department until 2002. Sales tax was not collected and remitted to the state until then. The audit assessed gross retail tax; taxpayer is not protesting this part of the assessment. Taxpayer is protesting the assessment of use tax on items used in producing an agricultural commodity, alpaca fleece.

The audit's rationale for assessing use tax was that taxpayer operated the ranch as a "hobby." Additional facts will be added as necessary.

I. Use Tax—Agricultural exemptions

DISCUSSION

Taxpayer protests the assessment of use tax on items purchased and used in producing agricultural commodities, specifically alpaca fleece. Taxpayer argues that most of the items in question are entitled to the agricultural exemptions outlined in Indiana's tax statutes and regulations. Taxpayer concedes that there are items that are not available for exemption, and agrees with some of the assessment; see, Letter of Protest dated November 2, 2004. The audit's rationale for assessing the gross retail tax and denying the exemptions were based on the determination that taxpayer operated a "hobby" ranch.

As a preliminary matter, the Department must look at the so-called "hobby farm" issue as it relates to use tax. First of all, the federal statutes are concerned with income taxes and allowable loss deductions from income; there is nothing in the federal statutes showing any relevance to either gross retail or use taxes. There is also nothing in the federal statutes that would have any impact on the availability of exemptions from gross retail and use taxes.

IC § 6-3-1-3.5 defines individual adjusted gross income tax in terms of Section 62 of the Internal Revenue Code, "modified as follows." Section 62 begins with an individual's gross income tax "minus the following deductions." So, in order to arrive at an individual's Indiana income tax liability, the Department looks at the federal adjusted gross income (gross income minus allowable deductions) and then modifies that figure according to IC § 6-3-1-3.5(a). One of the deductions allowable under the federal scheme is losses from the sale of property (section 62(a)(3)) which references sections 161 *et seq*. Section 161 provides that "there shall be allowed as deductions the items specified in this part," i.e., Part VI. Section 165 allows deductions for losses "incurred in any transaction entered into for profit;" (165(c)(2)); section 167 allows deductions for depreciation of property used in a trade or business. Taxpayer ascribes his lack of profitability to costs associated in building up his herd, known as "alpaca compounding," claiming that income from producing the agricultural commodity, alpaca fleece, will rise as the herd increases and sales of their fleece and fleece related products increase.

The audit disallowed the agricultural exemptions, arguing that since taxpayers operated the ranch as a "hobby" and not for profit under section 165(c)(2) and section 183, taxpayer was not entitled to the exemptions under Indiana's tax laws. Section 183 disallows deductions from income tax for activities not engaged in for profit. Section 183(d) creates a presumption that if income exceeds deductions for three of five consecutive years, then the activity is engaged in for profit. The audit applied section 183(d) in order to characterize taxpayer's agricultural activities as a hobby because the production of alpaca fleece showed no profit yet. Then the audit determined that since taxpayer's alpaca farm was a "hobby," taxpayer was not entitled to any exemptions from the state's gross retail or use taxes for any purchases made in connection with the alpacas.

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

The standards for sustaining a claim for the agricultural exemption can be found at IC § 6-2.5-5-1, IC § 6-2.5-5-2, and 45 IAC 2.2-5-1 through 45 IAC 2.2-5-6. Both IC § 6-2.5-5-1 and IC § 6-2.5-5-2 exempt certain transactions involving particular items from the state's gross retail and use taxes if the following requirements are met: taxpayer must acquire the property for "direct use in the direct production of food or commodities for sale" and be "occupationally engaged in the production of food or commodities" to be sold "for human or animal consumption." IC § 6-2.5-5-1. Secondly, "transactions involving agricultural machinery or equipment are exempt... if" taxpayer "acquires it for use in conjunction with the production of food or commodities for sale" and is "occupationally engaged in the production of food or commodities which he sells for human or animal consumption." IC § 6-2.5-5-2.

The following quote presents audit's position on taxpayer's activities:

> Per 45 IAC 2.2-5-1, "Domestic animals and birds, pets, game animals and birds, *furbearing animals* (emphasis added in original), fish and other animals or poultry not directly used by the farmer in the direct production of food or agricultural commodities are subject to tax." These animals do not produce any food or commodity other than their fleece. That same citation goes on to state that other various animals are exempt "provided that they are directly used by the farmer in the direct production of food or agricultural commodities *for sale* (emphasis added in original).
>
> Since taxpayer does not meet the federal definition of farmer, he is not considered to be "occupationally engaged" in farming for State purposes. He does not meet the State definition of "farmer" because he does not raise food or commodities for human consumption nor does he sell commodities provided by the animals. Taxpayer is subject to sales/use tax on all purchases.

The agricultural exemption statutes, IC § 6-2.5-5-1 and IC § 6-2.5-5-2, provide in pertinent parts:

> Transactions involving animals, feed, seed, plants, fertilizer, insecticides, fungicides, and other tangible personal property are exempt from the state gross retail tax if:
>
> (1) the person acquiring the property acquires it for his direct use in the direct production of food or commodities for sale: and
>
> (2) the person acquiring the property is occupationally engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food or commodity production.
>
> IC § 6-2.5-5-1
>
> (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.
>
> (b) Transactions involving agricultural machinery or equipment are exempt from the state gross retail tax if:
>
> IC § 6-2.5-5-2

The remainder of the statute uses language similar to that contained in IC § 6-2.5-5-1 in that engaging in producing commodities for sale is key to the exemption.

Taxpayer's purchases/transactions fall within the coverage of both these statutes if the Department determines that alpaca fleece is an agricultural commodity. The agricultural exemption regulations, 45 IAC 2.2-5-1, 45 IAC 2.2-5-2, 45 IAC 2.2-5-3, 45 IAC 2.2-5-4, and 45 IAC 2.2-5-6 supply many useful definitions, but do not define "an agricultural commodity." Several of the regulations even go so far as to list out specific items as either exempt or non-exempt purchases, *see*, e.g., 45 IAC 2.2-5-4, but there is really no one definition of "an agricultural commodity." Therefore, a bit of extrapolation is required.

The closest the state regulations come to a definition of agricultural commodity is 45 IAC 2.2-5-1(b)(2): "Baby chicks, ducklings, geese, turkey poults, hatching eggs, pigs, hogs *[sic.]* lambs, sheep, livestock, calves, and cows are exempt from tax, provided that they are directly used by the farmer in the direct production of food or agricultural commodities for sale."

The audit conceded that taxpayer's alpacas "do not produce any food or commodity <u>other than their fleece</u>." [emphasis added]. Taxpayer's letter of protest, testimony at the hearing, and materials presented at the hearing, and documents submitted post-hearing all support taxpayer's contention, and the Department so finds, that alpaca fleece is an agricultural commodity no different than sheep or lamb's wool.

To summarize:

> Taxpayer has sufficiently documented his subjective and objective intent to raise alpacas and produce their fleece (the agricultural commodities at issue) for profit. Taxpayer is not engaged in this activity as a hobby. Alpaca raising requires an initial investment of thousands of dollars. Taxpayer is increasing the size of his herd ("alpaca compounding") before he begins selling animals for profit. This is a clear business decision based on common sense. Taxpayer turns in alpaca fleece to the co-op which takes in fleece from its members, turns the fleece into thread and then into items members purchase at wholesale to sell at retail. Taxpayer submitted several catalogues where alpaca products of all kinds are available for customers to purchase at retail. Alpaca products are luxury items commanding top prices that will certainly enlarge taxpayer's profit margins in the years to come. Alpaca fleece is an agricultural commodity no different than sheep or lamb's wool, **and** is a renewable commodity—alpacas are sheared once a year and can produce fleece as long as they live and their fleece's quality matches product quality and the tastes of the commercial market.

Pursuant to taxpayer's November 2, 2004 Letter of Protest, the items listed in the following sections are exempt from the state's gross retail and use taxes: sections 2, 3, 4, 5, 6, 8, 9, 10, and 11. Fencing in section 9 is not exempt; *see*, 45 IAC 2.2-5-2(d)(3); cutters, combs, and oil in section 10 are exempt for the reason stated.

FINDING

Taxpayer's protest concerning the audit's assessment of gross retail tax, based on agricultural exemptions for producing an agricultural commodity, specifically alpaca fleece, is sustained.

DEPARTMENT OF STATE REVENUE

0420040446.LOF

LETTER OF FINDINGS NUMBER: 04-0446
Sales and Withholding Tax
Responsible Officer
For the Tax Period 2000-2002

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

ISSUE

1. Sales Tax-Responsible Officer Liability

Authority: IC 6-2.5-9-3, IC 6-8.1-5-1(b), Indiana Department of Revenue v. 654 N.E. 2nd 279 (Ind.1995).

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

STATEMENT OF FACTS

The Indiana Department of Revenue, hereinafter referred to as the "department," assessed food and beverage taxes, sales taxes, interest and penalty against the taxpayer as a responsible officer of a corporation that did not properly remit said trust taxes during the tax years 2000-2002. The taxpayer protested the assessment of tax. A hearing was held and this Letter of Findings results.

1. Sales Tax-Responsible Officer Liability

DISCUSSION

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

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

An individual who:

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

(2) has a duty to remit state gross retail or use taxes to the department;

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

Pursuant to Indiana Department of Revenue v. Safayan 654 N.E. 2d 279 (Ind.1995), any officer, employee, or other person who has the authority to see that they are paid has the statutory duty to remit sales taxes to the state.

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

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420050013.LOF

LETTER OF FINDINGS NUMBER: 05-0013
Sales and Use Tax
For Tax Years 1998-2001

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

ISSUE

I. Sales Tax--Imposition

Authority: IC 6-8.1-5-1; IC 6-8.1-10-1

Taxpayer protests imposition of sales tax, penalties and interest.

STATEMENT OF FACTS

Taxpayer pleaded guilty in criminal court to one (1) count of failure to remit retail sales tax. The court ordered restitution of the base tax. The Indiana Department of Revenue ("Department") billed taxpayer for the base amount and also for penalties and interest. Taxpayer protests the bills. Further facts will be supplied as required.

DISCUSSION

I. Sales Tax--Imposition

Taxpayer protests bills for sales tax, penalty and interest. Taxpayer has failed to supply any documentation or analysis in support of the protest. The Department refers to IC 6-8.1-5-1(b) which states in relevant part:

> 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.

As explained in the Statement of Facts, taxpayer pleaded guilty to one (1) count of failure to remit retail sales tax. The criminal court ordered restitution of the base tax. The Department issued bills for the base tax and penalties and interest. Taxpayer has not provided any explanation for its protest, let alone met the burden of proving that the assessments are wrong under IC 6-8.1-5-1(b). Also, under IC 6-8.1-10-1(e), the Department may not waive interest.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420050060.LOF

LETTER OF FINDINGS NUMBER: 05-0060
Sales and Use Tax
For the Periods 2000 and 2001

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

ISSUE

I. Sales Tax—Untaxed Sales of Catalogs and Promotional Items

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

Taxpayer protests the calculated amount of the sales tax due.

