DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 02-20130506
Income Tax
For Tax Years 2007-08

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 imposition of adjusted gross income tax on income from sales occurring in Indiana was correct. The imposition of adjusted gross income tax on the throwback of income from similar sales in other states was incorrect. Waiver of penalty is warranted.

ISSUES

I. Adjusted Gross Income Tax–Consolidated Return.

Authority: IC § 6-3-2-2; IC § 6-3-4-14; IC § 6-8.1-5-1; 15 U.S.C. § 381; Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992); Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232 (1987); 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); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); MBNA America Bank, N.A. & Affiliates v. Indiana Dept. of State Revenue, 895 N.E.2d 140 (Ind. Tax 2008); Indiana Dep't. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981); 45 IAC 3.1-1-38; 45 IAC 3.1-1-55; 45 IAC 3.1-1-110.

Taxpayer protests proposed assessments for additional adjusted gross income tax.

II. Adjusted Gross Income Tax–Throwback Sales.

Authority: IC § 6-8.1-5-1; 15 U.S.C. § 381; 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); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 3.1-1-53.

Taxpayer protests the throwback of income from other states to Indiana.

III. Tax Administration–Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer consists of related entities in an affiliated group which filed consolidated Indiana income tax returns. The entities are out-of-state businesses with operations in Indiana and other states. As originally filed, the consolidated returns included three entities: 1) a manufacturing entity ("Manufacturing"); 2) a retail entity ("Retail"); and 3) an inactive entity ("Inactive") which reported no income or expenses on the consolidated returns. The consolidated returns therefore used the information from Manufacturing and Retail to arrive at the reported numbers. As the result of an audit for income tax covering the tax years 2007, 2008, and 2009, the Indiana Department of Revenue ("Department") determined that Taxpayer had not included a fourth member ("Fourth") of the affiliated group which was doing business in Indiana and recalculated Taxpayer's consolidated return after including Fourth's information. As a result of that recalculation, the Department concluded that Taxpayer's consolidated return had underreported its Indiana adjusted gross income tax ("AGIT") for the tax years 2007 and 2008. The Department therefore issued proposed assessments for additional AGIT and interest for those years, as well as a penalty for 2008. Taxpayer protested a portion of the proposed assessments for AGIT as well as the

penalty. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax–Consolidated Return.

DISCUSSION

Taxpayer protests the imposition of additional Indiana AGIT for the tax years 2007 and 2008. The Department determined that Taxpayer owed additional AGIT on sales of tangible personal property ("TPP") which occurred in Indiana between Taxpayer and its customers. The Department added a fourth member ("Fourth") of Taxpayer's affiliated group to Taxpayer's Indiana consolidated return and then recalculated the Indiana AGIT for those years. The Department determined that Fourth was conducting business in Indiana through the following three separate activities: 1) Fourth was contracting with independently operated Indiana retail stores via trademark licensing agreements; 2) Fourth was rendering services to customers in Indiana via warranty service agreements; and, 3) Fourth was maintaining an inventory of TPP in Indiana for sale to Indiana customers. The Department considered these three activities to individually and collectively constitute operation of a business in Indiana. Therefore, the Department considered Fourth's income from sales to Indiana customers to be Indiana-sourced income.

Taxpayer's primary protest is that it does not believe that Fourth was doing business in Indiana, as required for inclusion in a consolidated return. Taxpayer disagrees with the Department's conclusion that the three activities regarding trademark licensing, warranty services, and maintenance of inventory constitute doing business in Indiana. Further, Taxpayer believes that the Department mischaracterized those three activities in its audit report.

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 Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. 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.

Regarding Taxpayer's primary protest, the adjusted gross income tax is imposed under IC § 6-3-2-2, which during the tax years at issue provided in part:

> (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.
> . . .
> (Emphasis added).

Further, 45 IAC 3.1-1-38 provides:

> For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state 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.

