

**Letter of Findings Number: 09-0363
Utility Receipts Tax
For Tax Years 2005-08**

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ISSUES

I. Utility Receipts Tax—"Wholesale Revenues."

Authority: IC § 6-2.3-1-4; IC § 6-2.3-1-6; IC § 6-2.3-1-14; IC § 6-2.3-2-1; IC § 6-2.3-3-5; IC § 6-8.1-5-1; Telecommunications Act of 1996, 47 U.S.C. § 151 et seq. (2009); 47 U.S.C. § 254 (2009).

Taxpayer protests the imposition of utility receipts tax on receipts relating to "wholesale revenues."

II. Tax Administration—Negligence Penalty.

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

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

III. Tax Administration—Interest.

Authority: IC § 6-8.1-10-1.

Taxpayer protests the imposition of interest.

STATEMENT OF FACTS

Taxpayer is a telecommunications company providing telephone services to Indiana customers. Taxpayer filed Utility Receipts Tax ("URT") returns. After an audit, the Indiana Department of Revenue ("Department") assessed additional URT, penalties, and interest for the tax years 2005, 2006, 2007, and 2008. The Department found that Taxpayer had failed to include a variety of its gross receipts that were related to certain federal and state revenue pooling systems. Taxpayer protested this assessment. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as required.

I. Utility Receipts Tax—"Wholesale Revenues."

DISCUSSION

Notices of proposed assessments are prima facie evidence that the Department's claim for unpaid taxes is valid. IC § 6-8.1-5-1(c). The taxpayer has the burden of proving that the Department incorrectly imposed the assessment. *Id.*

The Department found that Taxpayer had failed to include a variety of receipts as gross receipts subject to the URT.

The URT is imposed by 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; 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 a domiciliary of Indiana.

"Gross receipts" for purposes of the Indiana's URT 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.

IC § 6-2.3-1-6 defines "receives" as applied to a taxpayer, as follows:

- (1) the actual coming into possession of, or the crediting to, the taxpayer, of gross receipts; or
- (2) the payment of a taxpayer's expenses, debts, or other obligations by a third party for the taxpayer's direct benefit.

Accordingly, the URT is an income tax imposed on the gross receipts of a provider of retail utility services. The utility services subject to tax include telecommunication services. IC § 6-2.3-1-14(6).

Taxpayer protests the imposition of URT on certain of its receipts relating to the National Exchange Carrier Association ("NECA") and the Universal Service Fund ("USF") federal tariff and revenue pooling systems. These systems work to pool revenues and distributed them based on the companies' total revenues and the costs associated with providing services to high cost customers, low-income customers, schools, libraries, or rural health care providers to ensure that fair and affordable service is provided to all customers—i.e., "universal service." The Federal Communications Commission ("FCC") was granted the authority to create these pooling systems to ensure the availability of universal telecommunication services in the Telecommunications Act of 1934, as amended ("Act"). See Telecommunications Act of 1996, 47 U.S.C. § 151 et seq. (2009). The NECA and USF pooling systems are used to collect and distribute telecommunications company revenues in accordance with the Act. The Act provides that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute... to... mechanisms established by the [FCC] to preserve and

advance universal service." Telecommunications Act of 1996, 47 U.S.C. § 254(d) (2009).

The NECA and USF pooling systems receive contributions from and make distributions to the telecommunications companies to provide assistance to companies servicing high cost and low-income customers. The NECA and USF pooling systems have different qualifications for the companies receiving funds based on the percentage of certain types of high cost or low-income customers that the company services such as the number of rural customers, schools, and medical providers serviced. Therefore, one company may receive funds from only the NECA, from only the USF, or from both depending on the percentage of those types of customers serviced with telecommunications.

Taxpayer maintains that certain of its receipts relating to these NECA and USF federal tariff and pooling systems are not subject to the URT. Taxpayer protests the imposition of URT on the receipts in the following revenue accounts entitled by Taxpayer as follows: "Interstate SWA Settlement" account number 5087 (discussed in subpart A.1); "Interstate CCL Settlement" account number 5088 (discussed in subpart A.2); "Interstate Switch Access Revenue" account number 5082.000 (discussed in subpart B); "Special Access Revenue" account number 5084 (discussed in subpart C); and "Inter Loop High Cost Settlement" account number 5086 (discussed in subpart D).

A. "NECA Revenue."

Taxpayer protests the imposition of URT on receipts in Taxpayer's accounts entitled "Interstate SWA Settlement" (account no. 5087) and "Interstate CCL Settlement" (account no. 5088). Taxpayer asserts that the receipts in these accounts are from the NECA and are "wholesale revenues" that are not subject to the URT.