II. Use Tax—Untaxed Purchases of Catalogs and Promotional Items Distributed without Charge to Recipients in Indiana

Authority: IC 6-2.5-3-2.

Taxpayer protests the calculated amount of use tax due.

STATEMENT OF FACTS

Taxpayer is a wholesaler of janitorial and sanitation supplies. Taxpayer also sells and gives away to customers marketing merchandise, including catalogs, flyers, and printed advertising literature. These are purchased by retail vendors to use in promoting sales to consumers. Taxpayer operates warehouses across the United States, including a distribution center in Indiana. The Department conducted an audit on a best information available basis at Taxpayer's parent headquarters. The Department issued sales and use tax assessments; Taxpayer filed a protest and a hearing was held.

I. Sales Tax—Untaxed Sales of Catalogs and Promotional Items

DISCUSSION

All tax assessments are presumed to be accurate; the taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). IC 6-2.5-2-1 imposes sales tax on retail transactions made in Indiana and a retail merchant is required to collect the tax as agent for the state. IC 6-2.5-4-1 defines a retail transaction as the acquisition of tangible personal property for resale to a customer for consideration. When tangible personal property is transferred to a customer, sales tax is to be calculated and collected.

IC 6-8.1-5-4(a) requires a taxpayer to maintain books and records in a manner that allows the Department review those books and records to determine liabilities and taxes due. IC 6-8.1-5-1(a) authorizes the Department to make a proposed assessment based on the best information available to the Department. The Department issued an best information assessment in this instance. The

Audit Summary stated that Taxpayer did not comply with audit requests to produce records regarding the volume of taxable catalog and promotional items sales in Indiana.

For the hearing, Taxpayer submitted two binders of records to substantiate amount due for untaxed sales of catalogs and promotional items. Taxpayer stated that while there is an amount of approximately $1,444 due for 2001, it disputes the additional assessment by the Department of $51,087 due for 2000 and $51,674 due for 2001. Despite the detailed and voluminous documentation submitted to the Department for the hearing and the rationale forwarded at the hearing, the Department does not find the evidence sufficient to rebut the assessment.

FINDING

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

II. Use Tax—Untaxed Purchases of Catalogs and Promotional Items Distributed without Charge to Recipients in Indiana

DISCUSSION

Indiana imposes an excise tax—commonly called the use tax—on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction. IC 6-2.5-3-2. Taxpayer distributed printed promotional materials to its customers without charge. Taxpayer had not paid sales tax when it acquired those materials for distribution. For this reason, use tax was due when Taxpayer gave those materials to its customers without charge. Taxpayer is protesting the best information available assessment made by the Department. Despite the detailed and voluminous documentation submitted to the Department for the hearing and the rationale forwarded at the hearing, the Department does not find the evidence sufficient to rebut the assessment.

FINDING

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

DEPARTMENT OF STATE REVENUE

04-20050096.LOF

LETTER OF FINDINGS NUMBER: 05-0096
Sales/Use Tax
For the Years 2002-2003

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

ISSUE

I. Sales and Use Tax-Manufacturing exemption
Authority: Ind. Code § 6-2.5-5-3

Taxpayer protests the assessment of use tax with respect to a piece of machinery that straightens coiled steel.

STATEMENT OF FACTS

Taxpayer is a business engaged in the production of lawn equipment, and operates a facility in Indiana. As part of its operation, Taxpayer purchased a machine for the purpose of straightening steel coils prior to their insertion into a press designed to form the parts necessary for their lawn equipment. The Department assessed use tax with respect to the machine, which Taxpayer protested.

I. Sales and Use Tax-Manufacturing exemption

DISCUSSION

Under Ind. Code § 6-2.5-5-3, machinery directly used in the direct production of other tangible personal property is exempt from sales and use tax. Taxpayer argues that its machine is an integral part of its production of lawn equipment. In particular, Taxpayer notes its entire process. First, a coil of steel is loaded into a feeder. Second, the feeder feeds the steel into the machine, which straightens the steel prior to the steel entering a press. Third, an exact length of steel enters the press. Fourth, the press cuts the steel to the exact specification. When the steel is cut, the steel passes through the press. At this point, the machine sends a length of steel through it to be straightened, and the exact same length of steel passes through the press, repeating the process until the full coil is used.

Here, the straightening of steel does not constitute the production of other tangible personal property, notwithstanding its proximity to the production press. The first step in the actual production of tangible personal property is the production press. Accordingly, Taxpayer's protest is denied.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420050129.LOF

LETTER OF FINDINGS NUMBER: 05-0129
Sales and Withholding Tax
Responsible Officer
For the Tax Period 1989-1992

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

ISSUE

1. Sales and Withholding Tax-Responsible Officer Liability

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

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

STATEMENT OF FACTS

The taxpayer was the manager of a corporation that operated a restaurant and failed to pay its sales and withholding taxes during the tax period 1989-1992. The Indiana Department of Revenue assessed the unpaid sales taxes, withholding taxes, interest, and penalty against the taxpayer as a responsible officer of that corporation. The taxpayer protested the assessment of tax and a hearing was held.

1. Sales and Withholding Tax-Responsible Officer Liability

DISCUSSION

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

The proposed withholding taxes were assessed against the taxpayer pursuant to IC 6-3-4-8(g), which provides in relevant part 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 proposed sales tax liability was issued under authority of IC 6-2.5-9-3 that provides as follows:

An individual who:

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

(2) has a duty to remit state gross retail or use taxes to the department;

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

The taxpayer was the manager of the restaurant. As the manager, the taxpayer is presumed to have been in a position to exercise control over the fiscal aspects of the restaurant. He argues, however, that in reality he had no control over the finances and did not determine which creditors would be paid. Since he did not produce any documentation to substantiate this claim, he failed to sustain his burden of proving that he did not have a duty to deduct and remit corporate sales and withholding taxes to the state.

Alternatively, the taxpayer argues that the amount of the assessed taxes for the corporation was too high. Although he was given ample opportunity to do so, he failed to produce any documentation to substantiate this claim. He failed to sustain his burden of proving that the amount of trust taxes assessed was incorrect.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

2820050151.LOF

LETTER OF FINDINGS NUMBER: 05-0151
Controlled Substance Excise Tax
For the Tax Period 2004

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

ISSUE

1. Controlled Substance Excise Tax: Imposition

Authority: IC 6-7-3-5. IC 6-8.1-5-1 (b), Hurst v. Department of Revenue, 721 N.E.2d 370 (Ind. Tax. 1999), Hall v. Department of Revenue, 720 N.E.2d 1287 (Ind. Tax 1999), Taxpayer protests the imposition of the Controlled Substance Excise Tax.

STATEMENT OF FACTS

Taxpayer was arrested for possession of marijuana on January 1, 2004. The county prosecutor sent the Indiana Department of Revenue (department) on March 1, 2005, a letter stating that the prosecutor would not press criminal charges concerning the possession of marijuana. The Indiana Department of Revenue issued a record of Jeopardy Finding, Jeopardy Assessment Notice and Demand on March 9, 2000, in a base tax amount of $20,039.95. Taxpayer filed a protest to the assessment. A hearing on the protest was held on July 14, 2005 and this Letter of Findings results.

DISCUSSION

1. Controlled Substance Excise Tax: Imposition

IC 6-7-3-5 imposes the Controlled Substance Excise Tax on the possession of marijuana in the State of Indiana. Indiana Department of Revenue assessments are presumed to be correct and Taxpayer bears the burden of proving that an assessment is incorrect. IC 6-8.1-5-1(b). Possession of the marijuana can be either actual or constructive. Hurst v. Department of Revenue, 721 N.E.2d 370 (Ind. Tax. 1999), Hall v. Department of Revenue, 720 N.E.2d 1287 (Ind. Tax 1999). Although both direct and circumstantial evidence may prove constructive possession, proof of presence in the vicinity of drugs, presence on property where drugs are located, or mere association with the possessor is not sufficient. Hurst at 374-375. To prove constructive possession, there must be a showing that Taxpayer had not only the requisite intent but also the capability to maintain dominion and control over the substance. Hurst at 374.

In the Hall case, the Indiana Department of Revenue assessed Controlled Substance Excise Tax individually on a husband and wife. The couple owned and lived together in a residence. The marijuana was grown in a basement room with a locked door. Only the husband had a key to the room. Although the wife co-owned the house, lived in the house, did laundry in the room adjacent to the room which housed the marijuana and the smell of marijuana permeated the house; the Court found that the wife did not have the capability to maintain dominion and control over the marijuana. Therefore she did not constructively possess the marijuana and the Controlled Substance Excise Tax was improperly imposed against the wife.

Taxpayer contends that he did not possess the marijuana at issue in this case. He stated that his codefendant actually possessed the marijuana. He supports this contention by stating that he was not in the house when the police made the arrest. He further states that he had no knowledge of the presence of marijuana in his house.

In this case, the police searched the house owned by the taxpayer. They found marijuana in a green tote bag in the living room and in a kitchen drawer. Digital scales of the type often used to weigh marijuana were also found in the kitchen drawer with the marijuana. Other common indicia of drug trafficking such as large amounts of cash and guns were found in various areas of the house.

The presence of the marijuana and other indicia of marijuana trade throughout the taxpayer's house indicated that the taxpayer had the intent to possess the marijuana and the capability to maintain dominion and control over the marijuana. The taxpayer constructively possessed the marijuana. The tax was properly imposed.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120050157P.LOF

LETTER OF FINDINGS NUMBER: 05-0157P
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 Indiana resident.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer requests the late penalty be abated as the taxpayer was ignorant of tax regulations, and, the taxpayer did not have all of the relevant information at the due date to prepare the income tax return.

The taxpayer incurred a $4,000,000 increase in reportable income for the tax year in question.

$2,400,000 of this income increase came from the disallowance of losses as the State of Indiana does not recognize Federal Schedule A deductions. The taxpayer was ignorant of this regulation. According to 45 IAC 15-11-2(b), ignorance is negligence and is subject to the negligence penalty.

The remaining $1,600,000 of the income increase is the result of an increase in the rate-of-return for the taxpayer's investments. 70% of the investment entities provided the relevant tax records by the tax filing due date. Of the remaining 30%, most of these investment entities were hedge funds where the income could be estimated from 3rd quarter financials. The Department feels the taxpayer had adequate information available to make a reasonable estimate of income at the due date.