As stated in Regulation 6-3-2-2(b)(010) [45 IAC 3.1-1-37], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of IC 6-3-2-2(b)-(n).

Next, IC § 6-3-4-14 provides:

(a) An affiliated group of corporations shall have the privilege of making a consolidated return with respect to the taxes imposed by IC 6-3. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all of the provisions of this section including all provisions of the consolidated return regulations prescribed pursuant to Section 1502 of the Internal Revenue Code and incorporated herein by reference and all regulations promulgated by the department implementing this section prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.
(b) For the purposes of this section the term "affiliated group" shall mean an "affiliated group" as defined in Section 1504 of the Internal Revenue Code with the exception that the affiliated group shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana.
(c) For purposes of IC 6-3-1-3.5(b), the determination of "taxable income," as defined in Section 63 of the Internal Revenue Code, of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, shall be determined pursuant to the regulations prescribed under Section 1502 of the Internal Revenue Code.
(d) Any credit against the taxes imposed by IC 6-3 which is available to any corporation which is a member of an affiliated group of corporations making a consolidated return shall be applied against the tax liability of the affiliated group.

Also, 45 IAC 3.1-1-110 states:

An affiliated group as defined in IC 6-3-4-14(b) may file consolidated returns for Adjusted Gross Income Tax and Supplemental Net Income Tax purposes if the members of the affiliated group consent to follow the provision of IC 6-3-4-14 and the regulations established thereunder, including Federal regulations promulgated pursuant to Internal Revenue Code section 1502 which are incorporated by reference in IC 6-3-4-14. The inclusion of a member of an affiliated group in the consolidated return is deemed to be its consent to the consolidated filing. Once an election is made to file consolidated, a taxpayer must obtain written permission from the Department to change from this method of reporting.

Taxpayers filing consolidated returns should notify the Department of their election to so file by attaching to their first consolidated return a statement indicating which corporations are joining in the return. In addition, a worksheet must accompany all consolidated returns showing the consolidated income of the affiliates.

Finally, 45 IAC 3.1-1-55 provides 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.
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> . . . .

(Emphasis added).

The Department determined that Fourth had Indiana sourced income from sales transactions which occurred within Indiana's borders. Specifically, the Department determined that Manufacturing stored the TPP in an Indiana warehouse until Retailer received an order from one of its customers ("Customers") in Indiana. At that point, Manufacturing would ship the TPP to either Retailer's locations or to independently owned retail locations in Indiana. Title to the TPP would transfer from Manufacturing to Fourth and then to either Retailer or to independently owned retail stores in virtually instantaneous succession. The Department therefore determined that Taxpayer owned the TPP and sold it to Customers in Indiana, thereby giving rise to Indiana sourced income, as provided by IC § 6-3-2-2(a)(2). The Department added that income to Taxpayer's consolidated returns for the tax years 2007 and 2008, recalculated the tax due, and issued proposed assessments for additional AGIT.

Taxpayer disagrees with the Department's determination. In the first point of its primary protest, Taxpayer states that the Department's reference to Fourth's trademark licensing appears to be an argument for economic nexus. Taxpayer states that the concept of economic nexus only applies to financial institutions tax, as provided by the decision in MBNA America Bank, N.A. & Affiliates v. Indiana Dept. of State Revenue, 895 N.E.2d 140 (Ind. Tax 2008).

After review of the audit report, it is clear that the Department was not making an economic nexus argument to support its position that Fourth's licensing of Taxpayer's trademarks to independently owned retail stores constituted operation of a business in Indiana under 45 IAC 3.1-1-38(5). A review of 45 IAC 3.1-1-38(5) shows that ownership, rental or operation of a business or of property (real or personal) in the state constitutes "doing business" in Indiana for income tax apportionment purposes. Since the trademarks are not real or personal property, 45 IAC 3.1-1-38(5) does not apply to them. However, 45 IAC 3.1-1-38(7) provides that 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 constitutes "doing business" in Indiana.

