DEPARTMENT OF STATE REVENUE

04-20140502.LOF

Letter of Findings: 04-20140502
Gross Retail Tax
For the Years 2010, 2011, and 2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

The Department did not exceed its authority in promulgating an Information Bulletin addressing the sales tax transportation exemption because the Bulletin did not detract or expand the statutory exemption. Service company failed to meet its burden of demonstrating that its related transportation company was a segregated, distinct legal entity, that it transported service company's property pursuant to an arm's-length business agreement, was compensated for providing service company transportation services, and was entitled to claim the exemption.

ISSUES

I. Gross Retail Tax - Public Transportation Exemption.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-4; IC § 6-2.5-5-27; IC § 6-8.1-3-3; IC § 6-8.1-5-1(c); IC § 6-8.1-9-1(a); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Conklin v. Town of Cambridge City, 58 Ind. 130 (1877); Medco Health Solutions, Inc. v. Indiana Dept. of State Revenue, 9 N.E.3 263, 266 (Ind. Tax Ct. 2014); Wendt LLP v. Indiana Dep't of Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Villegas v. Silverman, 832 N.E.2d 598 (Ind. Ct. App. 2005); Carnahan Grain, Inc. v. Indiana Dep't of State Revenue, 828 N.E.2d 465 (Ind. Tax Ct. 2005); Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Panhandle Eastern Pipeline Co. v. Indiana Dep't. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001); Universal Group Limited v. Indiana Department of Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't. of State Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App. 1979); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); 45 IAC 2.2-5-61; 45 IAC 2.2-5-61(a); 45 IAC 2.2-5-61(j); Sales Tax Information Bulletin 12 (September 2014); Sales Tax Information Bulletin 12 (July 2010).

Taxpayer argues that its Transportation Company is entitled to claim the public transportation exemption and that the Department's audit decision to the contrary is erroneous.

II. Administration - Negligence Penalty.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(2); 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 authority to abate a ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an out-of-state service provider with multiple business locations across the country including Indiana. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's business records.

The audit resulted in an assessment of additional sales and use tax on the ground that Taxpayer and its separate, disregarded entity ("Transportation Company") were not entitled to claim the public transportation exemption.

Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Gross Retail Tax - Public Transportation Exemption.

DISCUSSION

The issue is whether Taxpayer has provided sufficient information to establish that its related Transportation Company was a separate legal entity, that the Transportation Company was engaged in public transportation, that Transportation Company was not transporting its own property, that Transportation Company was compensated for providing that service to Taxpayer, and that the Department exceeded its authority in finding to the contrary.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "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." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to an agency's reasonable interpretation of [the]statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

A. Audit Results.

The audit found that Taxpayer did not pay sales tax at the time it purchased trucks and vehicle parts used to provide delivery service to its customers. According to the audit report, Taxpayer relied on 45 IAC 2.2-5-61 in concluding that it - or its Transportation Company - could purchase the trucks and truck parts without paying sales tax. The regulation states in part:

> The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property. 45 IAC 2.2-5-61(a).

As more specific authority for its decision that Taxpayer was not entitled to the exemption, the audit cited to Sales Tax Information Bulletin 12 (September 2014), 20150128-IR-045150028NRA. See also Sales Tax Information Bulletin 12 (July 2010), 20100623 Ind. Reg. 045100390NRA. The Bulletin provides:

