

**Letter of Findings Number: 09-0388**  
**Income Tax**  
**For Tax Years 2005-07**

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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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

**ISSUE**

**I. Adjusted Gross Income Tax—Apportionment Sales Factor.**

**Authority:** IC § 6-3-2-2; IC § 6-8.1-5-1; [45 IAC 3.1-1-55](#); Black's Law Dictionary, (6th ed. 1990).

Taxpayer protests the imposition of income tax based on recalculation of its sales factor.

**STATEMENT OF FACTS**

Taxpayer is an out-of-state corporation doing business in Indiana. Taxpayer provides specialized services to clients throughout the world. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not included all Indiana business receipts in its calculations of the sales factor of the adjusted gross income tax apportionment formula for the tax years 2005, 2006, and 2007. Accordingly, the Department added those receipts to the sales factor, recalculated Taxpayer's Indiana apportionment percentage, and issued proposed assessments for adjusted gross income tax for those years. Taxpayer protests that the sales in question are not attributable to Indiana and so protests the imposition of income tax based on the inclusion of those sales. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Adjusted Gross Income Tax—Apportionment Sales Factor.**

**DISCUSSION**

Taxpayer protests the imposition of income tax for the tax years 2005-07. The Department recalculated Taxpayer's Indiana sales factor and apportionment percentages which resulted in additional Indiana adjusted gross income tax assessments for those years. Taxpayer states that the Department incorrectly added sales to the numerator of Taxpayer's Indiana sales factor formula. Taxpayer believes that it included the correct amount of Indiana sales in its calculations and that no additional Indiana adjusted gross income tax is due. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The Indiana adjusted gross income tax is imposed under IC § 6-3-2-2, which states in relevant parts:

(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:

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

...

(b) Except as provided in subsection (l), if business income of a corporation or a nonresident person is derived from sources within the state of Indiana and from sources without the state of Indiana, the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana by the following:

- (1) For all taxable years that begin after December 31, 2006, and before January 1, 2008, a fraction. The:
  - (A) numerator of the fraction is the sum of the property factor plus the payroll factor plus the product of the sales factor multiplied by three (3); and
  - (B) denominator of the fraction is five (5).
- (2) For all taxable years that begin after December 31, 2007, and before January 1, 2009, a fraction. The:
  - (A) numerator of the fraction is the property factor plus the payroll factor plus the product of the sales factor multiplied by four and sixty-seven hundredths (4.67); and
  - (B) denominator of the fraction is six and sixty-seven hundredths (6.67).

...

(e) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. Sales include receipts from intangible property and receipts from the sale or exchange of intangible property. However, with respect to a foreign corporation, the denominator does not include sales

made in a place that is outside the United States. Receipts from intangible personal property are derived from sources within Indiana if the receipts from the intangible personal property are attributable to Indiana under section 2.2 of this chapter. Regardless of the f.o.b. point or other conditions of the sale, sales of tangible personal property are in this state if:

- (1) the property is delivered or shipped to a purchaser that is within Indiana, other than the United States government; or
- (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and:
  - (A) the purchaser is the United States government; or
  - (B) the taxpayer is not taxable in the state of the purchaser.

Gross receipts derived from commercial printing as described in [IC 6-2.5-1-10](#) shall be treated as sales of tangible personal property for purposes of this chapter.

(f) Sales, other than receipts from intangible property covered by subsection (e) and sales of tangible personal property, are in this state if:

- (1) the income-producing activity is performed in this state; or
- (2) the income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

....

(Emphasis added).

Also, [45 IAC 3.1-1-55](#) states in relevant part:

Gross receipts from transactions other than sales of tangible personal property shall be included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within this state. Except as provided below if the income producing activity is performed within and without this state such receipts are attributed to this state if the greater proportion of the income producing activity is performed here, based on costs of performance.

The term "income producing activity" means the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit. Such activity does not include activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, "income producing activity" includes but is not limited to the following: (1) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service. (2) The sale, rental, leasing, or licensing the use of or other use of tangible personal property. (3) The sale, licensing the use of or other use of intangible personal property.

Income producing activity is deemed performed at the situs of real, tangible and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property.

Example: Taxpayer, a corporation whose principal business activity is the manufacture and sale of hot water heaters, obtains notes for the sale of such water heaters in connection with its Indiana business activity. The property has a business situs in this state, therefore, interest income derived from such notes is attributable to this state.

