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DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0053 ITC
Gross Income Tax
For The Period: 1992 and 1993

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ISSUES

I. **Gross Income Tax** –Sales in Interstate Commerce

Authority: IC 6-2.1-3-3; 45 IAC 1-1-121; Gross Income Tax Div. of Ind. v. Surface Combustion, 111 N.E.2d 50 (1953); Brown Boveri Corp. v. Ind. Dept. of State Revenue, 439 N.E.2d 561(1982).

The taxpayer protests the auditor's assessment subjecting sales in interstate commerce to gross income tax.

STATEMENT OF FACTS

The taxpayer is an out of state corporation qualified to do business in the State of Indiana. The taxpayer designs, manufactures, installs, and sells industrial air pollution control equipment. This includes cooling towers and industrial electrostatic precipitator systems (ESPs) to customers nationwide. The primary customers of the taxpayer are public utilities and other industrial operations who use the ESPs for the purpose of complying with environmental statutes and regulations. The taxpayer's protest in this matter relates to a contract for the purchase of ESPs between the taxpayer and a public utility.

I. **Gross Income Tax** – Sales in Interstate Commerce

DISCUSSION

The taxpayer ships its product in component parts as a convenience in transportation. The seller then assembles it or supervises assembly on the customer's premises. The taxpayer hires third party subcontractors to perform local installation services at the customer′s business situs. (Protest Letter p. 6). The taxpayer states that the typical work for the third party consists of ductwork and steel, concrete foundations, piling, precipitator steel erection, precipitator erection, demolition, insulation, electrical and excavation work. The taxpayer also supervises this

installation by the third party subcontractors, who paid Indiana Gross Income Tax on their gross receipts. The taxpayer states that the installation was incidental to and an integral part of the sale of the ESPs. Id.

The pertinent code section IC 6-2.1-3-3 states:

> Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign company is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution.

Indiana recognizes in 45 IAC 1-1-120 that income from sales made by nonresident seller to an Indiana buyer is generally not subject to gross income tax, such sales are taxed when the seller is engaged in business activity in Indiana and that activity is connected with or facilitates the sales.

The auditor has characterized the taxpayer as a contractor under 45 IAC 1-1-100 and the contract at issue as a service contract pursuant to 45 IAC 1-1-121. The taxpayer contends that the installation of ESPs at a customer′ s business situs was part of the entire contract of sale in interstate commerce. The taxpayer contends that 45 IAC 1-1-120 (1)(c) should apply to its activities, making the gross receipts from the contract and installation of the ESPs exempt from the Indiana Gross Income Tax.

Pursuant to Rule 45 IAC 1-1-121(d), gross receipts from contracts entered into by nonresidents to furnish and install tangible personal property in Indiana are subject to gross income tax. If the contract is simply one for the sale of tangible personal property with incidental services taking place within the State of Indiana it may be found to be tax-exempt because it is a transaction in interstate commerce. However, the contract may consist of services performed that are definitively taxable if the services take place in Indiana.

The taxpayer argues that the Department assessed the additional tax as if the taxpayer were a contractor under 45 IAC 1-1-100 and as if its ESP installation activities were a local construction contract of the type discussed in Holland Furnace Co., et al v. Department of Treasury of the State of Indiana, 133 F.2d 212 (7th Cir. 1943). (Protest Letter p. 3)

In support of its position, the taxpayer cites the Indiana cases of Gross Income Tax Div. of Ind. v. Surface Combustion, 111 N.E.2d 50 (1953); Brown Boveri Corp. v. Ind. Dept of State Revenue, 439 N.E.2d 561(1982).

The Department interprets the relevant court decisions to mean that whenever a product is shipped in component parts as a convenience in transportation and the seller then assembles it or supervises assembly on the customer's premises, the transaction is a sale in interstate commerce if the following conditions are met:

> (a) Installation consists of no more than setting the products on bases or connecting it to pipes, wires, supports, etc., provided by the customer;

(b) The product remains personal property after installation;

(c) The property is suitable for sale to other customers in the regular course of the seller's business; and

(d) The service necessary for installation is of such a technical nature that only the seller is capable of providing the necessary skilled workman.