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

0320050166.LOF

LETTER OF FINDINGS NUMBER: 05-0166
Withholding Tax
Responsible Officer
For the Tax Period 1995-1996

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

ISSUE

1. Withholding Tax-Responsible Officer Liability

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

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

STATEMENT OF FACTS

The taxpayer was an employee of a corporation that did not remit the proper amount of withholding taxes during the tax period of 1995-1996. The Indiana Department of Revenue assessed the unpaid withholding taxes, interest, and penalty against the taxpayer as a responsible person of that corporation. The taxpayer protested the assessment of tax and a hearing was held.

1. Withholding Tax-Responsible Officer Liability

DISCUSSION

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

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

The taxpayer produced substantial documentation that he had no control over the financial activities of the corporation. Therefore, he had no duty to collect and remit withholding taxes to the state. He is not personally responsible for the payment of the corporate withholding tax liabilities.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0120050188.LOF

LETTER OF FINDINGS NUMBER: 05-0188
Adjusted Gross Income Tax
For the Tax Period 1999-2001

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

ISSUE

1. Adjusted Gross Income Tax-Imposition

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

The taxpayer protests the imposition of adjusted gross income tax.

STATEMENT OF FACTS

The taxpayer did not file adjusted gross income tax returns for the tax periods 1999-2001. The Indiana Department of Revenue (department) computed the Indiana adjusted gross income tax due based upon the taxpayer's federal adjusted gross income. The department assessed the adjusted gross income tax, penalty and interest against the taxpayer. The taxpayer protested the assessment of tax. A hearing was scheduled, but the taxpayer did not appear. This Letter of Findings is based upon the documentation in the file.

1. Adjusted Gross Income Tax-Imposition

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).

Indiana imposes an adjusted gross income tax on residents. IC 6-3-2-1. Every Indiana resident with income subject to the Indiana adjusted gross income tax is required to file a return and remit said tax to the state annually. The taxpayer failed to do this. Therefore the department computed the tax due to the state and issued an assessment pursuant to its authority granted by IC 6-8.1-5-1.

The taxpayer failed to present any arguments or evidence to indicate that the department erred in the computation of his adjusted gross income tax due. The taxpayer did not sustain his burden of proof.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-20050195.LOF

LETTER OF FINDINGS NUMBER: 05-0195
Adjusted Gross Income Tax
For the Years 1999-2002

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

ISSUES

I. Adjusted Gross Income Tax—Eligibility for inclusion in a consolidated return.

Authority: Ind. Code § 6-3-2-2; Ind. Code § 6-3-2-2.8; Ind. Code § 6-3-3-2.; Ind. Code § 6-3-4-14; Ind. Code § 6-3-8-2; Ind. Code § 27-1-18-2; *Associated Insurance Co. v. Indiana Dep't of State Revenue*, 655 N.E.2d 1271 (Ind. Tax 1995)

Taxpayer protests the disallowance of a life insurance company from its consolidated group for adjusted gross income tax and supplemental net income tax purposes.

II. Adjusted Gross Income Tax—Computation of research expense credit

Authority: Ind. Code § 6-3.1-4-2; Ind. Code § 6-3.1-4-4; I.R.C. § 41; I.R.C. § 1501

Taxpayer protests the disallowance of its method of computing the credit for research expenses.

III. Adjusted Gross Income Tax—Inclusion of subsidiary in a consolidated return.

Authority: 45 IAC 3.1-1-38

Taxpayer protests the exclusion of a subsidiary from its consolidated income tax return.

IV. Tax Administration--Penalty

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

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

STATEMENT OF FACTS

Taxpayer is a holding company for a group of corporations engaged in a myriad of different industries. One of the corporations in Taxpayer's group for federal income tax purposes is a domestic life insurance company. During the years in question, Taxpayer filed consolidated returns including several corporations, including the life insurance company.

As a result of Department audit, the non-insurance subsidiaries and the life insurance company were effectively separated for adjusted gross income tax and supplemental net income tax purposes. This had the effect of increasing Taxpayer's total tax due for the years in question.

In addition, various subsidiaries of Taxpayer engaged in activities that resulted in eligibility for a research and development credit. When computing the percentage of the credit apportioned to Indiana, Taxpayer initially used the percentage based on its consolidated group's apportionment factor. However, Taxpayer amended its returns to divide its credit pro rata among its eligible subsidiaries, then used the apportionment factor for each separate company to compute its allowable credit. The Department disallowed Taxpayer's approach used in its amended returns.

Further, for the years in question, Taxpayer did not initially include one subsidiary on its initial tax returns. Upon audit, Taxpayer sought to include the subsidiary as part of its consolidated group, but the Department did not permit Taxpayer to include that subsidiary, claiming that the subsidiary did not have nexus with Indiana. Finally, Taxpayer protests the imposition of a ten percent (10%) penalty for negligence.

I. Adjusted Gross Income Tax— Eligibility for inclusion in a consolidated return.

DISCUSSION

First, Taxpayer argues that the non-insurance subsidiaries and the life insurance company should be permitted to file consolidated returns for all tax types. In particular, Taxpayer argues that its calculations of adjusted gross income and supplemental net income tax should permit the full benefit of the two groups combined income (or losses) and their combined adjusted gross income.

Under Ind. Code § 6-3-4-14:

(a) An affiliated group of corporations shall have the privilege of making a consolidated return with respect to the taxes imposed by IC 6-3. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all of the provisions of this section including all provisions of the consolidated return regulations prescribed pursuant to Section 1502 of the Internal Revenue Code and incorporated herein by reference and all regulations promulgated by the department implementing this section prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

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

(c) For purposes of IC 6-3-1-3.5(b), the determination of "taxable income," as defined in Section 63 of the Internal Revenue Code, of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, shall be determined pursuant to the regulations prescribed under Section 1502 of the Internal Revenue Code.

(d) Any credit against the taxes imposed by IC 6-3 which is available to any corporation which is a member of an affiliated group of corporations making a consolidated return shall be applied against the tax liability of the affiliated group.

Taxpayer argues that the life insurance company does, for purposes of this section, have Indiana adjusted gross income, even though the adjusted gross income of the life insurance company is not subject to tax.

At the onset of this discussion, Taxpayer and the Department appear to agree on at least one piece of methodology. First, the gross income tax of both the non-insurance subsidiaries and the life insurance company are computed in the normal manner. Second, the non-insurance subsidiaries, on a consolidated basis and under the provisions of Ind. Code § 6-3-2-2, and the life insurance company under Ind. Code § 6-3-8-2(c)(2), would compute their apportionment factors, and apply the respective apportionment factors to their respective incomes to arrive at adjusted gross income (or in the case of the life insurance company, a *pro forma* adjusted gross income).

At this point, however, the calculations begin to differ. First, the gross income tax becomes a credit against adjusted gross income tax. Ind. Code § 6-3-3-2. Taxpayer seeks to use the combined gross income tax against the adjusted gross income tax of just the non-insurance subsidiaries due to the exemption from adjusted gross income tax for domestic insurance companies. Ind. Code § 6-3-2-2.8(4). However, the Department sought to allow the gross income tax of only the non-insurance subsidiaries as a credit against the adjusted gross income tax of those same entities, with the gross income tax of the life insurance company standing alone.

A further difference occurs in the supplemental net income tax. Under the supplemental net income tax provisions, a taxpayer's adjusted gross income tax is figured under the normal apportionment/allocation method provided under Ind. Code § 6-3-2-2, except in the case of domestic insurance companies. In the case of domestic insurance companies, the adjusted gross income is apportioned on a single-factor basis, namely premiums at risk. Ind. Code § 6-3-8-2(b)-(c).

For most corporations, a deduction is allowable for the highest of a taxpayer's adjusted gross income tax, gross income tax, or gross premiums tax. In the case of a domestic life insurance company, a deduction is allowable for the higher of the gross income tax or gross premiums tax. *Id.*

Here, it is difficult to reconcile Taxpayer's position that the income of the entities should be consolidated for either tax type. First, with respect to adjusted gross income tax, the life insurance company is exempt. Period. Accordingly, the life insurance company's income situation does not affect the adjusted gross income for the non-insurance subsidiaries.

Further, with respect to the credit against adjusted gross income tax, Taxpayer seeks a "best of both worlds" situation. Taxpayer is seeking to compute its adjusted gross income tax without the inclusion of an entity-namely, the life insurance company. Then, once it gets done with that, it seeks to use that same entity to claim a credit against the tax for all other entities. In short, Taxpayer is using an artificially high figure for gross income tax to offset a lowered adjusted gross income tax.

Taxpayer argues that it is in fact eligible to use the credit for gross income taxes owed by the life insurance company in order to offset the adjusted gross income tax owed by the non-life insurance subsidiaries. Taxpayer argues that Ind. Code § 6-3-4-14 permits corporations that file consolidated federal income tax returns and that have adjusted gross income from Indiana sources to file consolidated adjusted gross income tax returns. Taxpayer asserts that the insurance companies have adjusted gross income from Indiana sources, but merely do not pay tax on that.

Taxpayer further cites to *Associated Insurance Co. v. Indiana Dep't of State Revenue*, 655 N.E.2d 1271 (Ind. Tax 1995). In that particular case, the taxpayer consisted of a group of insurance companies that filed a consolidated gross income tax return. Several members of the group were eligible for a credit based on providing health insurance to individuals who could not otherwise obtain private health insurance. *Id.* at 1272. Various members of the group accrued credits greater than those members' gross income tax liabilities, as computed on a separate-company basis. The taxpayer sought to use the credit against the overall gross income tax liability of the consolidated group, rather than limit the credit to the liabilities of the separate members that incurred eligible expenses. The court held that the credits were allowable to offset the entire liability. *Id.* at 1276.

Here, Taxpayer's situation is distinctly different. Unlike the insurance companies in *Associated Insurance* that sought to apply a credit for a tax for which all members of the group were liable, Taxpayer here is seeking to use a credit to reduce its consolidated tax liability while not being subject to the very liability that it is seeking to reduce.

Further, within the overall structure of Indiana's tax code, Taxpayer's argument fails. When read together, the effect is that corporate taxpayers pay the higher of their adjusted gross income tax liability or gross income tax liability. This implies that the taxpayers are subject to both liabilities. While this is certainly true of the non-insurance subsidiaries, the life insurance company is not subject to both taxes; it is only subject to gross income tax, and then only if it elects to be so treated to be subject in lieu of the gross premiums tax under Ind. Code § 27-1-18-2. Accordingly, based on the overall structure of the tax codes, the only logical result is that non-insurance subsidiaries must be segregated from the life insurance company.

Finally, even if Taxpayer does qualify for inclusion of the insurance company in its consolidated return, the issue of whether the return fairly reflects Taxpayer's Indiana source income must be addressed. Under Ind. Code § 6-3-2-2(l),

> If the allocation and apportionment provisions of this article do not fairly reflect 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

Here, Taxpayer is seeking to effectively eliminate its adjusted gross income tax liability by use of a credit from an entity that is not even subject to the tax. To achieve a more equitable allocation of the income that Taxpayer provided, separate accounting between the life insurance company and the non-life insurance subsidiaries was a method to fairly reflect the income of each part of its business. Accordingly, Taxpayer's protest is denied on this basis.