The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

If receipts from sales other than sales of tangible personal property do not constitute a principal source of business income and such receipts are included in the denominator of the receipts factor, such receipts are in this state if: (a) the income producing activity is performed wholly within this state; or (b) the income producing activity is performed both in and outside this state and a greater proportion of the income producing activity is performed in this state than in any other state, based on costs of performance.

Examples:

- (1) The taxpayer is engaged in the heavy construction business in which it uses cranes, tractors, and earth-moving vehicles.

The taxpayer makes short-term rentals of the equipment when not needed on any project. The taxpayer rented some of the equipment to X for three weeks. The equipment was used by X for two weeks in this state and one week in State Y. The taxpayer's direct costs in connection with the equipment during the rental period was \$500 each week. Accordingly, the greater proportion of such costs was incurred in this state. All of the rental receipts are business income and for purposes of the sales factor are included in the numerator for this state.

(2) Taxpayer, whose commercial domicile is in this state, manufactures and sells industrial chemicals. Taxpayer owns patents on certain of its products. The taxpayer licensed the production of the chemicals in foreign countries in return for which the taxpayer receives royalties which constitute a relatively minor amount of its income. The royalties are business income and for purposes of the sales factor are included in the numerator for the state of the taxpayer's commercial domicile.

Except as provided by special apportionment formulas, receipts from sales other than sales of tangible personal property which constitute a principal source of business income shall be attributed to this state in accordance with the following:

- (a) Gross receipts from the sale, lease, rental or other use of real property are in this state if the real property is located in this state.
- (b) Gross receipts from the rental, lease, licensing the use of or other use of tangible personal property shall be assigned to this state if the property is within this state during the entire period of rental, lease, license or other use. If the property is within and without this state during such period, gross receipts attributable to this state shall be based upon the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during such period.
- (c) Income from transportation between a point in Indiana and a point outside Indiana shall be attributed to this state on a mileage basis. See Regulation 6-3-2-2(l)(020) [45 IAC 3.1-1-63].
- (d) Gross receipts for the performance of personal services are attributable to this state to the extent such services are performed in this state. If the services are performed partly within and without this state, such receipts shall be attributed to this state based upon the ratio which the time spent in performing such services in this state bears to the total time spent in performing such services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example, time expended in negotiating the contract, is excluded from the computations.

....

(Emphasis added).

Taxpayer states that IC § 6-3-2-2(f)(2) supports its protest, since its income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in another country, based on costs of performance. Taxpayer states that its services are performed in another country and that the greatest amount of its costs occurs in that country, not in Indiana.

The Department determined that Taxpayer performed specialized consulting services for customers throughout the world, including customers in Indiana. The services are performed under a contract with a related company which in turn contracts with the end-users of the services. Therefore, Taxpayer was performing services on behalf of the related company.

The Department explained that [45 IAC 3.1-1-55](#) did not allow Taxpayer to use the cost of performance. The Department determined that the example found at [45 IAC 3.1-1-55](#) example (2)(d) provides the proper method to calculate Taxpayer's Indiana sales factor. The Department calculated the ratio of Taxpayer's Indiana billable hours compared to Taxpayer's total billable hours, as listed on Taxpayer's federal returns. The Department then applied that ratio to Taxpayer's total sales to determine Taxpayer's Indiana sales.

Also, Taxpayer's principle source of business income is from the rendering of the specialized services. As defined in Black's Law Dictionary, 1136 (6<sup>th</sup> ed. 1990), "performance" is:

The fulfillment or accomplishment of a promise, contract, or other obligation according to its terms, relieving such person of all further obligation or liability thereunder.

No matter if the end-users of the services or if the related company are determined to be Taxpayer's customer, the services are "performed" in Indiana. It does not matter where the services originated. As provided by [45 IAC 3.1-1-55\(d\)](#):

Except as provided by special apportionment formulas, receipts from sales other than sales of tangible personal property which constitute a principal source of business income shall be attributed to this state in accordance with the following.

...

If the services are performed partly within and without this state, such receipts shall be attributed to this state based upon the ratio which the time spent in performing such services in this state bears to the total time spent in performing such services everywhere if the services are performed partly within and without this state. Such receipts shall be attributed to this state based upon the ratio which the time spent in performing such services in this state bears to the total time spent in performing such services everywhere.

The Department followed this provision. Taxpayer has not provided any documentation to rebut the Department's position and has not met the burden imposed by IC § 6-8.1-5-1(c).

#### FINDING

Taxpayer's protest is denied.

*Posted: 12/23/2009 by Legislative Services Agency*  
An [html](#) version of this document.