As stated previously, the URT is an income tax imposed on the receipts received for providing utility services for consumption. Further, "receives," as defined for the purposes of the Indiana's URT, includes "the payment of a taxpayer's expenses, debts, or other obligations by a third party for the taxpayer's direct benefit." IC § 6-2.3-1-6(2). Accordingly, when a taxpayer provides utility services and directly benefits from payments it receives for its expenses, debts, or obligations, then that taxpayer obtains gross receipts that are subject to the URT.

Taxpayer asserts that the receipts it receives from the NECA revenue pooling system are for "wholesale transactions" that are not subject to the URT. Taxpayer maintains that the distributions are received in a "wholesale transaction" because the distributions are separate and distinct from a retail sale made to customers and as such cannot be subject to the URT.

Taxpayer receives distributions from the NECA revenue pooling system to recover its expenses and obligations of providing utility services to high cost customers in Indiana. Taxpayers would not receive these distributions but for its retail sale of the utility service to those customers. Taxpayer agrees to provide telecommunications services to those customers who agree to pay for telecommunications services. Taxpayer reports its revenue and cost information for providing telecommunications services to its customers to the NECA pooling system. The NECA pooling system makes distributions based upon the specific information submitted. Taxpayer receives the funds from the NECA pooling system because Taxpayer provided telecommunications services—i.e., "the retail sale of the utility service for consumption"—to certain high cost customers. If Taxpayer had not provided the telecommunications services to these customers, then the NECA pooling system would not make a distribution to Taxpayer. Since the NECA, which is a third party, pays something of value for Taxpayer's expenses and obligations from which Taxpayer receives a direct benefit, the receipts from the NECA revenue pooling system are gross receipts subject to the URT.

However, the NECA administers the pooling system and makes distributions from two revenue pools, the "Common Line" revenue pool and the "Traffic Sensitive" revenue pool. The "Common Line" revenue pool contains funds that were paid by end users for the end users' use of certain lines. Thus, the receipts received from the "Common Line" revenue pool are subject to the URT. On the other hand, the "Traffic Sensitive" revenue pool contains funds paid by long distance companies. The long distance companies pay into the pool based upon its long distance customers' per-minute use of the lines of the local exchange carrier—i.e., Taxpayer. The long distance carriers charge and receive payment from the end user—i.e., the long distance customer—for the telephone services provided. Thus, the receipts received from the "Traffic Sensitive" revenue pool are not income received in consideration of the provision of retail utility services and are not subject to the URT.

1. "Interstate SWA Settlement" Account.

Taxpayer has provided sufficient documentation demonstrating that the receipts in Taxpayer's account entitled "Interstate SWA Settlement" are receipts that the Taxpayer receives in the form of distributions from the NECA "Traffic Sensitive" revenue pool. As stated previously, the receipts from the "Traffic Sensitive Pool" are not income received in consideration of the provision of retail utility services and are not subject to the URT.

Therefore, Taxpayer's protest to the imposition of URT on these receipts is sustained.

2. "Interstate CCL Settlement" Account.

The documentation presented by Taxpayer demonstrate that the receipts in Taxpayer's account entitled "Interstate CCL Settlement" are receipts that the Taxpayer receives in the form of distributions from the NECA "Common Line" revenue pool. As stated previously, the receipts received from the "Common Line Pool" are attributable to end users and are subject to the URT.

Therefore, Taxpayer's protest to the imposition of URT on these receipts is denied.

B. "Switch Access Revenue Charges."

Taxpayer protests the imposition of URT on receipts in Taxpayer's account entitled "Interstate Switch Access Revenue" (account no. 5082.000). Taxpayer asserts that the receipts in this account are for "wholesale revenues" that are not subject to the URT.

While "Switch Access Revenue" may be charged directly to end users in certain circumstances, Taxpayer has provided sufficient documentation demonstrating that the receipts in its "Interstate Switch Access Revenue" account were received from interexchange carriers that are reselling telecommunications services. Under IC § 6-2.3-3-5(a), "Gross receipts do not include a wholesale sale to another generator or reseller of utility services." Thus, since these receipts are received for wholesale sales to another generator or reseller of utility services, the receipts are not gross receipts that are subject to the URT.

Therefore, Taxpayer's protest to the imposition of URT on these receipts is sustained.

C. "Special Access Revenue Charges."

Taxpayer protests the imposition of URT on receipts in Taxpayer's account entitled "Special Access Revenue" (account no. 5084). Taxpayer asserts that the receipts in this account are for "wholesale revenues" and/or represent internal charges for regulatory purposes and, as such, are not subject to the URT. Taxpayer maintains its receipts from the sales of the telecommunications services are not "retail sales" because the sales are to "other carriers."