With respect to the supplemental net income tax, Taxpayer's argument fails again. First, the very statute that prescribes the method by which the tax is computed, Ind. Code § 6-3-8-2, gives a method (one-factor apportionment) for domestic life insurance companies and a separate method (apportionment and allocation per Ind. Code § 6-3-2-2) for other corporations subject to the tax. This implies that the Legislature did not intend for the two types of businesses to be combined. Accordingly, the audit was correct in computing Taxpayer's supplemental net income tax separately for the life insurance company and the non-life insurance subsidiaries.

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Computation of research expense credit

DISCUSSION

Taxpayer argues that the auditor computed Taxpayer's credit for research expenses incorrectly. Under Ind. Code § 6-3.1-4-2, as it existed for the years in question, the statute provided in relevant part:

> (b) A taxpayer who does not have income apportioned to this state for a taxable year under IC 6-3-2-2 is entitled to a research

expense tax credit for the taxable year in the amount of the product of:
(1) five percent, multiplied by
(2) the remainder of the taxpayer's Indiana qualified research expenses for the taxable year, minus:
(A) the taxpayer's base period Indiana qualified research expenses, for taxable years beginning before January 1, 1990
(B) the taxpayer's base amount, for taxable years beginning after December 31, 1989
(c) A taxpayer who has income apportioned to this state for a taxable year under IC 6-3-2-2 is entitled to a research expense tax credit for the taxable year in the amount of the lesser of:
(1) the amount determined under subsection (b); or
(2) five percent multiplied by the remainder of the taxpayer's total qualified research expenses for the taxable year, minus:
(A) the taxpayer's base period research expenses, for taxable years beginning before January 1, 1990
(B) the taxpayer's base amount, for taxable years beginning after December 31, 1989
further multiplied by the percentage determined under IC 6-3-2-2 for the apportionment of the taxpayer's income for the taxable year to this state.

Taxpayer sought to compute the amount of the credit based on the apportionment factors of each subsidiary that had qualifying research expenditures, rather than the apportionment factor for the entire consolidated group.

In order to do this, first Taxpayer found the amount of the increase in research expenses for each subsidiary. Then, Taxpayer prorated its expenses to each entity based on its increase. This gave each entity's share of research expenses. Then, the apportionment factor for each entity was applied to the entity's share of research expenses. This provided the amount that Taxpayer sought to use for paragraph (c) of the statutory calculation.

For instance, for one year the computation, using Taxpayer's methods as amended and Taxpayer's apportionment factor for the entire consolidated group was as follows:

Line		Indiana only qualified research	Total federal qualified research
4	Wages for qualified services	$14,177,632.00	$15,074,064.00
5	Cost of supplies	$5,123,701.00	$5,488,669.00
6	Rental or lease cost of computers		$0.00
7	65% of contract expenses	$4,323,696.00	$4,982,551.00
8	Total qualified research expenses	$23,625,029.00	$25,545,284.00
9	Fixed base percentage	0.01	0.01
10	Average annual gross receipts	$1,227,165,003.00	$1,227,165,003.00
11	Multiply line 10 by line 9	$12,271,650.03	$12,271,650.03
12	Subtract line 11 from line 8	$11,353,378.97	$13,273,633.97
13	Multiply line 8 by 50%	$11,812,514.50	$12,772,642.00
14	Enter the smaller of line 12 or line 13	$11,353,378.97	$12,772,642.00
15	Add lines 3 (not relevant for this taxpayer) and 14	$11,353,378.97	$12,772,642.00
16	Enter Indiana apportionment percentage for the current year		0.2039
17	Multiply line 15 column B by the percentage on line 16		$9,315,483.41
18	Enter the smaller of amount on line 15 column A, or line 17		$9,315,483.41
19	Allowable percentage for Indiana research expense tax credit		0.05
20	Multiply line 18 by 5%, enter amount of current year tentative credit		$465,774.17

However, Taxpayer, in computing the amount of the allowable credit, sought to do the following (a minor discrepancy exists between the calculations of the expenses eligible for computation):

Company	Qualifying expenditures	Amount for computation
A	$289,422.00	$12,768,207.00
B	$2,728,572.00	$12,768,207.00
C	$20,667,730.00	$12,768,207.00
D	$1,621,962.00	$12,768,207.00
E	$228,726.00	$12,768,207.00
Total	$25,536,412.00	

Company	Credit allocation %	Pre-apportionment QRE	Apportionment percentage	Post-apportionment QRE
A	1.13%	$144,711.01	0%	$0.00
B	10.69%	$1,364,286.11	16.88%	$230,291.49
C	80.93%	$10,333,865.81	86.81%	$8,970,828.91

D	6.35%	$810,981.06	0	$0.00
E	0.90%	$114,363.01	100%	$114,363.01
Total				$9,315,483.41

Thus, Taxpayer sought to use $9,315,483 as its qualified expenses in place $2,603,437 ($12,768,207*20.39%) based on the Department's apportionment formula.

Taxpayer argues that its computation is consistent with Ind. Code § 6-3.1-4-4, which provides:

> The provision of Section 41 of the Internal Revenue Code and the regulations promulgated in respect to those provisions are applicable to the interpretation and administration by the department of the credit provided by this chapter, including the allocation and pass through of the credit to various taxpayers and the transitional rules for determination of the base period.

Section 41(f) of the Internal Revenue Code provides that, where a group of corporations are part of a controlled group, the credit for research activities shall be aggregated and then divided up proportionately among the corporations based on their individual research expenses and payments. For these purposes, a "controlled group" is defined differently than an affiliated group for consolidated corporate income tax returns. Whereas I.R.C. § 1501 et seq. require eighty percent control of the relevant corporations by the same persons to be part of a consolidated income tax return, I.R.C. § 41(f)(5) only requires fifty percent control of the relevant corporations.

As a result of the different control provisions and the reference in Indiana's statutes to "taxpayer", Taxpayer argues that the intent of the provision requires computation of the credit on a separate corporation basis.

Basically, there are two methods for computing adjusted gross income tax in a consolidated group. The strongly preferred method is the combined approach. Under this approach, a consolidated group's income is to be figured on the basis of the whole consolidated group. That is, the net income for the various corporations and the apportionment factors are to be computed as if all the corporations were one large entity. This contrasts with the "stacked" method, in which each corporation's income and apportionment factors are determined separately, then the corporations respective income are added together to arrive at a total for the entire group.

In this instance, Taxpayer's argument is valid to the extent that the various ultimate taxpayers are separate entities for tax purposes. For instance, if the credit had to be distributed among several corporations that filed separately, or among partners in a partnership, then Taxpayer's method would be applicable.

Here, however, Taxpayer seeks the benefit of yet another "best of both worlds" approach. Basically, Taxpayer is attempting to seek the full benefit of the normal method in determining its income, while seeking the full benefit of the stacked method when seeking the tax credit for research expenses. Consistently throughout the income tax provisions, "taxpayer" in a consolidated group refers to the group, not the individual corporations that constitute the consolidated group. Accordingly, to the extent the corporations that constitute the consolidated group are eligible for expenses, Taxpayer is required to determine the credit for the group in the aggregate, then determine the portion allowable for credit using the aggregated apportionment factors for the consolidated group, not those of the individual members.

Further, even if Taxpayer's method is to be accepted, Taxpayer is required to determine the credit consistently for each entity. Here, Taxpayer sought to apply the calculation under subsection (b) in the aggregate, while the subsection (c) calculation was determined separately. Accordingly, even if Taxpayer's method of computing the credit on a stacked basis is accepted, Taxpayer has not provided sufficient information to demonstrate that its method was correct for computing the credit under subsection (b).

Taxpayer has further raised a constitutional challenge to Indiana's credit regime, charging that it potentially discriminates against multistate businesses. The Department is not an appropriate forum to make such decisions, and accordingly this argument is denied.

FINDING

Taxpayer's protest is denied.

III. Adjusted Gross Income Tax--Inclusion of subsidiary in a consolidated return.

DISCUSSION

Taxpayer also protests the auditor's disallowance of one subsidiary in its consolidated filing. Initially, Taxpayer had not included the subsidiary in its consolidated return. However, when the Department audited the file, Taxpayer sought to include the subsidiary in its consolidated group. Taxpayer has not provided sufficient information to permit the Department to conclude that the auditor was incorrect, and accordingly is denied.

FINDING

Taxpayer's protest is denied.

IV. Tax Administration--Penalty

DISCUSSION

Taxpayer argues that it is not subject to negligence penalties with respect to the additional taxes assessed against it. In particular, Taxpayer argues that the additional tax was due to its different, but reasonable, interpretation of the statute. Accordingly, it argues that it was not negligent in its tax returns for the years in question.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. Ind. Code § 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 has made the requisite showing per statute and regulation, and accordingly is sustained.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

4320050199.LOF

LETTER OF FINDINGS NUMBER: 05-0199
Underground Storage Tank Fees
For the Tax Period 1991-1996

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

ISSUE

1. Underground Storage Tank Fee- Imposition

Authority: IC 6-8.1-5-1 (b), IC 13-7-20-32, IC 13-7-20-41, IC 13-12-12-4, IC 6-8.1-1-1, IC 13-23-12-1, IC 13-11-2-150 & 151, IC 13-11-2-151(a) 1, IC 13-11-2-150.

The taxpayer protests the department's imposition of underground storage tank fees.

STATEMENT OF FACTS

The taxpayer is a corporation that operates a convenience grocery store with underground storage tanks. The taxpayer leased the real estate and operated the convenience grocery store in question from April 1, 1985 until May 1, 1996. On that date, the taxpayer purchased the real estate. After a review of the of fees paid on the taxpayer's underground storage tanks, the Indiana Department of Revenue (DOR) assessed additional underground storage tank fees for the tax period 1991-1996, interest and penalty. The taxpayer protested the imposition of the fees, interest and penalty. A hearing was held and this Letter of Findings results.

1. Underground Storage Tank Fee-Imposition

DISCUSSION

During the tax period 1991-1996, IC 13-7-20-32 and IC 13-7-20-41 imposed underground storage tank fees on the owner of underground storage tanks. Although the Indiana Department of Environmental Management (IDEM) administers the state regulation of underground storage tanks, these statutes mandate that the DOR collect and deposit the underground storage tank fees. IC 6-8.1-1-1 defines "listed tax" to include "any other tax or fee that the department is required to collect or administer." Since the DOR pursuant to statute must collect the underground storage tank fees, these fees constitute listed taxes. All of the laws and regulations concerning the DOR's collection of listed taxes apply to the DOR's collection of the underground storage tank fees. All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b).