> The following requirements are factors the department weighs in determining whether a transportation company is engaged in public transportation. An asterisk (*) indicates a requirement that is considered by the department to be a critical factor in determining whether a transportation company qualifies for the public transportation exemption. A transportation company fails to qualify for the exemption if it does not, at a minimum, adhere to all the critical requirements. However, failure to adhere to one or more of the "noncritical" requirements can also result in a transportation company's failure to qualify for the exemption. The requirements are:
> • The transportation company must transport the persons or property of another.*
> ° The transportation company must maintain all shipping/transporting documents for all transactions (e.g., trip reports, truck logs, and invoices).*
> • The transportation company must receive compensation for the services it provides.*
> • The transportation company must hold and pay for appropriate public transportation insurance.*
> • The transportation company must be fully and independently authorized by federal and/or state authorities to provide public transportation services.*
> • If an employee of the parent company performs duties for the parent company and also performs "leased" duties for the transportation company, the parent company must maintain detailed records of when and which duties that employee is performing for the parent company and when and which duties that employee is performing under the lease.*
> • If the parent company makes a capital contribution of the vehicles to the transportation company, titles to the vehicles must be transferred to the transportation company.*
> • The transportation company and the parent company must maintain separate books and records, including

separate charts of accounts for each company:
° Transactions between the parent company and the transportation company must evidence a commercially reasonable, arms-length relationship between the parties.
° Transactions between the parent company and the transportation company must be evidenced by actual invoicing and payments for all transactions.*
° The parent company and the transportation company must segregate and account for each entity's purchases and expenses.*
• The parent company and the transportation company must maintain separate bank accounts.
• The parent company and the transportation company must issue separate W2 forms to their employees.
• The parent company and the transportation company must maintain separate federal depreciation schedules pursuant to generally accepted accounting standards.
• Any income earned by the transportation company for transporting for a third party is to be recognized by the transportation company.
• Because the transportation company and the parent company must have a distinct, arms-length business relationship, their separate incomes and expenses must be reflected on the taxpayers' federal income tax filings, all of which must be reconciled with the taxpayers' own records. When transactions are eliminated as intercompany transactions, the taxpayers must file the appropriate schedules with their federal returns.*
• If the parent company owns and holds titles to the vehicles, the parent company may lease those vehicles to the transportation company. However:
° The lease must be documented as a commercially reasonable, arms-length transaction; and
° The lease must be evidenced by actual payments to the parent company.
• If the transportation company owns the vehicles, titles to the vehicles must be held by the transportation company.
• The parent company and transportation company must have separate employees, or, if the transportation company leases its employees from the parent company, there must be a meaningful, arms-length charge for the leased employees.

According to the Audit Report, Taxpayer failed to establish that its related Transportation Company "qualif[ied] for the public transportation exemption as allowed under 45 IAC 2.2-5-61" and the Information Bulletin for the following reasons:

• The Transportation Company had not "properly segregated [its] operations and record keeping from [Taxpayer]."

• "It does not appear that a commercially, reasonable, arms-length relationship exists between the [Taxpayer] and the [Transportation Company]."

• The Taxpayer's bank statements supplied to the audit "provided no beginning or ending balance [and] does not have the appearance of a normal working bank account for an independent entity."

• The documentation provided "does not verify that actual invoicing and payments occurred on all transactions between [Taxpayer and Transportation Company]."

• Taxpayer failed to provide requested documentation "relating to the employees of [Taxpayer] that are performing duties for the [Transportation Company] under the employee lease contract" and that the Transportation Company "is hauling materials for the [T]axpayer utilizing the [T]axpayer's employees to operate the vehicles while the [T]axpayer appears to pay for the expenses related to operating the vehicles."

• The audit concluded that Transportation Company was "not operating as an independent entity with a distinct arms-length business relationship with the [Taxpayer]."

As a result, the audit assessed tax on Taxpayer's purchase of vehicle repair parts and delivery trucks because - in the absence of a distinct Transportation Company with which it maintained an arm's-length business relationship - Taxpayer was transporting its own goods.

B. Taxpayer's Response.

Taxpayer maintains that the trucks and vehicle parts it purchased "meet the requirements for exemption under IC § 6-2.5-5-27 as well as under 45 IAC 2.2-5-61 and the [Information Bulletin 12]."

