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DEPARTMENT OF STATE REVENUE

FIRST SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 02-980356
Gross and Adjusted Gross Income Tax
For The Period: 1994 Through 1996

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ISSUES

I. Gross Income Tax—National Broadcasting Networks

Authority: IC 6-2.1; IC 6-2.1-3-28; 45 IAC 1-1-124

The taxpayer protests the imposition of gross income on receipts received from a national broadcasting network.

II. Adjusted Gross Income Tax—Business/Nonbusiness

Authority: IC 6-3-1-20; IC 6-3-1-21; 45 IAC 3.1-1-29; 45 IAC 3.1-1-30

The taxpayer protests the Department's treatment of the receipts from the sale of a television station as business income.

STATEMENT OF FACTS

During the years under audit the taxpayer owned 100% of the stock of corporation "S". Corporation "S" was included in the taxpayer's consolidated Indiana income tax return. At issue are the receipts received by corporation "S", which licensed the rights to nationally broadcast a major Indiana sporting event to a national broadcasting network. The taxpayer also owned 80% of the stock of "W"—a broadcasting corporation. "W" was included in the taxpayer's consolidated Indiana income tax return. "W" was engaged in two primary endeavors—television production and the operation of radio and television stations in Indiana and Florida.

I. Gross Income Tax—National Broadcasting Networks

DISCUSSION

A Letter of Findings was issued by the Department, on October 14, 1998, with regard to the above protested matters. (*See*, LOF 02-980356) The taxpayer requested a rehearing, and that rehearing was granted. The rehearing was held on January 14, 1999. The standard of review for a rehearing is set out in 45 IAC 15-5-5, which states:

> (b) If a rehearing is granted, the rehearing will not be held de novo unless abuse of discretion is alleged. When such abuse is alleged, the evidence will not be reweighed.
> Instead, the department will only consider evidence most favorable to the department's position and reverse only if the decision is clearly against the logic and effect of the facts and circumstances. However, if the taxpayer presents new and relevant evidence as a grounds for reversal, the new evidence will be weighed in light of all relevant facts and circumstances.

The taxpayer receives income from a national broadcasting network for the right of the broadcaster to telecast an Indiana sporting event. Corporation "S"—which is the portion at issue here—does not have business situs outside of Indiana. The sporting event takes place in Indiana, the national broadcast network films the event in Indiana, and the television signal originates in Indiana. The taxpayer protests the imposition of gross income tax on the receipts it receives from the national network. The taxpayer's argument is two-pronged: (1) the income is not subject to the levying provisions of 45 IAC 1-1-124; and (2) if, *arguendo*, the license fees were subject to the levying provisions they would still be exempt under IC 6-2.1-3-28.

The regulation in question, 45 IAC 1-1-124, states:

> (d) Income from the leasing of motion picture films and intangible telecast rights to exhibitors within Indiana is subject to gross income tax.

The taxpayer concludes that if it is not within the scope of the regulation, then the Department cannot tax the income. The Department agrees that the taxpayer does not come within the regulation cited above, but the taxpayer is still subject to the analysis of intangible income set out in 45 IAC 1-1-49 and 45 IAC 1-1-51.

Corporation "S" has business situs in Indiana. Under 45 IAC 1-1-49, situs can be established in a number of ways. The use and operation of an office, factory, or store, can establish situs. The

maintenance of inventory of goods for sale, distribution or manufacture can establish business situs, as well as the ownership, leasing, or rental of income-producing property. The taxpayer meets the elaborated criteria of business situs. The next issue is whether the income derived from the intangible forms an integral part of business conducted in Indiana. Indiana Dept. of Revenue v. Bethlehem Steel, 639 N.E.2d 264, is pertinent to this stage of analysis. The facts in Bethlehem involved the sale of tax benefits under "safe harbor leases." Bethlehem Steel sold equipment, then had the equipment leased back to them by the buyer, and the only money exchanged was the proceeds from the sale of the benefits. The Indiana Supreme Court found that while the taxpayer was not commercially domiciled in Indiana, it nonetheless had business situs here. The court then stated that for purposes of IC 6-2.1-2-2 and 45 IAC 1-1-51, Indiana could only tax the benefits sold if they were "integrally related" to Id. at 271. The taxpayer argues that the negotiations took place outside of Indiana, and that the network exercised most its rights outside of Indiana. The original Letter of Findings is pertinent on this point:

> The event that is to be televised takes place in Indiana, the national broadcast network films the event in Indiana, and the television signal originates in Indiana . . . a majority of the activities actually take place in Indiana.

