

Letter of Findings: 06-0300
Income Tax
For the Years 2002, 2003, 2004

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ISSUES

I. Gross Income Tax – Imposition.

Authority: IC § 6-2.1-1-2; IC § 6-2.1-2-2; IC § 6-8.1-5-1; IC § 6-8.1-5-4; *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests that certain sales are erroneously assessed for 2002 GIT.

II. Adjusted Gross Income Tax – Imposition.

Authority: IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; IC § 6-8.1-5-4; [45 IAC 3.1-1-1-38](#); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 15 U.S.C. §381; *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.*, 50 U.S. 214 (1992).

Taxpayer argues that because it is an out-of-state vendor and because its Indiana activities do not exceed the "mere solicitation" standard, it is not subject to Indiana AGIT for the years 2002, 2003, and 2004.

III. Adjusted Gross Income Tax – Sales Factor Calculation.

Authority: IC § 6-3-2-2.

Taxpayer protests that the numerator of the sales factor fractions in 2002 and 2003 are double counting some of its Indiana sales.

IV. Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the proposed assessment of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, a sales and distribution company, is a Delaware corporation domiciled out of state at its parent's headquarters. The parent company files a consolidated federal income tax return consisting of the parent and over thirty subsidiary corporations. A related entity located in Indiana sells its product in Indiana through Taxpayer. Limited information was provided to the audit regarding Taxpayer's operations, even upon numerous requests during the Department's audit.

The Indiana Department of Revenue (Department) conducted an income tax audit of Taxpayer for the years 2002, 2003, and 2004. Department's audit assessed additional gross and adjusted gross income tax. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Gross Income Tax – Imposition.

DISCUSSION

The Department's audit assessed additional gross income tax on Taxpayer for 2002. The audit used Taxpayer's own schedules and reports to arrive at its assessment.

Notices of proposed assessments are prima facie evidence that the Department's claim for unpaid taxes is valid. The Taxpayer has the burden of proving that the Department incorrectly imposed the assessment. IC § 6-8.1-5-1(b). *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Taxpayers are required to keep adequate books and records so that the Department can determine the proper tax owed to the state. IC § 6-8.1-5-4. [IC 6-8.1-5-1](#)(a) states that, "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available."

Prior to 2003, Indiana imposed a tax, known as the GIT, on the taxable gross income of a taxpayer who is a resident or domiciliary of Indiana and on the taxable gross income from Indiana sources by a taxpayer who is not a resident or domiciliary of Indiana. IC § 6-2.1-2-2. "Gross income" is defined to include "all the gross receipts a taxpayer receives... from the sale, transfer, or exchange of property, real or personal, tangible or intangible." IC § 6-2.1-1-2(a)(3).

Taxpayer agrees that adjustments need to be made to its gross income tax for 2002, but protests that certain sales that were counted as Indiana to Indiana sales were misrepresented as such on Taxpayer's own sales reports. At the hearing Taxpayer explained that Taxpayer's sales reports at the time included an entry for sales to "unassigned location." According to Taxpayer, during that period, its own Tax Department interpreted this descriptor to be the same as the destination location, which, in this instance, was Indiana. At the hearing Taxpayer stated it is unable to disprove that Indiana was the destination for those sales, but Taxpayer argues that if the "unassigned location" sales are subtracted from the total Indiana sales figure, that number would then be more in line with sales from other years. Taxpayer argues that if the "unassigned location" numbers are left in,

total Indiana sales are around three times those of proximate years. Taxpayer, however, provided no evidence to support this contention.

Taxpayer has not provided documentation to support its protest.

FINDING

Taxpayer's protest is respectfully denied.

II. Adjusted Gross Income Tax – Imposition.

DISCUSSION

Taxpayer argues that because it is an out-of-state vendor and because its Indiana activities do not exceed the "mere solicitation" standard, it is not subject to Indiana corporate adjusted gross income tax for the years 2002, 2003, and 2004. Taxpayer filed amended returns for these years to reflect this position.

Again, notices of proposed assessments are prima facie evidence that the Department's claim for unpaid taxes is valid. The Taxpayer has the burden of proving that the Department incorrectly imposed the assessment. IC § 6-8.1-5-1(b). *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Taxpayers are required to keep adequate books and records so that the Department can determine the proper tax owed to the state. IC § 6-8.1-5-4. IC 6-8.1-5-1(a) states that "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available."

The Department imposed tax on Taxpayer's adjusted gross income attributable to "sources within Indiana." IC § 6-3-2-1(b).