The issue of establishing nexus in Indiana under P.L. 86-272 has been addressed by the Indiana Supreme Court in Indiana Dep't. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981), when the court explained:

> Public Law 86-272 (15 U.S.C.A. § 381), in pertinent part is as follows:
>
> > (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
> >
> > > (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
> > >
> > > (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)
> > > Id. at 1265.

The Court then explained:

> We also believe that Congress perceived "solicitation" as embodying "sundry activities so long as those activities [are] closely related to the eventual sale of a product." Finally, when a corporate representative performs an "act of courtesy" in order to accommodate a customer, he has not ventured beyond the realm of

"solicitation."
Id. at 1268.

The United States Supreme Court explained its standard for determining "solicitation of sales" in Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992). In Wrigley, the Court explained:

> We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are entirely ancillary to requests for purchases -- those that serve no independent business function apart from their connection to the soliciting of orders -- and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. National Tires, Inc. v. Lindley, 68 Ohio App. 2d 71, 78-79 426 N.E.2d 793, 798 (1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business"). Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to requesting purchases, and cannot be converted into "solicitation" by merely being assigned to salesmen. See, e. g., Herff Jones Co. v. State Tax Comm'n, 247 Ore. 404, 412, 430 P.2d 998, 1001-1002 (1967) (no § 381 immunity for sales representatives' collection activities).
> Id, at 228-30.

The Court further explained:

> By contrast, Wrigley's in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which Wrigley's regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [Wrigley's] credit department communicating." App. 71, 72. It hardly appears likely that this mediating function between the customer and the central office would have been performed by some other employee -- some company ombudsman, so to speak -- if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases.
>
> Finally, Wrigley argues that the various nonimmune activities, considered singly or together, are de minimis. In particular, Wrigley emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007 [percent] of Wrigley's annual Wisconsin sales, and in absolute terms amounted to only several hundred dollars a year. We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in § 381, the prohibition on net-income taxation contained in that provision was inapplicable.
> Id. at 234-5.

Therefore, the Department may look at a taxpayer's Indiana activities as a whole to determine if the activities as a whole exceed the protection of Public Law 86-272. In this case, Fourth's licensing of trademarks to independently owned retailers went beyond the mere solicitation of orders and constituted more than de minimis activity in Indiana. The trademarks were being used in Indiana under the licensing agreements, creating an Indiana "business situs" and giving rise to Indiana income in their own right, as provided by 45 IAC 3.1-1-55. This exceeds mere solicitation of orders and is more than de minimis non-immune activity described in P.L. 86-272. Once the de minimis threshold has been crossed a taxpayer has nexus in that state, as provided by Kimberly-Clark and Wrigley. Therefore, the Department considered well-established Indiana and federal cases in addition to preexisting Indiana statutes and regulations when determining that Fourth's licensing of trademarks to Indiana licensees constituted doing business and creating nexus in Indiana.

Taxpayer's second point in its primary protest is in regard to the Department's determination that Fourth's warranties on the tangible personal property involved in the sales constituted "doing business" in Indiana under

45 IAC 3.1-1-38(4). As described in the audit report, Fourth fulfills its warranty obligations in Indiana by arranging for either Retailer or the independently owned retailers to address customer warranty requests and also to arrange for repair services when needed. Fourth in turn reimburses Retailer or the independent retailers for the expenses of performing the warranty services. The warranty, as described in the audit report, is between Fourth and Customers and therefore the Department considered that all warranty work was therefore performed in Indiana on behalf of Fourth.

Taxpayer disagrees with this conclusion. Taxpayer states that the warranty agreement between Fourth and Retailer establishes that the relationship between the two parties is that of independent contractors. Specifically, Taxpayer points to the language found in section 11 of the warranty agreement between Fourth and Retailer, which states:

> Under no circumstances shall [Retailer] be considered by this Agreement or any other fact or circumstance, to be an agent, partner, or co-venturer of [Fourth]. The relationship of the parties is that of independent contractors. [Retailer] shall not act or represent itself, either directly or by implication, as an agent, partner or co-venturer of [Fourth]. Nothing herein shall alter the relationship of parties or their rights to terminate such, as provided by Subsections (2) and (3) of Section 309 of Article (2) of the Uniform Commercial Code.