The taxpayer argued that it did not owe the unpaid storage tank fees because it was not the owner of the property with the underground storage tanks until May 1, 1996. In support of this contention the taxpayer submitted a copy of the sales agreement. This agreement specifically addressed the issue of payment of taxes, stating in relevant part as follows:

3. Taxes: Said real estate is sold and shall be conveyed to the Buyer free and clear of all liens and encumbrances, except a pro-rated portion of the 1996 taxes, due and payable in 1997, to be pro-rated as of the date of closing, which, together with all taxes and assessments made subsequent to the date hereof, the Buyer assumes and agrees to pay.

The liability under protest in this issue concerns the underground storage tank fees that were not paid prior to the transfer of ownership of the real estate and underground storage tanks to the taxpayer. However, during that period, the taxpayer leased the real estate from the person from whom he purchased the real estate. Under the terms of the lease agreement, the previous owner retained responsibility for the underground storage tanks and the payment of all taxes related to the real estate.

The fee is assessed based on IC 13-23-12-1 and is required of "the owner of an underground storage tank." IC 13-11-2-150 & 151 provide definitions for "Owner" and "Owner or Operator" respectively. The taxpayer, as the renter of the property, operated the station on a day to day basis. IC 13-11-2-151(a) 1 defines "Owner or operator" as "a person who owns or operates the facility." IC 13-11-2-150 has no provision to identify the "Owner" of a fuel storage tank as one involved in the operation of the facility.

IDEM records indicate that the previous owner sometimes paid the underground storage tank fees due during the tax period. These payments demonstrate that he was responsible for the payment of these fees and that he realized they were due. The IDEM records substantiate the taxpayer's contention that he has paid all underground storage tank fees due after he became the owner of the underground storage tanks.

FINDING

The taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

0420050202.LOF

LETTER OF FINDINGS NUMBER: 05-0202
Sales and Use Tax for 2005

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/Use Tax—Assessment on Purchase of Aircraft

Authority: IC 6-8.1-5-1(b); IC 6-2.5-3-2; IC 6-2.5-3-6(d)(2); IC 6-2.5-5; IC 6-2.5-5-8(b); IC 6-6-6.5-2; IC 6-2.5-4-10(a); IC 6-2.5-2-1; FAR 1, 91, 121, 135; Form 7695; Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); Gregory v. Helving, 293 U.S. 465 (1935); Horn v. Commissioner of the Internal Revenue, 968 F.2d 1229 (D.C, Cir. 1992); Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 55 N.E. 745 (1899); *Black's Law Dictionary*, Seventh Edition.

Taxpayer protests the assessment of sales and use tax on the purchase of an aircraft Taxpayer asserts is rented and leased.

STATEMENT OF FACTS

Taxpayer is a Delaware corporation. It purchased an aircraft in October 2004 which it leases to affiliated entity, Quality, an Indiana corporation. Taxpayer filed its application for aircraft registration and claimed a sales and use tax exemption for rental or lease to others per IC 6-2.5-5-8. The Department denied the exemption, finding there was insufficient evidence to support the claim of rental or leasing. Sales and use tax were assessed. A protest was filed and a hearing was held.

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

DISCUSSION

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

In October 2004, Taxpayer purchased an aircraft. IC 6-2.5-3-2 imposes an excise tax, commonly 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. In the case of aircraft, taxpayers are to pay the tax directly to the Department when registering the aircraft—unless the aircraft qualifies for an exemption. IC 6-2.5-3-6(d)(2).

Exemptions to the imposition of sales and use tax exist. *See, generally,* IC 6-2.5-5. IC 6-2.5-5-8(b) exempts from sales tax, property acquired for resale, rental, or leasing in the ordinary course of the person's business. The Indiana Supreme Court has stated:

It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the

Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption. Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

IC 6-6-6.5-2 requires a taxpayer to register its aircraft with the state through the Department within 31 days of the purchase date. Taxpayer filed a Form 7695 and claimed in Section D, a sale and use tax exemption for "Rental or Lease to others." IC 6-2.5-4-10(a) states that the rental or leasing of tangible personal property to another person is a retail transaction. In accord with IC 6-2.5-2-1, sales tax is to be imposed on the rental of the aircraft by Taxpayer to others. This means that sales tax is to be imposed on and collected from the related entity, Quality, when it uses Taxpayer's aircraft.

Taxpayer claims it is entitled to a sales and use tax exemption because it is engaged in the rental of the aircraft to others. This requires an analysis of the substance and form of the agreements Taxpayer has entered into with Quality. This requires a discussion of FAA regulations.

Aircraft operated in the United States are subject to strict regulation by the United States Department of Transportation, Federal Aviation Administration. Among its responsibilities and duties, the FAA regulates the registration, airworthiness certification, and continued operational safety of aircraft. Title 14, Chapter I of the Code of Federal Regulations contain the FAA's regulations (FAR). The regulations are organized by Parts and Subparts. Part 91 contains the general operating and flight rules. In general—with few exceptions not relevant to this protest before the Department—Part 91 applies to the operation of all aircraft and regulates all persons on board an aircraft. *See* FAR § 91.1. FAR § 91.315 and FAR § 91.325 do not permit a person to operate an aircraft for compensation or hire to carry others or to carry property. Operations for compensation and hire are regulated by Parts 121 and 135. Part 121 regulates operations of a commercial airliner and Part 135 regulates operations of a charter or air-taxi service. Those whose business is the transportation for compensation and hire under Part 121 and Part 135 are held to higher, stricter operating standards. Taxpayer has acknowledged these facts and has noted that the acquisition of a Part 121 or Part 135 certification is time-consuming and expensive.

Those operating solely under Part 91 authority operate in personal transportation of themselves only. Guests and other passengers are to be transported for no charge. FAR § 91.501 does name the narrow exceptions permitted to recover specific expenses for demonstrations to prospective customers, the carriage of property within the scope of business or employment, and in time-share agreements. But in general, those operating under Part 91 are required to operate in personal transportation only. Under Part 91, the FAA highly restricts the carriage of property and others for hire and compensation. It does permit the leasing of an aircraft to others, but to do so and remain within the requirements of Part 91, the operational control of the aircraft has to be transferred from the owner of the aircraft to the user of the aircraft. This type of lease is termed a dry lease. Operational control is defined in FAR § 1.1 as the exercise of authority over initiating, conducting or terminating a flight.

In a dry lease, the owner of the aircraft only charges for the physical use of the aircraft—with no charges for incidental costs. The lessee is required and responsible to provide and pay the costs for pilots, operational supplies, and maintenance under the requirements of Part 91. When a dry lease is used, the FAA does not consider the use of the aircraft to be a transportation service.

Quality has a need for an aircraft to transport its officers and employees. Because Taxpayer and Quality are related, many of the officers and employees of Taxpayer and Quality are the same persons. If Quality had purchased an aircraft or a fractional share in an aircraft, sales tax would have been due because the aircraft was acquired in a retail transaction and no exemption exists. But if the aircraft is purchased by an affiliated company and it holds the asset, those who seek to benefit their primary business enterprises can purchase the aircraft in an attempt to avoid paying sales tax by claiming to "rent" the aircraft to themselves. The 6% sales tax on $416,150 is $24,969. That is a substantial amount to seek to avoid paying. But in order to comply with FAA Part 91 requirements, Taxpayer cannot operate the aircraft on behalf of Quality. Under FAA regulations, control of the aircraft has to be placed with Quality. Taxpayer claims that the placement of the aircraft into a separate entity serves to insulate it from liability. But Taxpayer does not and may not operate the aircraft—it merely holds the asset for the benefit of the related entity, Quality.

Taxpayer does not and cannot operate the aircraft because the sole purpose for the creation of Taxpayer as a business entity is to hold the aircraft as an asset. If it operates the aircraft it becomes a transportation company and is held to the higher FAA regulations of Part 135. Part 91 requires that a lessee in a dry lease provide and pay for operation expenses, such as pilot services, maintenance, fuel, and insurance. FAR § 91.403 states that those with operational control are responsible for maintaining an aircraft in an airworthy condition.

> Taxpayer stated in its brief submitted to Department that the reason that the aircraft is held in a separate entity is for liability reasons. The use of a subsidiary company provides some asset protection. Because there is only a handful of insurance companies in the aircraft insurance business, there is no adequate source of liability insurance for Part 91 operators.
>
> …
>
> In the case of Part 91 operators, the aircraft is held in a separate corporation primarily for liability reasons. As a general rule, Part 91 operators can obtain no more than $100,000 per seat in liability coverage which is far below any actual potential damages resulting in injury or death to a passenger.

Taxpayer and the affiliated company, Quality, seek to limit liability and protect assets. But under Part 91, operational control has to be transferred to the lessee, it is the lessee—Quality—that bears liability when operating the aircraft.

Application of the Sham Transaction Doctrine

The lease agreement and the effect of the operation of the aircraft fall squarely within the doctrine of sham transaction. The sham transaction doctrine is well establish in state and federal tax jurisprudence. In Gregory v. Helving, 293 U.S. 465, 469 (1935), the United States Supreme Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and to hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose. *Id.* at 470. Transactions invalidated by the sham transaction doctrine are those motivated by nothing more than the taxpayer's desire to secure the attached tax benefit but are devoid of any economic substance. *See* Horn v. Commissioner of the Internal Revenue, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992).

If Quality was required to purchase transportation services in accordance with FAA regulations, it would need to secure a third-party to provide it with air travel services—operating under Part 121, an airline, or under Part 135, an air-taxi/charter service. What Quality would pay to the third-party would be applied to the costs of third-party to have purchased an aircraft and to operate that aircraft. But Quality does not wish to pay those costs—and it need not. What Quality wants is an aircraft of its own that it can control. And that is what Quality has acquired. The acquisition of the aircraft triggered sales and use tax. Taxpayer and Quality structured the transaction to secure the benefits of an exemption—but did not assume the associated burdens. The Indiana Supreme Court has stated that a party cannot have the benefits without the burdens. *See* Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 301-02; 55 N.E. 745, 749 (1899).

Taxpayer has secured the tax benefit of avoiding sales and use tax on the purchase of the aircraft. Additionally, because of the requirements of FAA regulations, Taxpayer cannot operate the aircraft on behalf of its related company; Taxpayer has to give the aircraft and operational control to Quality, who is required to maintain the aircraft and pay the necessary associated expenses. The rental rate is set to cover the cost of using the aircraft asset—and that is all that can be charged and still comply with FAA regulations. The hourly rental rate is $70.00. Taxpayer acknowledges a comparable fair market value comparison rate is around $250 per hour. Taxpayer states that the rental rate paid by the affiliated company, Quality, is reduced because it is responsible for maintaining the aircraft. The net effect of all this is Quality gets what it wanted all along—control and use of an aircraft; but it has avoided the upfront, one-time cost of having to pay the sales and use tax due. If Quality had purchased the aircraft outright, it still would be responsible for the associated costs of operating and maintaining the aircraft. But by structuring the transaction as Quality has, while it still pays those associated costs, the lease payments made to Taxpayer remain in the coffers of the those who have ownership interests—the members and shareholders. The lease payment is a wash. As well, the lease payments due to Taxpayer are reduced to reflect the assumption of the associated costs by the related companies. The net effect is that negligible sales tax is imposed, collected, and remitted on what is a transaction without economic substance. The business of America is business—and no business is generated here.