Taxpayer further argues that the Department overreached in promulgating the threshold requirements set out in

Information Bulletin 12. Taxpayer states that the Department violated the provisions of the Indiana Administrative Rules and Procedures Act in adopting standards which are purportedly not found in the statute setting out the public transportation exemption requirements. In making this argument, Taxpayer cites to IC § 6-8.1-3-3 which, according to Taxpayer, imposes certain rule making requirements on the Department which the Department failed to meet. IC § 6-8.1-3-3 provides as follows:

> (a) The department shall adopt, under IC 4-22-2, rules governing:
> (1) the administration, collection, and enforcement of the listed taxes;
> (2) the interpretation of the statutes governing the listed taxes;
> (3) the procedures relating to the listed taxes; and
> (4) the methods of valuing the items subject to the listed taxes.
> (b) No change in the department's interpretation of a listed tax may take effect before the date the change is:
> (1) adopted in a rule under this section; or
> (2) published in the Indiana Register under IC 4-22-7-7(a)(5), if IC 4-22-2 does not require the interpretation to be adopted as a rule;
> If the change would increase a taxpayer's liability for a listed tax.

In support of its argument, Taxpayer also cites to Villegas v. Silverman, 832 N.E.2d 598 (Ind. Ct. App. 2005) in which the court of appeals found that the Indiana Bureau of Motor Vehicles ("BMV") violated the state's rule making requirements when it implemented specific identification requirements in order to obtain an Indiana driver's license. The court stated that, "[A]dministrative agencies may make reasonable rules and regulations to apply and enforce legislative enactments." Id. at 608. "However, an administrative agency may only regulate by a new rule if the proper rulemaking procedures have been followed." Id.

In addition, Taxpayer cites to Universal Group Limited v. Indiana Department of Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994) as support for its position that the Department exceeded its authority in promulgating Information Bulletin 12. Taxpayer explains that "the Indiana Tax Court found that the [BMV] could not add or detract from common law requirements in a regulation any more than it could add or detract from statutory law." As the Tax Court ruled, "It does not lie with the Department to promulgate a regulation in excess of, or contrary to, the law." Id. at 557.

Taxpayer explains the relevance of the Universal decision:

> Just as in Universal, the Department is attempting [to] change the requirements for applying a common law construct with the requirements in its Bulletin. In this case it is not even bothering with going through the scrutiny of promulgating a regulation before imposing an extra legal requirement. The Department is in effect pulling a "twofer." It is attempting to add requirements to statutory law and common law with its Bulletin.

Taxpayer also argues that even if the Bulletin was a legitimate exercise of the Department's authority, Taxpayer fulfilled the requirements set out in Information Bulletin 12. Taxpayer states:

> Regardless of the legal merit of the Department's argument, the Taxpayer disagrees with the Department's assessments challenging [Transportation Company's] qualification for the public transportation exemption consistent with requirements set forth in the Bulletin.

C. Hearing Analysis.

Taxpayer maintains that the Department exceeded its authority when it adopted Information Bulletin 12, that the requirements set out in the Bulletin are nowhere to be found in either the exemption statute or the companion regulation, and that promulgation of the Bulletin was an attempt by the Department to avoid the scrutiny that accompanies formal adoption of a regulation. In addition, Taxpayer further maintains that it meets the threshold requirements set out in the Bulletin.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax 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(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Id.; USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466, 468-69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. Id. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

In general, all purchases of tangible personal property are taxable unless specifically exempt by statute. 45 IAC 2.2-5-61(j). An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax under IC § 6-2.5-5. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 101. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 101 (citing Conklin v. Town of Cambridge City, 58 Ind. 130, 133 (1877)).

IC § 6-2.5-5-27 states:

> 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.

