INDIANA DEPARTMENT OF STATE REVENUE

Revenue Ruling #2001-10 IT

October 11, 2001

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ISSUES

Gross Income Tax, Adjusted Gross Income Tax and Supplemental Net Income Tax – Nexus

Authority: IC 6-2.1-2-2, Rule 45 IAC 1.1-1-3, IC 6-2.1-3-24.5, IC 6-8.1-9-1, IC 6-3-2-1, IC 6-3-2-2, Rule 45 IAC 3.1-1-38, IC 6-3-8-2

The taxpayer requests the Department to rule whether or not:

1. The taxpayer is subject to Indiana gross income tax;

2. The taxpayer would be eligible for Indiana special corporation status retroactively and prospectively if it is determined that it is subject to Indiana gross income tax;

3. The taxpayer is subject to Indiana adjusted gross income tax and supplemental net income tax; and

4. Assuming all other facts are the same, the taxpayer would be subject to Indiana gross income tax, adjusted gross income tax or supplemental net income tax if it were incorporated outside Indiana.

STATEMENT OF FACTS

The taxpayer is a supplier of lumber, lumber components, and manufactured roof trusses to manufactured housing and recreational vehicle manufacturers. The taxpayer is eligible to make an election to be a Subchapter S corporation but has elected not to do so. The taxpayer is a closely held corporation and was incorporated in Indiana in 1989. Shortly after incorporating in Indiana, the taxpayer received a certificate of authority to conduct business in Michigan and moved its corporate offices to that state

soon thereafter. The taxpayer has six individual shareholders, all of which are Indiana residents.

All physical property of the taxpayer, including the taxpayer's manufacturing and administrative facilities, as well as its sales offices, are located in Michigan. Occasionally, the taxpayer contracts with third party subcontractors in Indiana to manufacture certain products for the taxpayer. As part of this arrangement, the taxpayer then ships inventory to the subcontractors for performance of the contracts. The taxpayer retains ownership of the inventory throughout the performance of the contract.

Approximately 97% of the taxpayer's sales are to manufacturers for use in the products they manufacture. The remaining three percent of the taxpayer's sales are "direct sales." "Direct sales" are sales of product that the taxpayer distributes but does not manufacture. The taxpayer will instruct their supplier to drop ship goods directly to the taxpayer's customers.

A significant portion of the taxpayer's sales are to Indiana customers. The taxpayer has five full time sales employees and one part-time employee that solicit sales orders. The taxpayer has two full-time inside sales representatives to assist the customers and sales employees with the processing of the sale and coordinating the sale through the manufacturing and shipping process. All sales employees are based in Michigan, spending most of their time traveling to customer sites in several states, including Indiana. The sales staff have regular customer routes throughout Indiana in which they travel on a weekly basis. The taxpayer participates in local advertising both within and without Indiana (e.g., via golf outings and Yellow Pages).

The taxpayer also maintains a managed inventory program whereby the taxpayer's sales force work with customers to manage the customer's inventory level. For a majority of its customers, the sales personnel monitor the inventory levels/production plans of the customer and make purchasing recommendations to their customer's purchasing agent based on the sales personnel's observations. The customer then reviews and accepts the order proposed by the sales person. Either the customer or the sales person will then send the order by fax or phone to be approved by the taxpayer's inside sales representative in Michigan for processing. Upon review and approval, the order is scheduled for manufacturing and/or shipment.

The taxpayer's products are delivered daily to Indiana customers primarily by a fleet of trucks leased or owned by the taxpayer. Third party contract carriers are typically hired for delivery distances which exceed two hours or when the taxpayer's shipping capacity limits their ability to timely ship local deliveries. The customer unloads the product from the truck and approves receipt of the product. Occasionally, the taxpayer's trucks will pick up product that has been approved by the taxpayer's manager as a return.

The taxpayer manufactures products to the customer's specifications and designs. The taxpayer uses Computer Aid Designers (based at the taxpayer's headquarters) to

review the prints and develop in-house drawings used for the taxpayer's manufacturing process. It is rare for the taxpayer to perform work on its product at a customer location. Usually, the product is repaired by the customer or returned.

DISCUSSION AND RULINGS

Issue #1: Whether or not the taxpayer is subject to Indiana gross income tax

IC 6-2.1-2-2 provides that gross income tax is imposed upon the receipt of taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer. Rule 45 IAC 1.1-1-3 defines "business situs", which if established by a taxpayer, gives nexus to the taxpayer in Indiana and subjects the taxpayer to gross income tax.