The relationship between Taxpayer and Quality is interfamilial. On the lease, the person who signed as president for Taxpayer is the same person who signs as president of the related company. There is no arms-length transaction to others; these are one and the same persons benefiting. IC 6-2.5-5-8(b) grants a sales tax exemption if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business. *Black's Law Dictionary*, Seventh Edition, defines business as "a commercial enterprise carried on for profit; a particular occupation or employment habitually engaged in for livelihood or gain." Taxpayer purports to operates as a business a business, yet does not have a profit motive; Taxpayer has stated that the purpose of establishing the separate entity to hold the aircraft is for liability benefits. The sales and use tax exemption for resale, rental, or leasing in the ordinary course of the person's business is not granted for those seeking to secure liability benefits; it is granted to those with a profit motive who will generate revenues from rental and lease transactions upon which sales tax is imposed. Taxpayer is not engaged in rental or leasing for the purposes of the sales and use tax statutes.

FINDING

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

DEPARTMENT OF STATE REVENUE

0420050242.LOF

LETTER OF FINDINGS NUMBER: 05-0242
Sales and Use Tax for 2005

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/Use Tax—Assessment on Purchase of Aircraft

Authority: IC 6-8.1-5-1(b); IC 6-2.5-3-2; IC 6-2.5-3-6(d)(2); IC 6-2.5-5; IC 6-2.5-5-8(b); IC 6-6-6.5-2; IC 6-2.5-4-10(a); IC 6-2.5-2-

1; FAR 1, 91, 121, 135; Form 7695; Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); Gregory v. Helving, 293 U.S. 465 (1935); Horn v. Commissioner of the Internal Revenue, 968 F.2d 1229 (D.C, Cir. 1992); Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 55 N.E. 745 (1899); *Black's Law Dictionary*, Seventh Edition.

Taxpayer protests the assessment of sales and use tax on the purchase of an aircraft Taxpayer asserts is rented and leased.

STATEMENT OF FACTS

Taxpayer is a corporation. It purchased an aircraft in May 2004 which it leases to affiliated entity, Superior, a corporation. Taxpayer filed its application for aircraft registration and claimed a sales and use tax exemption for rental or lease to others per IC 6-2.5-5-8. The Department denied the exemption, finding there was insufficient evidence to support the claim of rental or leasing. Sales and use tax were assessed. A protest was filed and a hearing was held.

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

DISCUSSION

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

In May 2004, Taxpayer purchased an aircraft. IC 6-2.5-3-2 imposes an excise tax, commonly 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. In the case of aircraft, taxpayers are to pay the tax directly to the Department when registering the aircraft—unless the aircraft qualifies for an exemption. IC 6-2.5-3-6(d)(2).

Exemptions to the imposition of sales and use tax exist. *See, generally,* IC 6-2.5-5. IC 6-2.5-5-8(b) exempts from sales tax, property acquired for resale, rental, or leasing in the ordinary course of the person's business. The Indiana Supreme Court has stated:

> It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption.
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> Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

IC 6-6-6.5-2 requires a taxpayer to register its aircraft with the state through the Department within 31 days of the purchase date. Taxpayer filed a Form 7695 and claimed in Section D, a sale and use tax exemption for "Rental or Lease to others." IC 6-2.5-4-10(a) states that the rental or leasing of tangible personal property to another person is a retail transaction. In accord with IC 6-2.5-2-1, sales tax is to be imposed on the rental of the aircraft by Taxpayer to others. This means that sales tax is to be imposed on and collected from the related entity, Superior, when it uses Taxpayer's aircraft.

Taxpayer claims it is entitled to a sales and use tax exemption because it is engaged in the rental of the aircraft to others. This requires an analysis of the substance and form of the agreements Taxpayer has entered into with Superior. This requires a discussion of FAA regulations.

Aircraft operated in the United States are subject to strict regulation by the United States Department of Transportation, Federal Aviation Administration. Among its responsibilities and duties, the FAA regulates the registration, airworthiness certification, and continued operational safety of aircraft. Title 14, Chapter I of the Code of Federal Regulations contain the FAA's regulations (FAR). The regulations are organized by Parts and Subparts. Part 91 contains the general operating and flight rules. In general—with few exceptions not relevant to this protest before the Department—Part 91 applies to the operation of all aircraft and regulates all persons on board an aircraft. *See* FAR § 91.1. FAR § 91.315 and FAR § 91.325 do not permit a person to operate an aircraft for compensation or hire to carry others or to carry property. Operations for compensation and hire are regulated by Parts 121 and 135. Part 121 regulates operations of a commercial airliner and Part 135 regulates operations of a charter or air-taxi service. Those whose business is the transportation for compensation and hire under Part 121 and Part 135 are held to higher, stricter operating standards. Taxpayer has acknowledged these facts and has noted that the acquisition of a Part 121 or Part 135 certification is time-consuming and expensive.

Those operating solely under Part 91 authority operate in personal transportation of themselves only. Guests and other passengers are to be transported for no charge. FAR § 91.501 does name the narrow exceptions permitted to recover specific expenses for demonstrations to prospective customers, the carriage of property within the scope of business or employment, and in time-share agreements. But in general, those operating under Part 91 are required to operate in personal transportation only. Under Part 91, the FAA highly restricts the carriage of property and others for hire and compensation. It does permit the leasing of an aircraft to others, but to do so and remain within the requirements of Part 91, the operational control of the aircraft has to be transferred from the owner of the aircraft to the user of the aircraft. This type of lease is termed a dry lease. Operational control is defined in FAR § 1.1 as the exercise of authority over initiating, conducting or terminating a flight.

In a dry lease, the owner of the aircraft only charges for the physical use of the aircraft—with no charges for incidental costs. The lessee is required and responsible to provide and pay the costs for pilots, operational supplies, and maintenance under the requirements of Part 91. When a dry lease is used, the FAA does not consider the use of the aircraft to be a transportation service.

Superior has a need for an aircraft to transport its officers and employees. Because Taxpayer and Superior are related, many of the officers and employees of Taxpayer and Superior are the same persons. If Superior had purchased an aircraft or a fractional share in an aircraft, sales tax would have been due because the aircraft was acquired in a retail transaction and no exemption exists. But if the aircraft is purchased by an affiliated company and it holds the asset, those who seek to benefit their primary business enterprises can purchase the aircraft in an attempt to avoid paying sales tax by claiming to "rent" the aircraft to themselves. The 6% sales tax on $3,500,000 is $210,000. That is a substantial amount to seek to avoid paying. But in order to comply with FAA Part 91 requirements, Taxpayer cannot operate the aircraft on behalf of Superior. Under FAA regulations, control of the aircraft has to be placed with Superior. Taxpayer claims that the placement of the aircraft into a separate entity serves to insulate it from liability. But Taxpayer does not and may not operate the aircraft—it merely holds the asset for the benefit of the related entity, Superior.

Taxpayer does not and cannot operate the aircraft because the sole purpose for the creation of Taxpayer as a business entity is to hold the aircraft as an asset. If it operates the aircraft it becomes a transportation company and is held to the higher FAA regulations of Part 135. Part 91 requires that a lessee in a dry lease provide and pay for operation expenses, such as pilot services, maintenance, fuel, and insurance. FAR § 91.403 states that those with operational control are responsible for maintaining an aircraft in an airworthy condition.

> Taxpayer stated in its brief submitted to Department that the reason that the aircraft is held in a separate entity is for liability reasons. The use of a subsidiary company provides some asset protection. Because there is only a handful of insurance companies in the aircraft insurance business, there is no adequate source of liability insurance for Part 91 operators.
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> In the case of Part 91 operators, the aircraft is held in a separate corporation primarily for liability reasons. As a general rule, Part 91 operators can obtain no more than $100,000 per seat in liability coverage which is far below any actual potential damages resulting in injury or death to a passenger.

Taxpayer and the affiliated company, Superior, seek to limit liability and protect assets. But under Part 91, operational control has to be transferred to the lessee, it is the lessee—Superior—that bears liability when operating the aircraft.

Application of the Sham Transaction Doctrine

The lease agreement and the effect of the operation of the aircraft fall squarely within the doctrine of sham transaction. The sham transaction doctrine is well establish in state and federal tax jurisprudence. In Gregory v. Helving, 293 U.S. 465, 469 (1935), the United States Supreme Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and to hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose. *Id.* at 470. Transactions invalidated by the sham transaction doctrine are those motivated by nothing more than the taxpayer's desire to secure the attached tax benefit but are devoid of any economic substance. *See* Horn v. Commissioner of the Internal Revenue, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992).

If Superior was required to purchase transportation services in accordance with FAA regulations, it would need to secure a third-party to provide it with air travel services—operating under Part 121, an airline, or under Part 135, an air-taxi/charter service. What Superior would pay to the third-party would be applied to the costs of third-party to have purchased an aircraft and to operate that aircraft. But Superior does not wish to pay those costs—and it need not. What Superior wants is an aircraft of its own that it can control. And that is what Superior has acquired. The acquisition of the aircraft triggered sales and use tax. Taxpayer and Superior structured the transaction to secure the benefits of an exemption—but did not assume the associated burdens. The Indiana Supreme Court has stated that a party cannot have the benefits without the burdens. *See* Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 301-02; 55 N.E. 745, 749 (1899).

Taxpayer has secured the tax benefit of avoiding sales and use tax on the purchase of the aircraft. Additionally, because of the requirements of FAA regulations, Taxpayer cannot operate the aircraft on behalf of its related company; Taxpayer has to give the aircraft and operational control to Superior, who is required to maintain the aircraft and pay the necessary associated expenses. The rental rate is set to cover the cost of using the aircraft asset—and that is all that can be charged and still comply with FAA regulations. The hourly rental rate is $900. Taxpayer acknowledges a comparable fair market value comparison rate is around $3,000 per hour. Taxpayer states that the rental rate paid by the affiliated company, Superior, is reduced because it is responsible for maintaining the aircraft. The net effect of all this is Superior gets what it wanted all along—control and use of an aircraft; but it has avoided the upfront, one-time cost of having to pay the sales and use tax due. If Superior had purchased the aircraft outright, it still would be responsible for the associated costs of operating and maintaining the aircraft. But by structuring the transaction as Superior has, while it still pays those associated costs, the lease payments made to Taxpayer remain in the coffers of the those who have ownership interests—the members and shareholders. The lease payment is a wash. As well, the lease payments due to Taxpayer are reduced to reflect the assumption of the associated costs by the related companies. The net effect is that negligible sales tax is imposed, collected, and remitted on what is a transaction without economic substance. The business of America is business—and no business is generated here.