45 IAC 2.2-5-61, in relevant part, provides:

> (a) The state gross retail tax shall not apply to the sale and storage or use in this state of tangible personal property which is directly used in the rendering of public transportation of persons or property.
> (b) Definition: Public Transportation. Public transportation shall mean and include the movement, transportation, or carrying of persons and/or property for consideration by a common carrier, contract carrier, household goods carrier, carriers of exempt commodities, and other specialized carriers performing public transportation service for compensation by highway, rail, air, or water, which carriers operate under authority issued by, or are specifically exempt by statute or regulation from economic regulation of, the public service commission of Indiana, the Interstate Commerce Commission, the aeronautics commission of Indiana, the U.S. Civil Aeronautics Board, the U.S. Department of Transportation, or the Federal Maritime Commissioner; however, the fact that a company possesses a permit or authority issued by the P.S.C.I., I.C.C., etc., does not of itself mean that such a company is engaged in public transportation **unless it is in fact engaged in the transportation of persons or property for consideration** as defined above.
> (c) In order to qualify for exemption, the tangible personal property must be reasonably necessary to the rendering of public transportation. The tangible personal property must be indispensable and essential in directly transporting persons or property. (**Emphasis added**).

In Indiana Dep't. of State Revenue v. Calcar Quarries, Inc., 394 N.E.2d 939 (Ind. Ct. App. 1979), the taxpayer, Calcar Quarries, Inc. (Calcar), had multiple lines of business, including a stone quarry, a hot mix asphalt plant, and a ready mix concrete facility in Indiana. Id. at 940. After an audit, the Department determined that Calcar engaged primarily in the service of hauling its own product, and, thus, was not entitled to public transportation exemption on trucks and equipment it purchased or rented because it was not engaged in public transportation. Id. The Indiana Court of Appeals found that Calcar's trucks had been used for hauling property owned by others. Id. at 941. Additionally, the Court of Appeals also found that Calcar charged separately for the stone and maintained separate accounting records for its trucking operation from those of the quarry, asphalt, and ready mix operations. Id. The Indiana Court of Appeals further noted:

> [W]hen an item has been used for several purposes and only some of the purposes qualify the item for exemption, the taxpayer can gain exemption for the total amount of the purchase price of the item by showing that the item was used predominantly in an exempt manner.

Id. at 941 n.1.

The court of appeals concluded that Calcar demonstrated that it predominantly used the trucks and equipment in transporting property of others.

In Panhandle Eastern Pipeline Co. v. Indiana Dep't. of State Revenue, 741 N.E.2d 816 (Ind. Tax Ct. 2001), Panhandle Eastern Pipeline Co., and its subsidiaries (Panhandle) claimed that they were entitled to a 100 percent exemption of sales/use tax for equipment purchased and used in the distribution of natural gas, but the Department only granted a prorated exemption based on the actual amount of gas Panhandle publicly transported. Id. at 817. Ruling in favor of Panhandle, the Tax Court stated:

> [T]he public transportation exemption provided by section 6-2.5-5-27 is an all-or-nothing exemption. If a taxpayer acquires tangible personal property for predominate use in providing public transportation for third parties, then it is entitled to the exemption. If a taxpayer is not predominately engaged in transporting the property of another, it is not entitled to the exemption.

Id. at 819.

In Carnahan Grain, Inc. v. Indiana Dep't of State Revenue, 828 N.E.2d 465 (Ind. Tax Ct. 2005), the Department determined that, based upon total miles traveled for each of the audited years, the taxpayer, Carnahan Grain, Inc. (Carnahan), predominantly used the tractor-trailers and related equipment to haul property owned by third parties, but it received only approximately 22 percent of its total income from hauling property of others. Thus, the Department assessed Carnahan additional sales/use tax on the tractor-trailers and related equipment on the ground that, although Carnahan predominantly used the tractor-trailers for third-party hauling, it was not predominantly engaged as a business in hauling for third parties, pursuant to the two-prong test outlined in the Panhandle Eastern Pipeline Co. decision. Id. at 467. Rejecting the Department's "income" approach, the Tax Court explained the proper application, as follows:

> If [] the property is used predominantly for third-party public transportation, then the taxpayer is entitled to the exemption. Conversely, if the property is not predominantly used for third-party public transportation (i.e., it is predominantly used to transport the taxpayer's own property), then the taxpayer is not entitled to the exemption.