Rule 45 IAC 1.1-1-3 states:

> (a) A "business situs" arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile.
> (b) A taxpayer may establish a business situs in ways, including but not limited to, the following:
> (1) Use, occupancy, or operation of an office, shop, construction site, store, warehouse, factory, agency route, or other place where the taxpayer's affairs are conducted.
> (2) Performance of services.
> (3) Maintenance of an inventory or stocks of goods for sale, distribution, or manufacture.
> (4) Sale or distribution of merchandise from company-owned vehicles where title to the goods passes at the time of sale or distribution.
> (5) Acceptance of orders without the right of approval or rejection in another state.
> (6) Ownership, leasing, rental, or other business activities connected with income-producing property (real or personal).
> (7) Ownership (in whole or part) of a partnership doing business in Indiana unless the ownership is that of a limited partner who does not participate in the control of the business.
> (8) Other business or investment activities, other than de minimis, performed on behalf of the taxpayer by an employee of the taxpayer. These activities shall be considered together, not in isolation, in deciding if they are de minimis.

In the instant case, the taxpayer by virtue of having, on occasion, inventory in Indiana, providing a managed inventory program for Indiana customers, delivery of its products by its trucks to Indiana customers, occasional pick up of its products by its trucks from Indiana customers and occasional repair of its products at customer locations in Indiana

has established nexus in Indiana for gross income tax purposes, pursuant to the above statute and regulation, therefore, is subject to Indiana gross income tax.

Ruling #1

The Department rules that the taxpayer is subject to Indiana gross income tax.

Issue #2: Whether or not the taxpayer would be eligible for Indiana special corporation status retroactively and prospectively if it is determined that it is subject to Indiana gross income tax

IC 6-2.1-3-24.5 states:

> (a) For purposes of this section, "small business corporation" has the same definition that the term has in Section 1361(b) of the Internal Revenue Code. However, a corporation is a small business corporation for the purposes of this section even if one (1) of its shareholders is a qualified trust that forms a part of an employee stock ownership plan under Section 401(a) of the Internal Revenue Code.
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> (b) Except as provided in subsection (c), gross income received by a small business corporation is exempt from gross income tax.
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> (c) A small business corporation is not exempt from gross income tax under this section for a taxable year if for that taxable year twenty-five percent (25%) or more of the small business corporation's gross income consisted of passive investment income (as defined in Section 1362(d)3(C) of the Internal Revenue Code).
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> (d) Upon request of the department, a corporation that claims an exemption under this section shall provide the department with proof, on forms provided by the department, that the corporation was a small business corporation during the taxable year for which the exemption is claimed.

To the extent the taxpayer falls within the ambit of the above statute retroactively and prospectively, and to the extent the provisions of IC 6-8.1-9-1 (statute of limitations) are satisfied the taxpayer will be eligible for Indiana special corporation treatment retroactively as well as prospectively.

Ruling #2

The Department rules that the taxpayer is eligible for Indiana special corporation status, both retroactively and prospectively, to the extent the taxpayer falls within the ambit of IC 6-2.1-3-24.5 and to the extent that the provisions of IC 6-8.1-9-1 are satisfied.

Issue #3: Whether or not the taxpayer is subject to Indiana adjusted gross income tax and supplemental net income tax.

IC 6-3-2-1 imposes adjusted gross income tax on adjusted gross income derived from sources within Indiana. IC 6-3-2-2(a) provides that adjusted gross income derived from sources in Indiana includes income from "doing business" in Indiana. Rule 45 IAC 3.1-1-38, interpreting IC 6-3-2-2, provides that for apportionment purposes, a taxpayer is "doing business" in Indiana if it operates a business enterprise or activity in Indiana including, but not limited to:

1. Maintenance of an office or other place of business in Indiana;

2. Maintenance of an inventory of merchandise or material for sales, distribution, or manufacture, or consigned goods;

3. Sale or distribution of merchandise to customers in Indiana directly from company owned or operated vehicles where title to goods passes at the time of sale or distribution;

4. Rendering services to customers in Indiana;

5. Ownership, rental or operation of a business or of property (real or personal) in Indiana;

6. Acceptance of orders in Indiana; and

7. Any other act in Indiana which exceeds the mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income.

Here, the taxpayer by virtue of having, on occasion, inventory in Indiana, providing a managed inventory program for Indiana customers, delivery of its products by its trucks to Indiana customers, occasional pick up of its products by its trucks from Indiana customers and occasional repair of its products at customer locations in Indiana has established nexus in Indiana for adjusted gross income tax and supplemental net income tax (IC 6-3-8-2) purposes, pursuant to the above statutes and regulation, therefore, is subject to Indiana adjusted gross income tax and supplemental net income tax.

RULING #3

The Department rules that the taxpayer is subject to Indiana adjusted gross income tax and supplemental net income tax.

Issue #4: Assuming all other facts are the same, whether or not the taxpayer would be subject to Indiana gross income tax, adjusted gross income tax or supplemental net income tax if it was incorporated outside Indiana

Assuming all other facts are the same, the state of incorporation of a taxpayer is not determinative of whether or not it is subject to Indiana gross income tax, adjusted gross income tax or supplemental net income tax.

RULING #4

The Department rules that the taxpayer would be subject to Indiana gross income tax, adjusted gross income tax and supplemental net income tax if it was incorporated outside Indiana.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, changes in statute, a regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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