The relationship between Taxpayer and Superior is interfamilial. On the lease, the person who signed for Taxpayer is related to the person who signed for the related company. There is no arms-length transaction to others; Superior is the one benefiting. IC 6-2.5-5-8(b) grants a sales tax exemption if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business. *Black's Law Dictionary*, Seventh Edition, defines business as "a commercial enterprise carried on for profit; a particular occupation or employment habitually engaged in for livelihood or gain." Taxpayer purports to operate as a business, yet does not have a profit motive; Taxpayer has stated that the purpose of establishing the separate entity to hold the aircraft is for liability benefits. The sales and use tax exemption for resale, rental, or leasing in the ordinary course of the person's business is not granted for those seeking to secure liability benefits; it is granted to those with a profit motive who will generate revenues from rental and lease transactions upon which sales tax is imposed. Taxpayer is not engaged in rental or leasing for the purposes of the sales and use tax statutes.

FINDING

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

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 05-0261
Sales and Use Tax for 2005

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/Use Tax—Assessment on Purchase of Aircraft

Authority: IC 6-8.1-5-1(b); IC 6-2.5-3-2; IC 6-2.5-3-6(d)(2); IC 6-2.5-5; IC 6-2.5-5-8(b); IC 6-6-6.5-2; IC 6-2.5-4-10(a); IC 6-2.5-2-1; FAR 1, 91, 121, 135; Form 7695; Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); Gregory v. Helving, 293 U.S. 465 (1935); Horn v. Commissioner of the Internal Revenue, 968 F.2d 1229 (D.C, Cir. 1992); Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 55 N.E. 745 (1899); *Black's Law Dictionary*, Seventh Edition.

Taxpayer protests the assessment of sales and use tax on the purchase of an aircraft Taxpayer asserts is rented and leased.

STATEMENT OF FACTS

Taxpayer is a Delaware corporation. It purchased an aircraft in April 2004 which it leases to affiliated entity, Flyers, an Indiana corporation. Taxpayer filed its application for aircraft registration and claimed a sales and use tax exemption for rental or lease to others per IC 6-2.5-5-8. The Department denied the exemption, finding there was insufficient evidence to support the claim of rental or leasing. Sales and use tax were assessed. A protest was filed and a hearing was held.

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

DISCUSSION

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

In April 2004, Taxpayer purchased an aircraft. IC 6-2.5-3-2 imposes an excise tax, commonly 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. In the case of aircraft, taxpayers are to pay the tax directly to the Department when registering the aircraft—unless the aircraft qualifies for an exemption. IC 6-2.5-3-6(d)(2).

Exemptions to the imposition of sales and use tax exist. *See*, generally, IC 6-2.5-5. IC 6-2.5-5-8(b) exempts from sales tax, property acquired for resale, rental, or leasing in the ordinary course of the person's business. The Indiana Supreme Court has stated:

> It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption.
> Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

IC 6-6-6.5-2 requires a taxpayer to register its aircraft with the state through the Department within 31 days of the purchase date. Taxpayer filed a Form 7695 and claimed in Section D, a sale and use tax exemption for "Rental or Lease to others." IC 6-2.5-4-10(a) states that the rental or leasing of tangible personal property to another person is a retail transaction. In accord with IC 6-2.5-2-1, sales tax is to be imposed on the rental of the aircraft by Taxpayer to others. This means that sales tax is to be imposed on and collected from the related entity, Flyers, when it uses Taxpayer's aircraft.

Taxpayer claims it is entitled to a sales and use tax exemption because it is engaged in the rental of the aircraft to others. This requires an analysis of the substance and form of the agreements Taxpayer has entered into with Flyers. This requires a discussion of FAA regulations.

Aircraft operated in the United States are subject to strict regulation by the United States Department of Transportation, Federal Aviation Administration. Among its responsibilities and duties, the FAA regulates the registration, airworthiness certification, and continued operational safety of aircraft. Title 14, Chapter I of the Code of Federal Regulations contain the FAA's regulations (FAR). The regulations are organized by Parts and Subparts. Part 91 contains the general operating and flight rules. In general—with few exceptions not relevant to this protest before the Department—Part 91 applies to the operation of all aircraft and regulates all persons on board an aircraft. *See* FAR § 91.1. FAR § 91.315 and FAR § 91.325 do not permit a person to operate an aircraft for compensation or hire to carry others or to carry property. Operations for compensation and hire are regulated by Parts 121 and 135. Part 121 regulates operations of a commercial airliner and Part 135 regulates operations of a charter or air-taxi service. Those whose business is the transportation for compensation and hire under Part 121 and Part 135 are held to higher, stricter operating standards. Taxpayer has acknowledged these facts and has noted that the acquisition of a Part 121 or Part 135 certification is time-consuming and expensive.

Those operating solely under Part 91 authority operate in personal transportation of themselves only. Guests and other passengers are to be transported for no charge. FAR § 91.501 does name the narrow exceptions permitted to recover specific expenses for demonstrations to prospective customers, the carriage of property within the scope of business or employment, and in time-share agreements. But in general, those operating under Part 91 are required to operate in personal transportation only. Under Part 91, the FAA highly restricts the carriage of property and others for hire and compensation. It does permit the leasing of an aircraft to others, but to do so and remain within the requirements of Part 91, the operational control of the aircraft has to be transferred from the owner of the aircraft to the user of the aircraft. This type of lease is termed a dry lease. Operational control is defined in FAR § 1.1 as the exercise of authority over initiating, conducting or terminating a flight.

In a dry lease, the owner of the aircraft only charges for the physical use of the aircraft—with no charges for incidental costs. The lessee is required and responsible to provide and pay the costs for pilots, operational supplies, and maintenance under the requirements of Part 91. When a dry lease is used, the FAA does not consider the use of the aircraft to be a transportation service.

Flyers has a need for an aircraft to transport its officers and employees. Because Taxpayer and Flyers are related, many of the officers and employees of Taxpayer and Flyers are the same persons. If Flyers had purchased an aircraft or a fractional share in an aircraft, sales tax would have been due because the aircraft was acquired in a retail transaction and no exemption exists. But if the aircraft is purchased by an affiliated company and it holds the asset, those who seek to benefit their primary business enterprises can purchase the aircraft in an attempt to avoid paying sales tax by claiming to "rent" the aircraft to themselves. The 6% sales tax on $205,000 is $12,300. That is a substantial amount to seek to avoid paying. But in order to comply with FAA Part 91 requirements, Taxpayer cannot operate the aircraft on behalf of Flyers. Under FAA regulations, control of the aircraft has to be placed with Flyers. Taxpayer claims that the placement of the aircraft into a separate entity serves to insulate it from liability. But Taxpayer does not and may not operate the aircraft—it merely holds the asset for the benefit of the related entity, Flyers.

Taxpayer does not and cannot operate the aircraft because the sole purpose for the creation of Taxpayer as a business entity is to hold the aircraft as an asset. If it operates the aircraft it becomes a transportation company and is held to the higher FAA regulations of Part 135. Part 91 requires that a lessee in a dry lease provide and pay for operation expenses, such as pilot services, maintenance, fuel, and insurance. FAR § 91.403 states that those with operational control are responsible for maintaining an aircraft in an airworthy condition.

> Taxpayer stated in its brief submitted to Department that the reason that the aircraft is held in a separate entity is for liability reasons. The use of a subsidiary company provides some asset protection. Because there is only a handful of insurance companies in the aircraft insurance business, there is no adequate source of liability insurance for Part 91 operators.
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> In the case of Part 91 operators, the aircraft is held in a separate corporation primarily for liability reasons. As a general rule, Part 91 operators can obtain no more than $100,000 per seat in liability coverage which is far below any actual potential damages resulting in injury or death to a passenger.

Taxpayer and the affiliated company, Flyers, seek to limit liability and protect assets. But under Part 91, operational control has to be transferred to the lessee, it is the lessee—Flyers—that bears liability when operating the aircraft.

Application of the Sham Transaction Doctrine

The lease agreement and the effect of the operation of the aircraft fall squarely within the doctrine of sham transaction. The sham transaction doctrine is well establish in state and federal tax jurisprudence. In Gregory v. Helving, 293 U.S. 465, 469 (1935), the United States Supreme Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and to hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose. *Id.* at 470. Transactions invalidated by the sham transaction doctrine are those motivated by nothing more than the taxpayer's desire to secure the attached tax benefit but are devoid of any economic substance. *See* Horn v. Commissioner of the Internal Revenue, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992).

If Flyers was required to purchase transportation services in accordance with FAA regulations, it would need to secure a third-party to provide it with air travel services—operating under Part 121, an airline, or under Part 135, an air-taxi/charter service. What Flyers would pay to the third-party would be applied to the costs of third-party to have purchased an aircraft and to operate that aircraft. But Flyers does not wish to pay those costs—and it need not. What Flyers wants is an aircraft of its own that it can control. And that is what Flyers has acquired. The acquisition of the aircraft triggered sales and use tax. Taxpayer and Flyers structured the transaction to secure the benefits of an exemption—but did not assume the associated burdens. The Indiana Supreme Court has stated that a party cannot have the benefits without the burdens. *See* Cambria Iron Co., v. Union Trust Co., 154 Ind. 291, 301-02; 55 N.E. 745, 749 (1899).

Taxpayer has secured the tax benefit of avoiding sales and use tax on the purchase of the aircraft. Additionally, because of the requirements of FAA regulations, Taxpayer cannot operate the aircraft on behalf of its related company; Taxpayer has to give the aircraft and operational control to Flyers, who is required to maintain the aircraft and pay the necessary associated expenses. The rental rate is set to cover the cost of using the aircraft asset—and that is all that can be charged and still comply with FAA regulations. The hourly rental rate is $150. Taxpayer acknowledges a comparable fair market value comparison rate is over $400 per hour. Taxpayer states that the rental rate paid by the affiliated company, Flyers, is reduced because it is responsible for maintaining the aircraft. The net effect of all this is Flyers gets what it wanted all along—control and use of an aircraft; but it has avoided the upfront, one-time cost of having to pay the sales and use tax due. If Flyers had purchased the aircraft outright, it still would be responsible for the associated costs of operating and maintaining the aircraft. But by structuring the transaction as Flyers has, while it still pays those associated costs, the lease payments made to Taxpayer remain in the coffers of the those who have ownership interests—the members and shareholders. The lease payment is a wash. As well, the lease payments due to Taxpayer are reduced to reflect the assumption of the associated costs by the related companies. The net effect is that negligible sales tax is imposed, collected, and remitted on what is a transaction without economic substance. The business of America is business—and no business is generated here.