Id. at 468.

Specifically, following the Calcar decision, the court in Carnahan Grain reasoned that "when an item has been used for several purposes and only some of the purposes qualify the item for exemption, the taxpayer can gain exemption for the total amount of the purchase price of the item by showing that the item was used predominantly in an exempt manner." Id. at 469 (quoting Calcar, 394 N.E.2d at 941 n.1). The Tax Court ruled in Carnahan's favor based upon miles the trucks traveled to conclude that Carnahan predominantly used the trucks to transport property of others and thus public transportation exemption applied to the trucks and related equipment. Id.

In Wendt LLP v. Indiana Dep't of Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012), the taxpayer, Wendt LLP, was in the business of relocating oversized factory machinery, claiming that it was entitled to the public transportation exemption on its tangible personal property used in the course of its business. Following the rulings of Panhandle Eastern Pipeline Co. and Carnahan Grain, the Tax Court reiterated that "[t]he public transportation exemption is all-or-nothing exemption" and this exemption requires "an item to be predominantly used, not exclusively used, in public transportation to be exempt." Id. at 484-85.

Accordingly, pursuant to the above mentioned statutes, regulations, and case law, a taxpayer is not required to be exclusively or predominately engaged in the business of transporting property of others to claim the public transportation exemption. A taxpayer is entitled to the public transportation exemption on its purchase of an item only when the taxpayer demonstrates that the item is directly and predominantly used to transport property of others for consideration.

In effect, the statute, regulation, and case law teach that the exempt property must be predominately used to provide public transportation, that the business claiming the exemption must be transporting property belonging to others, and that the business must be compensated for doing so.

In this case, Taxpayer is not independently entitled to the exemption because, in providing services to its customers, Taxpayer is transporting its own property and would be "compensating" itself for doing so. Taxpayer apparently sought to overcome this hurdle by establishing related Transportation Company which transports that

very same property and is compensated by Taxpayer for doing so. In making this determination, it is the Department's expectation that the Transportation Company be more than a transparent, disregarded entity but must be a separate distinct entity which is paid to provide Taxpayer transportation services pursuant to an arm's-length agreement. Neither Taxpayer nor the Department seems to disagree on that fundamental principle. The issue is whether Transportation Company is simply an alter ego or whether this entity is a separate, distinct entity fully entitled to claim the exemption.

The statute, regulation, and cases agree the exemption is appropriate when transporting property of others but offer little, specific guidance for either the Department or the claimant entity. Information Bulletin 12 provides that guidance but Taxpayer argues that, in setting out that guidance contained in that Bulletin, the Department exceeded its authority because the Bulletin expands upon or detracts from the statutory exemption.

In addressing this issue, the Department notes that a fundamental principle is that tax exemptions are "strictly construed against the taxpayer" and any exemption claim must fall "within the exact letter of the law." RCA Corp., 310 N.E.2d 97, 101. The Department does not agree that Information Bulletin 12 promulgates a standard which is "in excess of, or contrary to the law." Universal, 642 N.E.2d at 557. Instead, the Department finds that the Bulletin was properly implemented when it was adopted and "published in the Indiana Register . . . ." as required under IC § 6-8.1-3-3. The Bulletin neither expands nor detracts from the statutory exemption but merely attempts to stake out the four corners of that exemption. Taxpayers are entitled to quarrel with where the Department placed those stakes but that does not mean that the Department's effort to provide the guidance and specificity taxpayers expect and deserve was excessive or inappropriate. Rather, the Department recognizes that Indiana taxpayers are entitled to arrange and manage their business affairs fully aware of the extent to which and when it is subject to or exempt from taxes.

