DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 04-0041
Corporate Income Tax
For the Years 2001

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ISSUES

I. Gross Income Tax-Imposition of Tax

Authority: IC 6-8.1-5-1 (b), IC 6-2.1-2-2(a)(2), 45 IAC 1.1-2-5(f)(2).

The taxpayer protests the imposition of tax on certain income.

II. Tax Administration- Penalty

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

The taxpayer protests the imposition of penalty.

STATEMENT OF FACTS

The taxpayer sold direct broadcasting services (DBS) to customers in Indiana. The DBS services consisted of programming that was first collected by an affiliate of the taxpayer from numerous providers at "uplink" centers in states other than Indiana. At the uplink centers, sophisticated computer hardware and software was used to encrypt and reformat the signals. The signal was then transmitted to various satellites owned by one of taxpayer's affiliates. The satellites transmitted the programming signals to customers throughout the Untied States, including Indiana. The taxpayer sold its services primarily through independent retailers. These retailers solicited orders from potential customers and obtained approval of such customers from sales centers located outside of Indiana. Upon acceptance of his or her order, the customer may personally install or utilize a contractor affiliated with the retailer to install the satellite receiver and "set top" box at the customer's residence. In such instances, the independent retailers received the necessary equipment directly from manufactures. The taxpayer never acquired title to such equipment. In the recent past, the taxpayer sold its services directly to customers, complementing the sales by retailers. The taxpayer consummated all such direct sales from sales centers located outside Indiana. Until recently, all of the taxpayer's customers were required to purchase the equipment when they initiated programming service, and thereafter, retained title to the equipment. In approximately mid-1999, the taxpayer acquired the assets of a competitor, including that competitor's Indiana customers. Because certain of those customers had leased their equipment, the taxpayer allowed these customers to continue to lease the equipment after

the acquisition. During the tax period, all the taxpayer's employees and offices were located outside Indiana. The taxpayer's records indicate that the company may have stored a small amount of inventory in Indiana in facilities owned by others.

After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional gross income tax, interest, and penalty for 2001. The taxpayer protested the assessment and penalty. A hearing was held and this Letter of Findings results.

I. Gross Income Tax-Imposition of Tax

All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b). Indiana imposes a gross income tax on the "taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." IC 6-2.1-2-2(a)(2). The taxpayer contends that since its gross income in 1999 and 2000 was derived in the same manner as the 1998 nontaxable income, the 1999 and 2000 income is also not subject to Indiana gross income tax.

The distinction lies in the regulation promulgated by the department and effective as of January 1, 1999 that clarifies the department's interpretation of the gross income tax for the telecommunications industry. The definition of "services performed within Indiana," for the telecommunications industry is found at 45 IAC 1.1-2-5(f)(2) as follows:

> . . .sale of telecommunications, including telephone, telegraph, and non-cable television, if the telecommunications originate or terminate in Indiana and are charged to an Indiana address, and the charges are not taxable under the laws of another state.

The taxpayer and department agree that the taxpayer is selling telecommunications that are received in Indiana and charged to an Indiana address. The taxpayer contends, however, that the income received from Indiana is taxable under the laws of California and Colorado. To substantiate this contention, the taxpayer submitted copies of federal tax returns, California tax returns, and Colorado tax returns. Those returns indicate that in California and Colorado the taxpayer pays tax on less than fifty percent (50%) of its total federal income. This does not satisfy the taxpayer's burden of proving that it is properly subject to tax in California and Colorado on the income derived from its Indiana customers.

The taxpayer also argues that the regulation is unconstitutional. An administrative hearing is not the proper forum to determine the constitutionality of an administrative regulation.

FINDING

The taxpayer's protest is denied.

II. Tax Administration- Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Indiana Regulation 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 reach 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 taxpayer ignored the listed regulations and failed to report its income as required by said regulation. This failure to follow department's instructions constitutes negligence.

Finding

The taxpayer's protest to the imposition of the penalty is denied.

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