THE GROSS INCOME TAX OF THE STATE OF INDIANA

The gross income tax of the State of Indiana is a tax which is imposed on all of the gross receipts of a taxpayer, with no deductions allowable for costs, losses, or expenses incurred. See Indiana Code § 6-2.1-1-2. In contrast to an income tax, a tax on gross receipts affects each transaction in proportion to its magnitude and irrespective of whether it is profitable or otherwise. United States Glue Co. v. Town of Oak Creek, 247 U.S. 321 (1918) (discussing the differences between an income tax and a gross receipts tax).

The gross income tax of Indiana was enacted in 1933 as a temporary, stop-gap measure to help boost Indiana state revenue during the depths of the Great Depression. From 1933 to 1963, all taxpayers (individuals, trusts, estates, and corporations) were subject to the gross income tax of Indiana. However, with the passage of the Indiana Adjusted Gross Income Tax Act of 1963, all taxpayers who were made subject to the Indiana adjusted gross income tax were exempted from the gross income tax of Indiana, except for corporations. The State of Indiana is now one of only three states to have a broad-based corporate gross income tax. The State of Washington and the State of West Virginia are the other two.

The constitutionality of the gross income tax of Indiana was upheld in Miles v. Department of Treasury, 199 N.E. 372, (Ind. 1935). A transactional nexus is required for the imposition of the gross income tax of Indiana in contrast to a taxpayer nexus which is required for the imposition of the Indiana adjusted gross income tax and Indiana supplemental net income tax.

The Indiana gross income tax is aimed at receipts from activities or transactions connected with an instate business situs. Basically, it is levied on all gross income of residents or domiciliaries, corporations, and non-residents' gross income from Indiana sources.

With regard to the imposition of the tax on nonresidents, 45 IAC 1.1-2-1 states that "the gross income tax is imposed upon the receipt of . . . the gross income derived from an activity, a business, or another source within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." Therefore, transactions which are completed in-state by nonresident corporations will be subject to the gross income tax. See Indiana Code § 6-2.1-1-2 and 45 IAC 1.1-2-1(a)(2).

Gross income comprises the total amount of gross receipts derived from all sources, whether actually or constructively received by the taxpayer. A list of "gross income" items as provided by Indiana Code § 6-2.1-1-2(a), specifically includes the following receipts:

1. From trades, businesses, or commerce;
2. As admission fees or charges;
3. From the sale, transfer, or exchange of property, real or personal; tangible or intangible;
4. From the performance of contracts;
5. As prizes or premiums;
6. From insurance policies;
7. As damages or judgments;
8. From investment of capital, including interest, discounts, rentals, royalties, dividends, fees, and commissions;
9. From the surrender, sale, transfer, exchange, redemption of, or distribution upon, stock of corporations or associations; and
10. From any other source not specifically described in this subsection.

As indicated above, a taxpayer must include in gross income any type of benefit received, whether actually or constructively received. The terms "receipt" or "receipts" refer to income of any kind including notes, property, value in the form of services, or items in any form credited to the taxpayer in lieu of cash. See Indiana Code § 6-2.1-1-10. The terms "receive" or "received" refer to either the actual coming into possession of gross income or the crediting to the taxpayer of gross income. See Indiana Code § 6-2.1-1-11. "Receipts" include not only amounts actually received, but also amounts credited to the taxpayer, available for the taxpayer's withdrawal, paid to another for the benefit of the taxpayer, or to which the taxpayer is entitled. See Indiana Code § 6-2.1-1-11 and 45 IAC 1.1-1-5.

The courts have indicated that the definition of gross income extends only to the receipt of some direct benefit by the taxpayer. The Indiana Supreme Court in Indiana Department of State Revenue, Indiana Revenue Board, Indiana Gross Income Tax Division v. Colpaert Realty Corp., 109 N.E.2d 415 (Ind. 1952), and Department of State Revenue v. Crown Dev. Co., 109 N.E.2d 426 (Ind. 1952), held that the assumption of a taxpayer-seller's liability by a purchaser of the encumbered property was not taxable as a constructive receipt to the seller because it was only an indirect benefit to the seller and not a direct benefit as contemplated by Indiana Code § 6-2.1-1-11.