1. Service Compensation.

Overreaching or not, Taxpayer states that it and Transportation Company meet the requirements set out in Information Bulletin 12 and are entitled to the exemption. The LOF addresses these requirements as follows:

According to Taxpayer, Transportation Company receives compensation for providing transportation services. The audit report disagreed stating that the bank statement provided during the audit had "no beginning or ending balance [and] does not have the appearance of a normal working bank account for an independent entity." In addition, the audit report stated that the bank statement "does not verify that actual invoicing and payments occurred on all transactions between the two entities." Taxpayer explains:

> There were three (3) transactions for the month of June 2013 on the bank statement: One (1) transaction for a deposit which equaled the amount billed the taxpayer for the transportation fees for the month of May 2013; Two (2) withdrawals, one (1) for the amount billed to the transportation company by the taxpayer for the lease of taxpayer's employees to drive the delivery trucks, and one (1) for the difference between the transportation fees deposited and the disbursement for the leased employee' s, leaving the ending bank balance to zero (0). All three (3) transactions were done on the same day, June 28, 2013.

Taxpayer explains that it is its "common practice to 'sweep' unused cash from its subsidiaries" and a cash sweep "is used as a tool to better invest [Taxpayer] and Subs cash on a daily basis." The cash sweep purports to explain why Transportation Company's bank account lacks neither a beginning or ending balance. In addition, at the time of the protest, Taxpayer provided monthly invoices billing Taxpayer for services rendered during the audit period.

2. Separate Employees.

The audit report cited to the Bulletin provision which provides that "[t]he parent company and transportation company must have separate employees, or, if the transportation company leases its employees from the company, there must [be] a meaningful, arm's-length charge for the leased employees." The audit report noted that Taxpayer provided the contract between Taxpayer and Transportation Company but had not provided a detailed list of the leased employees. At the time of the administrative hearing, Taxpayer provided a listing of leased employees.

3. Vehicle Titles.

The audit report cited to the Bulletin provision which provides that "[i]f the parent company makes a capital contribution of the vehicles to the transportation company, titles to the vehicles must be transferred to the transportation company." The audit stated that it had not received any documentation confirming that the vehicle

titles were transferred to the Transportation Company. Taxpayer responded that the vehicles were transferred by Taxpayer to Transportation Company and that, at the time of the protest, provided sample copies of vehicles registrations. Taxpayer explains that rather than re-titling the vehicles at the time the contribution was made, the vehicles were titled to Transportation Company when the individual vehicle registrations became due.

4. Purchases and Expenses.

The audit report cited to the Bulletin provision which provides that "[t]he parent company and the transportation company must segregate and account for each entity's purchases and expenses." The audit concluded that, based upon the information provided, "[T]he Taxpayer must be paying the expenses for the repairs to the vehicles for [Transportation Company]," and that "[T]axpayer failed to provide sufficient documentation to establish that each entity's purchases and expenses were being properly segregated." In response, Taxpayer maintains that it does maintain separate books, income statements, and balance sheets for itself and Transportation Company. Taxpayer explains that "The transportation related expenses are . . . charged to the respective divisions since those divisions bear the ultimate cost of the transportation which is billed by [Transportation Company] on a cost plus basis." Taxpayer further explains that "on occasion a transportation related invoice prepared by a vendor may come in with the incorrect legal entity name" but that although it has informed its vendors to bill Transportation Company for transportation related expenses, it "does not control . . . third-party procedures."

5. Arm's-Length Relationship.

The audit report cited to the Bulletin provision which provides:

> The transportation company and the parent company must have a distinct, arms-length business relationship, with their separate income and expenses reflected on the taxpayer's federal income tax filings, all of which must be reconciled with the taxpayers' own records; when transactions are eliminated as intercompany transactions the taxpayers must file the appropriate schedules with their federal returns.

6. Depreciation Schedules.

The audit found that Taxpayer did not have a separate schedule for the income and expenses attached to its federal return and that the "two entities did not have a schedule for intercompany eliminations." Taxpayer challenges the relevance of this observation because Transportation Company "is a disregarded entity for federal purposes" and that, under Treas. Reg. § 301.7701-2(c)(2)(i), Transportation Company "would never be mentioned on a federal return, let alone have its own schedule."