Taxpayer argues that its inventory in Indiana is "de minimus [*sic*]," that its payroll amounts to three sales employees who work out of their homes. Taxpayer argues, in its January 30, 2006 letter to the auditor and at the hearing, that the activities of its salespeople are limited to solicitation of orders for which approval or rejection is determined out of state. Additionally, Taxpayer argues that its sales people are not authorized to approve credit. Sales orders are solicited in Indiana by the sales people, forwarded out of state for approval, and if approved, the orders are filled and delivered into Indiana by common carrier or company-owned trucks.

At the hearing Taxpayer agreed that it had some inventory in Indiana, but could not describe where and how it is kept. The Department requested documentary substantiation of Taxpayer's claims. For example, the Department suggested that sales staff job descriptions, documentation that show the day-to-day activities of sales employees, etc... might be relevant.

Furthermore, a Department audit investigation determined that a related entity located in Indiana sells its product in Indiana through Taxpayer; i.e., Taxpayer takes possession of the product in Indiana.

IC 6-3-2-1 imposes a tax on the adjusted gross income derived from "sources within Indiana." IC 6-3-2-2(a) provides that adjusted gross income derived from sources within Indiana includes "income from doing business in this state." IC 6-3-2-2(a).

45 IAC 3.1-1-38, in interpreting IC 6-3-2-2(a), provides that for apportionment purposes a taxpayer is "doing business" in Indiana if it operates a business enterprise or activity in Indiana 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 argues that 15 U.S.C.S. § 381 (Public Law 86-272) controls those occasions in which Indiana may properly impose a tax on the net income, derived from sources within that state, on foreign (out-of-state) taxpayers. 15 U.S.C.S. § 381 establishes the minimum standard for the imposition of a state income tax based on the solicitation of interstate sales. *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.*, 50 U.S. 214, 233 (1992). 15 U.S.C.S. § 381 prohibits a state from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within that state unless those business activities exceed the mere solicitation of sales. 15 U.S.C.S. § 381(a), (c).

Taxpayer is mistaken that its activities within Indiana consist only of solicitation of sales. At the hearing, Taxpayer acknowledged that it had inventory in Indiana. The Department requested additional documentation to clarify how much inventory was held in Indiana and how the inventory related to Taxpayer's sales in Indiana. Taxpayer did not provide this information despite the fact that it was awarded ample time to do so. Therefore, the Department's proposed assessment stands, since having inventory in Indiana relating to Taxpayer's sales in Indiana constitutes nexus and exceeds the protection of P.L. 86-272.

FINDING

Taxpayer's protest is respectfully denied.

III. Adjusted Gross Income Tax – Sales Factor Calculation.

DISCUSSION

Taxpayer protests that sales numerator of the sales factor fraction of the adjusted gross income tax apportionment calculation for the 2002 and 2003 years is incorrect.

Where a corporation – such as Taxpayer – receives income from both Indiana and out-of-state sources, the amount of tax is determined by a three-factor apportionment formula set out in IC § 6-3-2-2(b). That formula operates by multiplying taxpayer's total business income by a fraction composed of a property factor, a payroll factor, and a sales factor. IC § 6-3-2-2(b). The "sales factor" consists of a fraction, "the numerator of which is the total sales of the taxpayer in [Indiana] during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year." IC § 6-3-2-2(e).

Taxpayer points out that the audit report includes in its calculations numbers for both "Indiana Destination" and "Indiana to Indiana" sales. Taxpayer argues that the "Indiana to Indiana" sales numbers are already included in the "Indiana Destination" sales totals, thus resulting in a double-counting of "Indiana to Indiana" sales. Taxpayer refers the Department to Exhibits IV, VI, and VIII attached to its August 11, 2006, letter to the Department. Taxpayer has provided sufficient evidence to substantiate its claim.

FINDING

Taxpayer's protest is sustained.

IV. Tax Administration – Negligence Penalty.

DISCUSSION

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

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

Additionally [45 IAC 15-11-2](#)(c) states:

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. In this case, Taxpayer has not established that its failure to remit Indiana tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayers' protest is sustained.

CONCLUSION

The assessment of gross income tax does not change.

Taxpayer is assessed adjusted gross income tax on its Indiana source income. However, the "Indiana to Indiana" sales should be subtracted from the sales numerators for the years 2002 and 2003, since they are already included in "Indiana Destination" sales.

The penalty is not waived.

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