However, if the "other carriers" are providing "DSL-Internet services," "Frame Relay services," "ATM data transfer services," or other non-telecommunications services, then these "other carriers" are consumers of the Taxpayer's telecommunications services. See IC § 6-2.3-3-5(a) (providing that "gross receipts do not include a wholesale sale to another generator or reseller of utility services") (Emphasis added). Thus, while the "other carriers" may be resellers of services, the "other carriers" are not resellers of "utilities services." Since the "other carriers" are not "another generator or reseller of utility services," Taxpayer's sales to the "other carriers" are not "wholesale sales" of "utility services" as required by IC § 6-2.3-3-5(a). Thus, Taxpayer receipts from the sales to the "other carriers" are gross receipts subject to the URT.

Alternatively, Taxpayer maintains the receipts in this account represent internal accounting allocations the Taxpayer made for regulatory purposes. However, the documentation provided by Taxpayer is insufficient to demonstrate that this account contains any such internal allocations.

Therefore, Taxpayer's protest to the imposition of URT on these receipts is denied.

D. "USAC-High Cost Revenue."

Taxpayer protests the imposition of URT on receipts in Taxpayer's account entitled "Inter Loop High Cost Settlement" (account no. 5086). The receipts in Taxpayer's account entitled "Inter Loop High Cost Settlement" are receipts that the Taxpayer receives in the form of distributions from the "USF-High Cost" revenue pool, which is administered by the USAC. Taxpayer receives distributions from the "USF-High Cost" revenue pool to recover its expenses and obligations of providing retail utility services for consumption to high cost, typically rural, customers in Indiana.

As stated previously, the URT is an income tax imposed on the receipts received for providing utility services for consumption. Further, "receives," as defined for the purposes of the Indiana's URT, includes "the payment of a taxpayer's expenses, debts, or other obligations by a third party for the taxpayer's direct benefit." IC § 6-2.3-1-6(2). Accordingly, when a taxpayer provides utility services and directly benefits from payments it receives for its expenses, debts, or obligations, then that taxpayer obtains gross receipts that are subject to the URT.

Taxpayer asserts that the receipts from the "USF-High Cost" revenue pool, in that account, are for "wholesale transactions" that are not subject to the URT. Taxpayer maintains that the distributions are received in a "wholesale transaction" because the distributions are separate and distinct from a retail sale made to customers and as such cannot be subject to the URT.

However, Taxpayer would not receive these distributions, but for its retail sale of the utility service to those customers. Taxpayer agrees to provide telecommunications services to customers who agree to pay for telecommunications services. Taxpayer reports its revenue and cost information for providing telecommunications services to its customers to the USF pool. The pooling system makes distributions based upon the information submitted. Taxpayer receives the funds from the USF pooling system because Taxpayer provided telecommunications services—i.e., "the retail sale of the utility service for consumption"—to certain high cost customers. If Taxpayer had not provided the telecommunications services to these customers, then the USF pool would not make a distribution to Taxpayer. Since the USF, which is a third party, pays something of value for Taxpayer's expenses and obligations from which Taxpayer receives a direct benefit, the receipts from the "USF-High Cost" revenue pool are gross receipts subject to the URT.

Therefore, Taxpayer's protest to the imposition of URT on these receipts is denied.

FINDING

In summary, Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest is sustained for subparts A(1) and B. Taxpayer's protest is denied for subparts A(2), C, and D.

II. Tax Administration—Negligence Penalty.**DISCUSSION**

Taxpayer protests the imposition of the penalties. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1(d). Further, the Indiana Administrative Code, [45 IAC 15-11-2\(b\)](#) provides:

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 may waive the negligence penalty as provided in [45 IAC 15-11-2\(c\)](#), as follows:

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.

Taxpayer has provided sufficient information to establish that its failure to pay the deficiency was not due to Taxpayer's negligence, but was due to reasonable cause as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest to the imposition of penalty is sustained.

III. Tax Administration–Interest.

DISCUSSION

The Department assessed interest on the tax liabilities. Taxpayer protests this imposition of interest. The Department refers to IC § 6-8.1-10-1(a) which provides, as follows:

If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on the person's return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

Moreover, pursuant to IC § 6-8.1-10-1(e), the Department does not have the authority to waive the interest.

FINDING

Taxpayer's protest to the imposition of interest is respectfully denied.

CONCLUSION

Taxpayer's protest is denied in part and sustained in part. Taxpayer's protest is sustained on Issue I(A)(1) regarding the imposition of URT on the receipts in its "Interstate SWA Settlement" account. Taxpayer's protest is denied on Issue I(A)(2) regarding the imposition of URT on receipts in its "Interstate CCL Settlement" account. Taxpayer's protest is sustained on Issue I(B) regarding the imposition of URT on the receipts in its "Switch Access Revenue" account. Taxpayer's protest is denied on Issue I(C) regarding the imposition of URT on the receipts in its "Special Access Revenue" account. Taxpayer's protest is denied on Issue I(D) regarding the imposition of URT on the receipts in its "Inter Loop High Cost Settlement" account. Taxpayer's protest is sustained on Issue II regarding the imposition of penalty. Taxpayer's protest is denied on Issue III regarding the imposition of interest.

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