Certain allowable deductions from gross income are set out in Indiana Code § 6-2.1-4. Outside of these specific exceptions, no deductions may be taken for return of capital invested, cost of property sold, cost of materials used, labor costs, interest, discounts, commissions paid or credited, losses, or any other expense paid or credited. See Indiana Code § 6-2.1-1-2(b). These deductions will be explored in detail later in the discussion of Chapter 4.

Chapter 1 of Indiana Code § 6-2.1, however, lists certain exclusions from gross income. There are twenty-two types of receipts which do not come within the definition of "gross income"; these are as listed in Indiana Code § 6-2.1-1-2(c):

1. The receipt or repayment of borrowed money;
2. Receipts from the issuance or redemption of bonds;

3. Amounts received as payment of the principal amount of a note taken in lieu of cash if:
   A. The face value of the note was included in the taxpayer's gross income at the time of acceptance;
   B. The note was taken before May 1, 1933; or
   C. The note is a renewal of a note that was taken before May 1, 1933;

4. Amounts received in payment of, or from the sale of, a promissory note or retail installment contract described in subsection (f) of this section to the extent the gross income tax has previously been paid for the receipt of the promissory note or retail installment contract;

5. Amounts received as withdrawal of deposits to the extent they constitute principal;

6. 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 (including the disposal of capital assets or other properties which were acquired and used in such trade or business;

7. That part of a commission received by a real estate broker that is paid within five (5) days of the receipt of the commission to a cooperating broker or to an associated broker or salesman;

8. Amounts received by a corporation or a division of a corporation owned, operated, or controlled by its member electric cooperatives as payment from the electric cooperatives for electrical energy to be resold to their member-owner consumers;

9. Amounts received by an association of members or a corporation as:
   A. Regularly paid dues, initiation fees, or membership fees paid for social membership; and
   B. Amounts paid to the organization by members if:
      i. The organization is organized not for profit;
      ii. Such amounts are payable upon the death of a member and do not exceed one dollar ($1.00) payable by each surviving member at the death of any one member;
      iii. The number of members who are permitted to make such payments does not exceed one thousand seven hundred (1,700) at any one time;
      iv. The total amount paid to the beneficiary of any one deceased member does not exceed one thousand dollars ($1,000); and;
      v. The amounts received are only for the purpose of paying reasonable expenses of the organization
and payments to beneficiaries of deceased members;

10. Amounts received as the corpus of an outright gift, devise, or bequest;

11. Cash discounts allowed and taken on sales;

12. Goods, wares, or merchandise, or the value thereof, returned by customers if the sale price is refunded either in cash or by credit;

13. Judgments for income that are not taxable under this article;

14. The receipt of capital by a corporation, partnership, firm, or joint venture from the sale of stock or shares in such corporation, partnership, firm, or joint venture, or contributions to the capital thereof;

15. The gross receipts represented by the value of real or tangible personal property received in reciprocal exchange for real or tangible personal property of like kind by and between the owners of the property to the extent of the value of the property or the interest therein of which title is surrendered;

16. The gross receipts represented by the value of stock of a corporation or association received in a reciprocal exchange by and between the owners of the stock (including the issuing corporation or association) for stock in the same corporation or association to the extent of the value of the stock or the interest therein of which title is surrendered;

17. The gross receipts represented by the value of bonds or similar securities issued by a corporation or association received in a reciprocal exchange by and between the owners of the bonds or securities (including the issuing corporation or association) for bonds or similar securities issued by the same corporation or association to the extent of the value of such bonds or similar securities or the interest therein of which title is surrendered;

18. The gross receipts represented by the value of stocks, bonds, or other securities received in a reciprocal exchange by and between the owners of the stocks, bonds, or other securities for other stocks, bonds, or other securities to the extent title is surrendered, if the exchange is made in the course of a consolidation, merger, or other reorganization and the stock, bonds, or other securities received are issued by one or more corporations or associations that are each a party to the reorganization;

19. The gross receipts represented by the value of stocks, bonds, or other securities received in a reciprocal exchange by and between the owners thereof of substantially all of the assets of another corporation if the exchange is made in the course of a consolidation, merger, or other reorganization and the stocks, bonds, or other securities received are issued by one or more corporations or associations that are each a party to the reorganization;

20. In the case of insurance carriers, amounts that become or are used to maintain a reserve or other policy liability, to
21. In the case of domestic insurance carriers, premium income that is derived from business conducted outside Indiana on which the domestic carrier pays a premium tax of one percent (1%) or more; and

22. Amounts received by a joint agency established under Indiana Code § 8-1-2.2 that constitutes a payment by a municipality that is a member of the joint agency for electrical energy that will be sold by the municipality to retail customers.