Therefore, Taxpayer believes that the fact that the warranty agreement between Fourth and Retailer states that Retailer is only acting as an independent contractor means that Fourth is not doing business in Indiana via the warranties it sells to customers.

The United States Supreme Court addressed this situation in Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue, 483 U.S. 232 (1987) when it stated:

> As a matter of law, the Washington Supreme Court concluded that this showing of a sufficient nexus could not be defeated by the argument that the taxpayer's representative was properly characterized as an independent contractor instead of as an agent. We agree with this analysis. In Scripto, Inc. v. Carson, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660 (1960), Scripto, a Georgia corporation, had no office or regular employees in Florida, but it employed wholesalers or jobbers to solicit sales of its products in Florida. We held that Florida may require these solicitors to collect a use tax from Florida customers. Although the "salesmen" were not employees of Scripto, we determined that "such a fine distinction is without constitutional significance." Id., at 211, 80 S.Ct., at 621. This conclusion is consistent with our more recent cases. See National Geographic Society v. California Equalization Board, 430 U.S. 551, 556-558, 97 S.Ct. 1386, 1390-1391, 51 L.Ed.2d 631 (1977).
>
> As the Washington Supreme Court determined, "the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales." 105 Wash.2d, at 323, 715 P.2d, at 126. The court found this standard was satisfied because Tyler's "sales representatives perform any local activities necessary for maintenance of Tyler Pipe's market and protection of its interests...." Id., at 321, 715 P.2d, at 125. We agree that the activities of Tyler's sales representatives adequately support the State's jurisdiction to impose its wholesale tax on Tyler.
> Id. at 250-51.

Also, as discussed above, the court in Wrigley explained, "We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not." Wrigley, at 234-5. Therefore, even if the relationship between Fourth and Retailer was that of independent contractors, Fourth's agreement with Retailer to have Retailer sell the warranties and to perform the warranty-related repairs on Fourth's behalf went beyond the mere solicitation of orders, were clearly related to Fourth's ability to establish and maintain a market in Indiana, and therefore go into the overall nexus determination, as provided by Tyler Pipe.

Taxpayer's third point in its primary point of protest is that it disagrees with the Department's conclusion that Fourth was maintaining an inventory of merchandise or materials for sale, distribution or consigned goods, as listed under 45 IAC 3.1-1-38(2). Taxpayer reiterates that Fourth did not own the TPP stored in the warehouse. Rather, Taxpayer points out that Manufacturing owned the TPP and that title to the TPP only flashed from Manufacturing to Fourth to Retail or to the independent retailers. Taxpayer states that Manufacturing bore all the risks regarding the manufacturing process plus the warehousing and transportation functions. Fourth, Taxpayer states, never took physical possession or control of the TPP in the supply chain. Therefore, Taxpayer believes, Fourth's actions did not constitute maintenance of an inventory of merchandise or materials for sale, distribution or consigned goods, as required by 45 IAC 3.1-1-38(2). Taxpayer therefore believes that Fourth did not exceed

the protection of P.L. 86-272 in this point of protest.

After review of the audit report and the materials provided by Taxpayer during the hearing process, the Department agrees that Manufacturing maintained the warehouse and inventory of TPP in Indiana and that Fourth did not maintain an inventory of goods in Indiana during the tax years at issue, as listed under 45 IAC 3.1-1-38(2). However, it is clear that Taxpayer took title to the TPP in an Indiana transaction and then sold the same TPP in an Indiana transaction. Taxpayer acquired and disposed of the TPP in a wholly Indiana transaction. Therefore, 45 IAC 3.1-1-38(7) plainly applies since P.L. 86-272 only provides protection to orders which are filled by shipment or delivery from a point outside the state.