Under the Department's analysis, the income the taxpayer receives forms an integral part of business conducted at an Indiana situs. The income derived is from an Indiana source—i.e., the taxpayer's business situs.

Corporation "S" is also commercially domiciled in Indiana. Regulation 45 IAC 1-1-51 states that "If a taxpayer's commercial domicile is in Indiana, all of the income from intangibles will be taxed . . commercial domicile analysis, which is similar to the analysis for business situs, also leads to the conclusion that the income the taxpayer received is taxable.

The taxpayer's next argument is that *if* the license fees are subject to tax, they are nonetheless exempt under IC 6-2.1-3-28. The taxpayer argues that the Department is "hairsplitting" and that the Department is attempting to in effect rewrite exemption IC 6-2.1-3-28 so that it only applies to "local broadcasting affiliates" that broadcast national network programs. The Department notes that exemptions are strictly construed against the taxpayer. *See*, Sony Music Entertainment, Inc. v. State Bd. of Tax Comm'rs, 681 N.E.2d 800, 801 (Ind. Tax Ct. 1997). The plain language of the statute is clear, and the fact that the taxpayer is not within the rubric of the exemption stands in relief when the elements of IC 6-2.1-3-28 are broken out:

1. Gross receipts
2. derived directly
3. from a national broadcasting network
4. for broadcasting national network programs

5. are exempt from gross income tax

The taxpayer clearly does not fall within "4." The gross receipts received by the taxpayer are not *for* broadcasting national network programs. The taxpayer is not broadcasting a national broadcasting network's programming.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax—Business/Nonbusiness

DISCUSSION

The taxpayer protests the Department's treatment of the receipts from the sale of a television station as business income. The taxpayer contends that in the early 1990s, newly promulgated FCC rules and regulations made it more difficult for medium sized and smaller stations to compete. Given these industry changes, and also due to changes in the taxpayer's business emphasis, the taxpayer began to divest itself of its radio and television stations. The taxpayer argues that it has never been in the business of buying and selling radio and television stations. The taxpayer also states that the proceeds from the sale were not used to acquire additional radio or television stations, nor were the proceeds invested in the taxpayer's regular trade or business. The taxpayer treated the gain as nonbusiness income, allocable to the State of Florida and reported it as taxable on its Florida tax return.

The taxpayer states that under 45 IAC 15-3-2, the taxpayer relied upon an unpublished 1990 Letter of Findings (LOF). The taxpayer fails to note that 45 IAC 15-3-2(d)(3) states:

> In respect to rulings issued by the department, based on a particular fact situation which may affect the tax liability of the taxpayer, *only* the taxpayer to whom the ruling was issued is entitled to rely on it. (Emphasis added)

Even if, *arguendo*, the taxpayer could rely on an unpublished LOF to *another* taxpayer, the facts between the 1990 LOF and the taxpayer's situation are not substantially the same. The taxpayer did not completely end its television and radio operations. Instead, it sold stations over a protracted period of time. And the Department does not draw the same conclusion from the 1990 LOF as the taxpayer does.

The crux of the dispute between the taxpayer and the Department centers on the definition of business income. Indiana Code 6-3-1-20 contains two independent tests of business income:

> The term "business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations. (Emphasis added)

Indiana has two tests—the transactional test and the functional test. The taxpayer argues that it does not meet the transactional test and that Indiana does not have a functional test. Alternatively, the taxpayer argues, even if Indiana does have a functional test, the income does not come under the functional test. The Department did not rule on whether the taxpayer met the transactional requirement of IC 6-3-1-20; instead, the Department reached its finding based upon the fact that the taxpayer falls squarely within the functional test. The taxpayer had an active business interest in the television and radio stations. The stations were an integral part of the taxpayer's business operations. Because the income from the sale of the stations is income from property in which the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's business operations, the income is business income. Per the taxpayer's brief, the taxpayer "engaged" in the business of "operating radio and television stations." The taxpayer meets the functional test because the taxpayer acquired, managed and disposed of the stations as integral parts of its business operations.

FINDING

The taxpayer's protest is denied.