If these conditions are not met, or if in addition to assembly, the seller performs additional services, such as installation, testing, construction, etc., the service transaction will not be considered part of a sale in interstate commerce, but will be treated as a construction contract.

The auditor concedes that the taxpayer meets the requirements of (b) and (d), but does not agree that with the taxpayer that conditions of (a) and (c) are met. The taxpayer states that the contract at issue was a Aturnkey operation" and the facts are substantially identical to those in Gross Income Tax Div. of Ind. v. Surface Combustion, 111 N.E.2d 50 (1953). (Protest letter p. 11).

In (c), The question remains whether the property is suitable for sale to other customers in the regular course of the seller's business. The product manufactured and sold by the taxpayer in this transaction could have been sold to other manufacturing facilities of equal size and output. Installation and testing to meet the customer's specifications would cause the only difference in the product for sale among different customers.

In (a), the auditor states that assembly is far more complicated than the requirement of simply connected pipes, wires, or supports. The auditor states that an enclosed structure is erected standing on a concrete foundation. Also, the taxpayer notes that the one contract of 5 million dollars took two years to arrive at a final billing and the 50 million dollar contract took over three years to reach a final billing.

The taxpayer disputes the auditor by stating that it hires third party subcontractors to perform local installation services at the customer′ s business situs. (Protest Letter p. 6). The taxpayer supervises this installation by the third party subcontractors, who paid Indiana Gross Income Tax on their gross receipts, and states that this was a necessary, incidental, and integral part of the sale of the ESPs. Id.

The taxpayer states that the agent of the Department ignored 45 IAC 1-1-120, which deals with an interstate sale of goods to an Indiana buyer. The taxpayer states that 45 IAC 1-1-121 (d) (which auditor relied upon) is based upon the decision in Holland Furnace Co., et al v. Department of Treasury of the State of Indiana, 133 F.2d 212 (7th Cir. 1943). The taxpayer states that in Holland, the installation services were not incidental to a sale in interstate commerce, but rather were local in character.

The Department finds that where the taxpayer only supplies materials to an Indiana customer, the

transactions are classified as nontaxable in-shipments and any income derived from such a sale is not subject to the gross income tax. 45 IAC 1-1-120(1)(b) states that the following is considered nontaxable in-shipments not subject to gross income tax: "[s]ales made by a nonresident who has a business situs or business activities within the State, but the situs or activities are not significantly associated with the sales, and the goods are shipped directly to the buyer upon receipt of a prior order."

However, 45 IAC 1-1-120(1)(b) further states that "for the sales to be considered as nontaxable under this rule, they must be initiated, negotiated and serviced by out-of-state personnel, and contact with the Indiana business situs or with employees operating within the State must be no more than incidental."

The taxpayer conducts each aspect of its materials sales, with the exception of the delivery, in New Jersey with New Jersey personnel. Only where the taxpayer has subcontracted with local workers for erecting services does the taxpayer establish an Indiana business situs. Therefore, where the taxpayer supplies materials only, the income derived from such transaction is in interstate commerce and is a nontaxable in-shipment; however, the labor and materials incidental to the labor are subject to the gross income tax. The installation may be an integral part of the sale of the ESPs but it is more than incidental. Therefore, the taxpayer is performing a service in Indiana, the receipts for which are subject to the gross income tax.

As a result, the taxpayer's sale of the ESPs will be exempt from the Indiana Gross Income Tax. The taxpayer's receipts from services performed during the onsite installation will be subject to the gross income tax.

FINDING

The taxpayer's protest is partially sustained and partially denied. Receipts from the sale of the ESPs are not subject to gross income tax. However, the taxpayer's receipts from the services performed during the onsite installation will be subject to the gross income tax.