The relationship between Taxpayer and Flyers is interfamilial. On the lease, the person who signed as president for Taxpayer is the same person who signs as president of the related company. There is no arms-length transaction to others; these are one and the same persons benefiting. IC 6-2.5-5-8(b) grants a sales tax exemption if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business. *Black's Law Dictionary*, Seventh Edition, defines business as "a commercial enterprise carried on for profit; a particular occupation or employment habitually engaged in for livelihood or gain." Taxpayer purports to operate as a business, yet does not have a profit motive; Taxpayer has stated that the purpose of establishing the separate entity to hold the aircraft is for liability benefits. The sales and use tax exemption for resale, rental, or leasing in the ordinary course of the person's business is not granted for those seeking to secure liability benefits; it is granted to those with a profit motive who will generate revenues from rental and lease transactions upon which sales tax is imposed. Taxpayer is not engaged in rental or leasing for the purposes of the sales and use tax statutes.

FINDING

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

DEPARTMENT OF STATE REVENUE
Revenue Ruling #2005-02URT
October 17, 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.

ISSUES

Utility Receipts Tax – Nexus

Authority: IC 6-2.3-2-1, IC 6-2.3-4-2, IC 6-2.3-1-4

The taxpayer requests the Department to rule whether or not the taxpayer has sufficient nexus with Indiana under any of the following scenarios to be subject to Utility Receipts Tax.

STATEMENT OF FACTS

The taxpayer is a non-resident engaged in the business of marketing natural gas to large industrial consumers and other wholesalers of natural gas located in Indiana. On a national level, about ten percent (10%) of the taxpayer's business is large industrial end-user consumers and the remaining sales are wholesale sales. In Indiana, however, nearly 100% of the taxpayer's sales are to large industrial consumers.

DISCUSSION – ISSUE #1
FLASH TITLE

The taxpayer uses the North American Energy Standards Board (the "NAESB") standard buy/sell agreement (the "Contract") as the basis of all of its natural gas sales. Sales under the Contract are typically specified in a confirmation that is determined on a periodic basis and contains specific details such as the amount of gas to be purchased, the price, the delivery details, etc. All the activity in connection with the Contract and confirmations such as the negotiations, acceptance of orders, right of approval or rejection, etc. are executed from the taxpayer's office outside the state of Indiana. The taxpayer does not maintain an office or other place of business in Indiana and does not have employees or agents in Indiana. The taxpayer does not maintain any natural gas inventory in Indiana. The taxpayer communicates with its Indiana customers via telephone or e-mail.

Sales of natural gas to customers in Indiana are back-to-back purchases and sales. A "back-to-back sale" occurs when a gas marketer, such as the taxpayer, purchases gas in the open market from a third party gas marketer or utility that is on the interstate pipeline at a point within Indiana and then sells the purchased gas at the exact same point to an Indiana consumer. Consequently, the taxpayer has title to the natural gas for a moment in time (flash title) in Indiana, the same moment in time the title is transferred to the ultimate consumer by operation of law. The taxpayer does not transport the gas, as it does not own or have a right to transport on the interstate pipeline associated with these Indiana sales. The consumer, having title, contracts with a local gas distribution company to transport the gas to their facility for consumption.

IC 6-2.3-2-1 states:

Sec. 1. An income tax, known as the utility receipts tax, is imposed upon the receipt of:

1. the entire taxable gross receipts of a taxpayer that is a resident or domiciliary of Indiana, and
2. the taxable gross receipts derived from activities or businesses or any other sources within Indiana by a taxpayer that is not a resident or domiciliary of Indiana.

IC 6-2.3-4-2 states:

Sec. 2. Gross receipts derived from business conducted in commerce between Indiana and either another state or territory or foreign country are exempt from utility receipts tax to the extent the state is prohibited from taxiing the gross receipts by the Constitution of the United States.

It is clear then, Utility Receipts Tax is imposed on the taxable gross receipts from sources within Indiana by a taxpayer that is not a resident or domiciliary of Indiana to the extent Indiana is not prohibited from taxing the gross receipts by the United States Constitution.

In this issue, all of the taxpayer's activities giving rise to its income from Indiana occur outside Indiana with the exception of flash title. The Department equates flash title with ownership of natural gas inventory in Indiana. The inventory is sold to Indiana customers. The inventory in Indiana creates substantial nexus for the taxpayer with Indiana under Commerce Clause jurisprudence, therefore, the taxpayer's Indiana receipts are subject to Utility Receipts Tax.

RULING – ISSUE #1

The Department rules flash title of inventory in Indiana creates substantial nexus with Indiana, therefore, the Taxpayer's receipts from Indiana are subject to Utility Receipts Tax.

DISCUSSION – ISSUE #1A
FLASH TITLE AND 2 INCIDENTAL VISITS

The facts are the same as Issue #1 (flash title) with one addition: as a matter of happenstance, a taxpayer employee may make up to two (2) day trips to Indiana in a four (4) year period. Such trips would not be regular or systematic visits, but would be isolated and infrequent, although both may occur in one calendar year when no visits had occurred in the preceding three years. The visits do exceed "mere solicitation" and any "ancillary activities".

Having determined that Issue #1 (flash title) creates substantial nexus for the taxpayer with Indiana, a determination is not required on this issue.

RULING-ISSUE #1A

A ruling is not applicable.

DISCUSSION – ISSUE #1B
FLASH TITLE AND 12 ANNUAL VISITS

The facts are the same as those in Issue #1 (flash title) with one addition: a taxpayer employee would visit Indiana regularly to meet with two (2) or three (3) customers per visit.

Having determined that Issue # 1 (flash title) creates substantial nexus for the taxpayer with Indiana, a determination is not required on this issue.

RULING-ISSUE #1B

A ruling is not applicable.

DISCUSSION – ISSUE #2
LOGISTICS SERVICES

The same facts as Issue #1 except that the taxpayer would have no activities in Indiana because instead of selling gas to Indiana customers that would necessitate the taxpayer having flash title in Indiana, the taxpayer would do nothing other than perform service outside Indiana for the Indiana customers. The taxpayer would be its Indiana customer's agent in managing a customer's transportation account with a third-party utility. Under this set of facts, the taxpayer does **not** sell natural gas to Indiana end users, but would solely schedule transportation of the natural gas between buyer and seller from a location outside Indiana. The seller would send an invoice to "the taxpayer as agent on behalf of customer" for the natural gas and the transportation services. The taxpayer, acting in its agency capacity, would pay the entire amount of the invoice. The taxpayer would then invoice its customer for the charges the taxpayer incurred on the customer's behalf as customer's agent such as costs related to the cost of the natural gas, the transportation service, and any logistical services the taxpayer provided.

All contracts for the purchase and transportation of the natural gas would be between the Indiana customer and the seller. The taxpayer would schedule the transportation; however, it would **not** take title to or make any purchase of the natural gas. As in Issue

#1, the taxpayer would not transport, own, or have a right to transport the natural gas on the interstate pipelines. The taxpayer would receive a fee for services of managing the Indiana customers' transportation, not for selling natural gas to Indiana customers. All the taxpayer activities related to the scheduling of the transportation would be performed at the taxpayer's headquarters outside of Indiana. The taxpayer will have no property in Indiana, and its employees would not enter Indiana to perform any duties.

Finally, in the event that the Indiana customer has excess volumes of natural gas, the taxpayer could also act on the Indiana customer's behalf by providing re-marketing services outside Indiana for an additional fee.

All of the taxpayer's activities giving rise to its income from Indiana occur outside of Indiana. Further, the taxpayer is not receiving consideration for the retail sale of utility services for consumption. IC 6-2.3-1-4. The taxpayer's receipts are from logistics services, therefore, are not subject to Utility Receipts Tax.

RULING –ISSUE #2

The Department rules the taxpayer's Indiana receipts from logistics services are not subject to Utility Receipts Tax.

DISCUSSION-ISSUE #3

TWO LINES OF BUSINESS, NO TRANSPORTATION

The facts in Issue #1 (flash title), #1A (2 incidental visits), and then #1B (12 annual visits) are combined each in turn with facts in Issue #2 (logistics services) to give the taxpayer receipts from two distinct lines of business. Moreover, in this fact scenario, the taxpayer does **not** either transport or obtain the right to transport natural gas on the interstate pipelines.

The Department has ruled in Issue #2 the taxpayer's receipts from logistics services are not subject to Utility Receipts Tax because all of the taxpayer's activities giving rise to its income from Indiana occurs outside Indiana and the taxpayer's receipts are not from the retail sale of utility services for consumption.

In the instant case, the taxable rulings of Issues #1, #1A and #1B do not cause the nontaxable ruling of Issue #2 to change.

RULING – ISSUE #3

The Department rules the taxpayer's Indiana receipts from logistics services are not taxable when coupled with Issues #1, #1A and #1B which are taxable.

DISCUSSION – ISSUE #4

DELIVERY BY TAXPAYER

The facts are identical to those under Issue #1 (flash title) with the following exceptions:

1. the natural gas is transported by the taxpayer, not a third party utility, to the Indiana customer via common carrier (the interstate pipeline). The taxpayer takes title to the natural gas and also bears the risk of loss during transportation; and
2. the natural gas is purchased outside Indiana by the taxpayer, which eliminates flash title resulting in no natural gas inventory in Indiana.

Here, the taxpayer purchases natural gas outside Indiana and transports the natural gas to its Indiana buyer via common carrier (interstate pipeline). Further, all the taxpayer's activities generating receipts from Indiana customers are performed outside Indiana. Commerce Clause jurisprudence dictates that these receipts are not subject to Utility Receipts Tax.

RULING – ISSUE #4

The Department rules the taxpayer's receipts from the sale of natural gas to Indiana customers, that was purchased outside Indiana and transported by the taxpayer via common carrier to Indiana customers, are not subject to Utility Receipts Tax.

DISCUSSION – ISSUE #5

TWO LINES OF BUSINESS, TRANSPORTATION

The facts in Issue #1(flash title), #1A (2 incidental visits), and then #1B (12 annual visits) are combined each in turn with facts in Issue #4 (delivery by taxpayer) to give the taxpayer receipts from two distinct lines of business. Moreover, in this fact scenario, the taxpayer **does** either transport or obtain the right to transport natural gas on the interstate pipelines.

Having determined that Issues #1, #1A and #1B create substantial nexus for the taxpayer with Indiana, any combination of these issues with Issue #4 will create substantial nexus for the taxpayer with Indiana. A determination, therefore, is not required on this issue.

RULING – ISSUE #5

A ruling is not applicable.

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.