The audit report cited to the Bulletin section which provides that "Transactions between the parent company and the transportation company must evidence a commercially reasonable, arm's-length relationship between the parties." The report stated that "to qualify as an arm's-length transaction, neither of the involved parties may have any interest in the transaction's consequences to the other party."

Taxpayer provided a copy of its agreement with Transportation Company detailing the "cartage fee charged by [Transportation Company] to [Taxpayer]." Taxpayer explains that the cartage fee "is on a cost-plus resulting in an arm's length profit earned by [Transportation Company]." Taxpayer maintains that the fee "is comparable to what it would be charged by a third party" and the audit contains no information which would contradict its assertion. Further, Taxpayer states the "[t]he internal accounting of the two corporations is [irrelevant] to the question of the arms-length nature of the [cartage] fee."

The audit report cited to the Sales Tax Information Bulletin 12 provision which states "The parent company and the transportation entity must maintain separate federal depreciation schedules pursuant to generally accepted accounting standards." The audit report states that "Taxpayer provided their depreciation schedule which included the vehicles for the public transportation company. [Taxpayer] did not maintain separate depreciation schedules for the [Transportation Company]." During the administrative protest, Taxpayer provided a copy of Transportation Company's depreciation schedule.

D. Conclusion.

As noted previously, the proposed assessment is presumed correct and Taxpayer bears the burden of establishing that the assessment is wrong. IC § 6-8.1-5-1(c). In weighing the evidence challenging the assessment, the Department bears in mind the rule that the public transportation exemption - as with all such exemptions - is "strictly construed against the taxpayer." RCA Corp. 310 N.E.2d at 97. However, the Department

also recognizes that it is bound by the rule that the exemption "statute must not be construed so narrowly that it does not give effect to the legislative intent because the intent of the legislature embodied in a statute constitutes the law." General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

The audit raised numerous, legitimate concerns that the Taxpayer and Transportation Company failed to establish and maintain a legitimate, arm's-length business relationship sufficient under the law to sustain a claim that Transportation Company was entitled to the benefit of the public transportation company.

Taxpayer maintains that Transportation Company "is a completely separate legal entity respected by [Taxpayer's] corporate process." The Department must disagree. Sales Tax Information Bulletin 12 contains a fundamental requirement ("critical factor") in determining whether a transportation company qualifies for the exemption.

> The transportation company and the parent company must maintain separate books and records, including separate charts of accounts for each company:
> • Transactions between the parent company and the transportation company must evidence a commercially reasonable, arms-length relationship between the parties.
> • Transactions between the parent company and the transportation company must be evidenced by actual invoicing and payments for all transactions.*
> • The parent company and the transportation company must segregate and account for each entity's purchases and expenses.

In effect, Taxpayer and its Transportation Company failed to maintain and document specific and detailed invoicing and payments for services provided by Transportation Company on behalf of Taxpayer.

Taxpayer did not maintain detailed records of any of the transactions. For example, Taxpayer did not provide trip reports, logs, or documentation of individual transportation transactions. Taxpayer and Transportation Company's "Transportation Agreement," provided to the auditor, required Taxpayer to maintain such individual transportation records. The agreement provides for an individual receipt to be kept for each shipment. Specifically, the Transportation Agreement states:

> Each shipment shall be evidenced by appropriate documentation, signed by Carrier, Shipper or Shipper's designee, and the recipient or vendor, as the case may be, showing the kind and quantity of Goods received and delivered by Carrier at the loading and unloading points, respectively. Each signed receipt shall be evidence of the Carrier's delivery of the Goods covered by the receipt . . . ."