Of these 22 exclusions, some stand out as either more significant or more controversial. An analysis of some of these exclusions from gross income reveals the following.

The exclusion in Indiana Code § 6-2.1-1-2(c)(4) applies to the sale of a promissory note or other similar type of instrument when the amount of the underlying transaction has been included in gross income. This reflects a policy of double taxation avoidance - the second transaction should not be taxed because the taxation of the sale of a note could discourage the negotiability of instruments. However, the requirements that the underlying transaction be taxed in order to qualify for the exclusion poses a dilemma for interstate sales of notes. The sale of a note in which the underlying transaction occurred in interstate commerce is subject to the gross income tax of Indiana because it was not previously taxed.

The exclusion in Indiana Code § 6-2.1-1-2(c)(6) is very significant for Indiana corporations with out-of-state operations. As long as an Indiana domiciled corporation derives receipts from operations originating from a non-Indiana business situs, those receipts are not taxed. This provision is a federal constitutional limitation on state taxing authority.

The cash discount exclusion of Indiana Code § 6-2.1-1-2(c)(11) has been the subject of two recent Indiana Court of Appeals decisions, which were noted in a recent survey of Indiana taxation in the Indiana Law Review. See Hetzner & Lindemann, “Taxation,” 18 Indiana Law Review 389. In the first case, which dealt with a sales tax issue, Indiana Department of Revenue v. Marsh Supermarkets, Inc., 412 N.E.2d 261 (Ind. Ct. App. 1980) the court in a decision for the taxpayer Marsh held that customer coupons used by the store to entitle customers to enjoy discounts, reduced the amount of the sale subject to sales tax to the price less the discount distributed to the customer. Concomitantly, such reduction was seen to reduce the gross income tax base - qualification for the Indiana Code § 6-2.1-1-2(c)(11) exclusion should naturally follow since the store never received any cash for the coupon.

Another type of discount discussed in the Marsh case was a supplier or manufacturer coupon. Unlike the store coupon, in which Marsh never received the discounted amount because it just excluded the amount from the price, a supplier coupon works by presentation of the coupon by the customer, acceptance by Marsh and a reduction in the price recorded in the cash...
register. To recoup this recorded cash shortage, Marsh presented the used coupon to a clearing house where it was paid for by the supplier. The precise holding in Marsh was that receipts for supplier coupons were exempt from sales tax. The receipts received by Marsh as reimbursement for the value of the supplier coupon were held to actually be quantity discounts from the supplier on the goods purchased by Marsh and not subject to gross income tax. Service fees (for handling costs) received in conjunction with the reimbursement were properly reported as income from services rendered.

The second case, Indiana Department of State Revenue v. Kroger Co., 453 N.E.2d 1175 (Ind. Ct. App. 1983), dealt directly with the Indiana gross income tax. At issue was whether the grocery's gross receipts should be reduced by the amount of Top Value Stamps given to its customers who in turn redeem the stamps for merchandise or cash based on the cash redemption value of the stamps. Kroger argued that the Indiana Code § 6-2.1-12(c)(11) exclusion applied stating that the fee paid to Top Value represented a "cash discount" given its customers and served to reduce the price paid for goods. The state countered with the argument that the stamp issuance should not be a cash discount because it was an advertising scheme and therefore a nondeductible cost of doing business.

The court agreed with the state insofar as finding that there was some advertising impact from the stamps, but it decided the case in favor of Kroger. The court held that the purchase of the stamps and later distribution to Kroger customers resulted in a cash discount. The court's economic analysis lead to the conclusion that Kroger customers were given what amounted to cash discounts, when presented the stamps, because they had a redeemable cash value. Therefore, Kroger could reduce its gross income by the amount of the fee paid to Top Value.

Even though the ultimate decision in Kroger is considered sound there has been criticism of the decision with respect to the extent of the exclusion. The court was willing to permit Kroger to exclude its payments to Top Value as the equivalent to the value customers of Kroger received upon trading the stamps back in after a purchase. This method of determining the exclusion may be inaccurate, because the reduction from total receipts is not the actual value of trading stamps either issued to or exchanged by customers. The reduction in gross income under this holding can exceed the value of stamps distributed because Kroger's payment to Top Value would not necessarily occur in the same tax year and in the same amount as the actual distribution of stamps. A better decision, which would require greater accounting cost, would have been to limit the exclusion from gross income to the redeemable cash value of the stamps distributed in the tax year.

