

Supplemental Letter of Findings: 07-044
Utility Receipts Tax
For the Years 2003, 2004, 2005, and 2006

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ISSUES

I. Municipal Water Utility – Utility Receipts Tax.

Authority: IC § 6-2.3-1-4; IC § 6-2.3-1-12; IC § 6-2.3-1-12(18); IC § 6-2.3-1-14; IC § 6-2.3-2-1; [IC 6-2.3-4-3](#); IC § 6-2.3-4-3(3); IC § 6-8.1-5-1(b); IC § 36-1-2-13; *General Motors Corp. v. Indiana Dep't of State Revenue*, 578 N.E.2d 399 (Ind. Tax. Ct. 1991); Commissioner's Directive 18 (December 2007).

Taxpayer argues that it is a nonprofit corporation formed to provide water to municipal residents and that it is not subject to the Utility Receipts Tax.

II. Negligence Penalty.

Authority: IC § 6-8.1-5-1(b); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(4); IC § 6-8.1-10-2.1(d); [45 IAC 15-11-2\(b\)](#); [45 IAC 15-11-2\(c\)](#).

Taxpayer believes it is entitled to abatement of the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a small Indiana municipality which provides water service to local residents. The Indiana Department of Revenue (Department) conducted an audit review of taxpayer's records. As a result of that review, the Department concluded that taxpayer had failed to file Utility Receipts Tax (URT) returns during the years under review. Consequently, the Department issued notices of proposed URT assessments for 2003, 2004, 2005, and 2006. Taxpayer disagreed and submitted a protest to that effect. An administrative hearing was conducted and the Department issued a Letter of Findings denying taxpayer's protest.

Believing that the Letter of Findings erred in its conclusion, taxpayer requested a rehearing on the matter. That request was granted. Thereafter, a second administrative hearing was conducted, taxpayer reiterated the basis for its protest, and this Supplemental Letter of Findings results.

I. Municipal Water Utility – Utility Receipts Tax.

DISCUSSION

Indiana Department of Revenue assessments are prima facie evidence that the tax assessment is correct. IC § 6-8.1-5-1(b). The taxpayer bears the burden of proving that the assessment is incorrect. *Id.*

The Indiana Utility Receipts Tax is imposed at IC § 6-2.3-2-1 as follows: "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 a domiciliary of Indiana...."

"Gross receipts" for purposes of the Indiana utility receipts tax is defined at IC § 6-2.3-1-4 as follows:

"Gross receipts" refers to anything of value, including cash or other tangible or intangible property that a taxpayer receives in consideration for the retail sale of utility services for consumption before deducting any costs incurred in providing the utility services.

In summary, the utility receipts tax is an income tax imposed on the receipts from retail sales of utility services for consumption by the purchaser. The utility services subject to tax includes the furnishing of water. IC § 6-2.3-1-14.

Nonetheless, taxpayer cites the exemption provision set out in IC § 6-2.3-4-3 which exempts...

Gross receipts received by:

- (1) a conservancy district established under [IC 14-33-20](#) or [IC 13-3-4](#) (before its repeal);
- (2) a regional water, sewage, or solid waste district established under [IC 13-26](#) or [IC 13-3-2](#) (before its repeal);
- (3) a *nonprofit corporation* formed solely for the purpose of supplying water to the public;
- (4) a county solid waste management district or a joint solid waste management district established under [IC 13-21](#) or [IC 13-9.5-2](#) (before its repeal);
- (5) a nonprofit corporation formed for the purpose of providing a combination of:
 - (A) water; and
 - (B) sewer and sewage service;
 to the public;
- (6) a county onsite waste management district established under [IC 36-11](#); or
- (7) a political subdivision for sewer and sewage service; are exempt from the utility receipts tax. (*Emphasis added*).

The original Letter of Findings concluded that the "Department is unable to agree... that taxpayer met its

burden of demonstrating that it is not subject to the Utility Receipts Tax because there is no evidence that taxpayer is a 'nonprofit corporation' as defined in IC § 6-2.3-4-3(3)."

Taxpayer argues that it is a political subdivision and that it falls within the general category of "corporation." Further, taxpayer states it was "considered exempt before the 2006 audit" and that Gross Income Tax Payments sent to the Department during 2003 were returned. Taxpayer interprets the Department's decision to return the Gross Income Tax Payments as the Department's determination that the water utility was exempt from state tax.

Again, the Department must disagree with taxpayer's contention. The municipality may be a "corporation," the water utility business may not return a "profit," the Gross Income Tax payments taxpayer remitted in 2003 may have been returned by the Department, but those particular elements do not resolve the issue. The issue is whether or not taxpayer – or rather its water service – constitutes a "nonprofit corporation formed solely for the purpose of supplying water to the public." The water utility is not registered as a corporation with the Indiana Secretary of State, there is nothing to indicate that the water utility was ever formed as distinct legal entity, and there is nothing to indicate that the water utility was ever granted any form of "nonprofit status."

IC § 6-2.3-1-12 – which defines "taxpayers" for purposes of the Utility Receipts Tax – includes a "political subdivision (as defined in [IC 36-1-2-13](#)) or the state of Indiana, to the extent engaged in private or proprietary activities or business...." IC § 6-2.3-1-12(18). IC § 36-1-2-13 defines a "political subdivision" as including any "municipal corporation or special taxing district." Plainly, the statute anticipates that municipal corporations or political divisions which decide to get into the utility business will be subject to the URT.

The Department has issued Commissioner's Directive 18 (December 2007) which addresses the issue squarely. Under the category of "exempt entities," the Directive includes as exempt, "A nonprofit corporation formed solely for the purpose of supplying water to the public. This does not include a municipal water company operated by a municipality or political subdivision." Taxpayer points out that the Directive was published too late in the day to clarify the current assessments stemming back from 2003, 2004, 2005, and 2006. However the statute standing alone, IC § 6-2.3-4-3(3), speaks clearly on the issue. An Indiana entity is exempt from paying URT if it is "a nonprofit corporation formed solely for the purpose of supplying water to the public...." *Id.* Even if the Department were to grant a certain deference to taxpayer's assertion that its tax exempt status is ambiguous, "Ambiguous exemption statutes must be strictly construed in favor of imposing tax and against the taxpayer." *General Motors Corp. v. Indiana Dep't of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax. Ct. 1991).

Nonetheless, the Department must conclude that there is no ambiguity. Taxpayer operates a municipal water utility. The water utility was formed by the municipality to provide water to its resident, but it was not formed as a "nonprofit corporation formed solely for the purpose of supplying water to the public." IC § 6-2.3-4-3(3). As a result, the taxpayer is subject to the URT.

FINDING

Taxpayer's protest is denied.

II. Ten-Percent Negligence Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty because it had a reasonable cause for its position that it was exempt from paying the URT.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(4) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to... pay the full amount of tax shown on the person's return... or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation [45 IAC 15-11-2](#)(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id.*

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

Under IC § 6-8.1-5-1(b), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

Given the totality of the circumstances, the Department is prepared to agree that taxpayer had a totally incorrect but reasonable belief that it was not subject to the URT.

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer is denied as to the substantive issue of whether it was required to pay the URT. Taxpayer is

sustained as to its protest of the negligence penalty.

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