Additionally, Taxpayer did not provide details of the "leased employees'" activities that were covered under Taxpayer and Transportation Company's "Personnel Lease Agreement." The "Personnel Lease Agreement" provided to the auditor required Taxpayer to maintain individual employee action details. Specifically, Taxpayer's Personnel Lease Agreement required that the employee services charges and payments made pursuant to the agreement be based upon "110 [percent] of the 'Adjusted Actual Cost,'" which is calculated based on actual "time spent by Workers in the performance of the Services."

As further explained in the audit report:

> The auditor requested copies of the invoices where [Transportation Company] bills [T]axpayer for delivering the [T]axpayer's merchandise for the audit period. The auditor also requested copies of the bank statements of the [Transportation Company]. The [T]axpayer provided one bank statement and one invoice where [Transportation Company] billed the [T]axpayer for transportation fees.
>
> There were three (3) transactions for the month of June 2013 on the bank statement: One (1) transaction for a deposit which equaled the amount billed the [T]axpayer for the transportation fees for the month of May 2013; Two (2) withdraws, one (1) for the amount billed the transportation company by the [T]axpayer for the lease of [T]axpayer's employees to drive the delivery trucks, and one (1) for the difference between the transportation fees deposited and the disbursement for the leased employee's, leaving the ending bank balance to zero (0). All three (3) transactions were done on the same day, June 28, 2013.

The audit concluded that "the documentation indicates that the [T]axpayer must be paying the expenses for the repairs to the vehicles for the public transportation company." Especially in the absence of "separate general ledgers and chart of accounts," the Department agrees with the audit's finding that Taxpayer and Transportation Company failed to establish and maintain in all respects a clear-cut, arm's-length business relationship. To find otherwise requires that the Department ignore the specific guidance set out in Sales Tax Information Bulletin 12,

which plainly states that "The transportation company and the parent company must maintain separate books and records, including separate charts of accounts for each company" and that this specific requirement is a "critical factor" necessary to obtain the exemption. As stated in the Bulletin, "A transportation company fails to qualify for the exemption if does not, at a minimum, adhere to all the critical requirements." (Emphasis added).

Bearing in mind that, "tax exemptions are strictly construed in favor of taxation and against the exemption," Kimball, 520 N.E.2d at 456, and the exemption claim must fit within the "exact letter of the law," Conklin, 58 Ind. at 133, the Department is unable to agree that Taxpayer has met its burden under IC § 6-8.1-5-1(c) of establishing that it and its Transportation Company established and maintained a distinct arm's-length business relationship and that the Transportation Company qualifies for the public transportation exemption.

In its protest letter, Taxpayer makes passing reference to certain "overpayments," challenges to the audit's sampling and projection methodology, and additional exemption certificates. The arguments are not well developed and this Letter of Findings has no basis to address the issues. In order to obtain a refund of any overpayments, Taxpayer must file a form GA-110L ("Claim for Refund"). IC § 6-8.1-9-1(a). Medco Health Solutions, Inc. v. Indiana Dept. of State Revenue, 9 N.E.3 263, 266 (Ind. Tax Ct. 2014).

FINDING

Taxpayer's protest is respectfully denied.

II. Administration - Negligence Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty imposed as a result of the Department's audit.

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)(2) 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 waive 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.

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(c), "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.

In particular, Taxpayer argues that it "had reasonable cause for any failure to collect and remit any sales tax or failure to self-assess and remit additional use tax" and that the amount of additional tax assessed "represents less than 1[percent] of the total collected and remitted."

After reviewing Taxpayer's "facts and circumstances," the Department finds that there is sufficient information to conclude that Taxpayer "exercised ordinary business care and prudence . . . ." and that there is no evidence of "willful neglect."

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's protest challenging the Department's promulgation of Sales Tax Information Bulletin 12 is denied; Taxpayer's Transportation Company is not entitled to claim the benefit of the public transportation exemption; the Department will abate the ten-percent negligence penalty; the Letter of Findings does not address the Taxpayer's challenge to the audit's sampling and sampling methodology.

Posted: 06/24/2015 by Legislative Services Agency
An html version of this document.