DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 99-0607
State Gross Income Tax
For Tax Years 1993, 1994, 1995, 1996 and 1997

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ISSUES

I. Applicability of the State's Gross Income Tax to Out-of State Taxpayer's Indiana Source Income.

Authority: IC 6-2.1-2-1-13; IC 6-2.1-2-2; IC 6-2.1-2-2(a); IC 6-2.1-2-2(c)(6); Ind. Dept. of State Revenue v. Frank Purcell Walnut Lumber, Co., 282 N.E.2d 336 (Ind. Ct. App. 1972); Uniden America v. Dept. of State Revenue, 718 N.E.2d 821 (Ind. Tax Ct. 1999).

Out-of-state taxpayer is protesting the audit's determination to subject sales, derived from transactions with its Indiana customers, to imposition of the state's gross income tax.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: 45 IAC 15-11-2(b); 45 IAC 15-11-2(c); IC 6-8.1-10-2.1(a); IC 6-8.1-10-2.1(d).

Taxpayer has asked that the Department exercise its discretion to abate the ten-percent negligence penalty. Taxpayer seeks abatement of the penalty not only for the contested gross income tax assessment, but also for all relevant income tax liabilities determined during the audit.

STATEMENT OF FACTS

Taxpayer is an out-of-state manufacturing business headquartered in Michigan but incorporated in Indiana. Taxpayer manufactures fabricated metal products. During the tax period at issue, taxpayer did not maintain and Indiana business location. During the 1997 tax year, taxpayer purchased and operated an Indiana manufacturing facility. Taxpayer operated that Indiana facility for six months before relocating the entire facility to Michigan. Taxpayer filed an Indiana

corporate income tax return for the year 1997. Taxpayer maintains a force of sales representatives, headquartered in Michigan, who travel into Indiana to solicit purchases of its products. The resulting sales orders are received, approved, and executed at the taxpayer's Michigan location.

DISCUSSION

I. Applicability of the State's Gross Income Tax to Out-of State Taxpayer's Indiana Source Income.

Taxpayer protests the audit's determination that it was subject to the state's gross income tax – other than for the year 1997 – during the tax years addressed during the audit. The audit subjected taxpayer's sales, made into Indiana, to the gross income tax. According to taxpayer, audit cited Ind. Dept. of State Revenue v. Frank Purcell Walnut Lumber, Co., 282 N.E.2d 336 (Ind. Ct. App. 1972) as the basis for determining that taxpayer was subject to the state's gross income tax. Taxpayer maintains that the holding in Uniden America v. Dept. of State Revenue, 718 N.E.2d 821 (Ind. Tax Ct. 1999) superseded the Purcell holding such that taxpayer, as an out-of-state manufacturer, is not subject to the state's gross income tax for sales made into the state of Indiana.

Indiana imposes a gross income tax pursuant to IC 6-2.1-2-2. That statute states, in relevant part that "[a]n income tax, known as the gross income tax, is imposed upon the receipt of: (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; (2) 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). The taxpayer's gross income includes all gross income not specifically exempted. IC 6-2.1-1-13. IC 6-2.1-1-2(c)(6) provides an exemption from the statute's definition of gross income. That section states that "[t]he term 'gross income' does not include . . . gross receipts received by corporations incorporated under the laws of Indiana from a trade or business situated and regularly carried on at a legal situs outside Indiana or from activities incident to such trade or business."

In Uniden, the tax court determined that taxpayer's Indiana source receipts were not subject to the state's gross income tax. Uniden, 718 N.E.2d at 829. Uniden was an out-of-state corporation, headquartered in Texas, and incorporated in Indiana. Id. at 823. Uniden made substantial sales in Indiana, which the Department determined were subject to the state's gross income tax because the income was derived from Indiana sources. Id. at 825. The court determined that, based upon an intervening recodification adopting IC 6-2.1-1-2(c)(6) and omitting the phrase "sources outside the state of Indiana," the Department's position, based upon the holding in Purcell, was erroneous as inconsistent with the intent of the legislature's 1981 recodification. Id. at 829. In effect, the court held that the gross receipts earned by the non-resident taxpayer, through interstate sales of products to Indiana residents, were not subject to the gross income tax because the Indiana destination sales "were not connected with Indiana in any significant manner." Id. at 825. Uniden's Indiana sales were derived from trade or business situated and regularly carried out at a legal situs outside Indiana and were not "gross income" for purposes of the tax. Id. at 825-26. Uniden's corporate headquarters and commercial domicile was in Texas, Indiana orders

were sent to Texas for acceptance, upon receipt and acceptance the Indiana orders were shipped from out-of-state warehouses to Indiana. Id. at 825.

Taxpayer has submitted information which purports to establish that its own situation parallels that of the taxpayer in Uniden. The taxpayer, although incorporated in Indiana, has its headquarters and manufacturing facility located in Michigan. Other than for the 1997 tax year, taxpayer has never maintained manufacturing, office, warehousing, or distribution facilities in Indiana. Taxpayer maintains a sales force which solicits business from new and existing Indiana customers. All Indiana source orders are sent to taxpayer's Michigan office for approval and fulfillment. The sales personnel are controlled from and headquartered out of the taxpayer's Michigan offices. Goods sent to Indiana customers originate in Michigan because taxpayer does not maintain an Indiana warehouse or distribution facility. Taxpayer supplies personnel to provide repair and modification services for its Indiana customers.

Taxpayer has presented information sufficient to establish that its Indiana source income, accumulated during the relevant tax years, is not "gross income" and is not subject to the state's gross income tax under the provisions of IC 6-2.1-1-2(c)(6). The taxpayer's Indiana source income was derived from "a trade or business situated and regularly carried on in a legal situs outside Indiana." IC 6-2.1-1-2(c)(6). The taxpayer's corporate headquarters and commercial domicile were located in Michigan. Orders for taxpayer's goods were sent to, received at, and approved in Michigan. Once those orders were received and approved, the goods were shipped from the taxpayer's Michigan location into Indiana. Taken together, these facts are sufficient to establish that taxpayer's Indiana source income was derived from business activities carried on at a location outside of Indiana and, consequently, is not subject to the state's gross income tax.

FINDING

Taxpayer's protest is sustained.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer has requested that the ten-percent negligence penalty, imposed the authority of IC 6-8.1-10-2.1(a), be abated for all of the taxpayer's income tax liabilities assessed during the years encompassed within the audit period. Taxpayer maintains that any mistakes it made, with regard to its income tax liabilities, were made in good faith, without negligence, and were partially attributable to the taxpayer's reliance upon the advice of its previous tax advisor.

IC 6-8.1-10-2.1(d) states that if a person, subject to the negligence penalty, imposed under IC 6-8.1-10-2(a) can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, 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. 45 IAC 15-11-2(b) defines "negligence" as the failure to use reasonable care, caution or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results

from a taxpayer's carelessness, thoughtlessness, disregard, or inattention to duties placed upon the taxpayer by the Indiana Code or Department regulations.

In order to waive the negligence penalty, the taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. 45 IAC 15-11-2(c). Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ." Id. In determining whether reasonable cause exists, the Department may consider the nature of the tax involved, previous judicial precedents, previous Department instructions, and previous audits. Id.

Taxpayer has provided no substantive, statutory, or factual basis upon which the Department can justifiably be expected to find a reasonable cause for taxpayer's failure to pay the assessed tax deficiency. The taxpayer's various assertions – even taken together – do not rise to the level of "reasonable cause" sufficient to permit the Department to waive the negligence penalty assessed against an otherwise substantial and sophisticated taxpayer.

FINDING

Taxpayer's protest is respectfully denied.

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