In conclusion, the Department does not agree with Taxpayer's protest. Each of the three primary activities listed by the Department in its audit report independently gives Fourth nexus with Indiana. Taken together, those activities go beyond de minimis non-solicitation activities and so give Fourth nexus with Indiana, as provided by Kimberly-Clark and Wrigley. Therefore, the Department correctly added Fourth's income from sales to Indiana customers to Taxpayer's consolidated return. Taxpayer has not met the burden imposed under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

II. Adjusted Gross Income Tax–Throwback Sales.

DISCUSSION

Taxpayer protests that the income from Fourth's sales outside Indiana should not be considered throwback sales for Indiana income tax purposes. The Department determined that Fourth had sales in other states where it had no nexus and so determined to throwback the income from those out-of-state sales to Indiana. Taxpayer argues that, if it is determined that Fourth's activities in Indiana constitute nexus and that the income from those sales should be sourced to Indiana, Fourth's activities in the other states would also constitute nexus with those states and that the income from those sales should be sourced to those states.

As provided in Issue I above, 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 Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. 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.

Regarding throwback sales, 45 IAC 3.1-1-53 states:

> Gross receipts from the sales of tangible personal property (except sales to the United States Government-See Regulation 6-3-2-2(e)(050) [45 IAC 3.1-1-54] are in this state: (a) if the property is delivered or shipped to a purchaser within this state regardless of the F.O.B. point or other conditions of sales; or (b) if the property is shipped from an office, store, factory, or other place of storage in this state, and the taxpayer is not taxable in the state of the purchaser. See Regulation 6-3-2-2(n)(010) [45 IAC 3.1-1-64].
>
> Examples:
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> . . .
>
> (5) If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. Such sale is termed a "Throwback" sale. Example: The taxpayer has its head office and factory in State A. It maintains a branch office and inventory in Indiana. Taxpayer's only activity in State B is the solicitation of orders by a resident salesman. All orders by the State B salesman are sent to the branch office in Indiana for approval and are filled by shipment from the inventory in Indiana. Since the taxpayer is immune under P.L.86-272 from tax in State B, all sales of merchandise to purchasers in State B are attributed to Indiana, the state from which the merchandise was shipped.
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> . . ..

(Emphasis added.)

The Department determined that Fourth was shipping the TPP from an Indiana warehouse to locations outside of Indiana in states where Fourth was not subject to income tax. Therefore, the Department considered the income from those sales to be subject to the throwback provisions of 45 IAC 3.1-1-53.

As provided in Issue I above, Fourth's activities in Indiana exceeded mere solicitation and so the income from sales in Indiana constituted Indiana sourced income. Fourth's activities in the other states were virtually identical to its activities in Indiana and exceeded mere solicitation in those other states. Therefore, as explained in detail in Issue I above, Fourth's activities in the other states were not protected by the provisions of P.L. 86-272, would subject the income from those sales to taxation by the other states, and so should not be considered throwback sales under 45 IAC 3.1-1-53. Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

III. Tax Administration - Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of a ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. 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 negligence. 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.

The standard for waiving the negligence penalty is given at 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. After review, although Taxpayer was denied in Issue I above, Taxpayer did provide reasonable arguments for its position. Taxpayer was sustained in Issue II above. Taxpayer's actions giving rise to the proposed assessments discussed in Issue I and Issue II were reasonable, therefore Taxpayer has affirmatively established that it exercised ordinary business care in this case. Waiver of penalty is warranted under 45 IAC 15-11-2(c).

FINDING

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

SUMMARY

Taxpayer's Issue I protest regarding the imposition of adjusted gross income tax is denied regarding the inclusion of "Fourth" in its consolidated returns. Taxpayer's protest in Issue II regarding throw back sales is sustained. Taxpayer's Issue III protest regarding the imposition of negligence penalty is sustained.

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