The exclusion for returned goods, in Indiana Code § 6-2.1-12(c)(12), is a double tax relief measure for corporations engaged in selling property which is later returned by the customer. Gross income does not include the receipts from sale of goods later returned by the purchaser who receives a credit for the purchase amount. However, total relief may not be available under
this exclusion where the sale was a transaction involving periodic payments since the installment sales method is not recognized for Indiana gross income tax purposes. For example, the seller of a vacant lot for the sale price of $25,000 receives $500 and a note to pay the balance of $24,500 in year two and following. In year one the seller reports $25,000 gross income. Two years later when the buyer defaults, the seller forecloses and resells to another for $25,000. The seller must report $25,000 gross income for that year.

The special provision for the recognition of Indiana gross income from installment contracts is in Indiana Code § 6-2.1-1-2(f). The total face value of a retail installment contract or promissory note derived from the sale of personal property should be included in Indiana gross income in the year it is received. In the case of a conditional sale of an interest in real property, in which title to the property passes after the last payment, payments received in a taxable year prior to the taxable year in which title is transferred should be included in gross income in the year of payment. See Indiana Code § 6-2.1-2-10.

Nontaxable "exchange" is defined as a swap or barter between two parties (two parties only). The property exchanged is owned by the parties thereto at the time the exchange agreement is entered into. The exchange is subject to gross income tax if a third party is involved, because of an anti-tax avoidance rule against using pre-existing contracts. See 6-2.1-1-2(g)(1) and 45 IAC 1.1-6-6. "Like-kind", as used in Indiana Code § 6-2.1-1-2(c)(15), is defined as property of the same class and kind without regard to grade or quality. See Indiana Code § 6-2.1-1-2(g)(2) and 45 IAC 1.1-6-6(a).

Because of the nature of certain businesses a different definition of gross income is required. This favored tax treatment or "gross profit basis" tax is not as advantageous as a net income basis tax, but it does provide some relief to the pyramid tax effect phenomena which may occur in these special industries. For these businesses, gross income is defined as gross earnings or gross receipts less certain allowable costs. The amounts subtracted generally represent a return of capital invested. Taxpayers as defined in sections 3 through 9 of Indiana Code § 6-2.1-1 can qualify under this gross earnings method and enjoy special beneficial calculations of gross income. (Numerous administrative hearings have resulted from these sections.)

Logically, a taxpayer will attempt to qualify its business operations within one of the above referenced sections in order to reduce its gross income by certain costs. Gross earnings consist of: the total gross receipts without any deductions whatsoever from such income as commissions, carrying charges, interest, dividends, fees, rentals and services but not limited thereto; the gross difference, on the sale or other taxable disposal of tangible or intangible property acquired in transactions forming a part of normal business, between the initial cost of such property to the seller and the total selling price without any deductions whatsoever; and, with regard to rights acquired in margin transactions, "gross receipts" shall be the difference between the initial cost of such rights without any deductions whatsoever. See 45 IAC 1.1-1-12 and 45 IAC 1.1-1-18.
The first taxpayer allowed to deduct certain costs from gross receipts is "livestock dealers". This taxpayer must purchase livestock for the purpose of immediate resale. Indiana gross income is equal to the gross earnings derived from the resale. See Indiana Code § 6-2.1-1-3 and 45 IAC 1.1-1-15.

Next the wholesale grocers. See Indiana Code § 6-2.1-1-4 and 45 IAC 1.1-1-18. Wholesale grocers "gross income" is the gross earnings that are derived from wholesale sales of grocery stocks, tobacco products, and expendable household supplies to retail food establishments. "Gross earnings" means the gross receipts derived from the wholesale sale of grocery stocks, tobacco products, and expendable household supplies that are customarily sold through retail food establishments, less the cost of the stocks of groceries tobacco products, and expendable household supplies. See Indiana Dep’t of State Revenue v. Best Ever Cos., 495 N.E.2d 785 (Ind. Ct. App. 1986), rejecting the definitions of "wholesale grocer" used in 45 IAC 1-1-77 (Reg. § 6-2-1-1(s)(010)) (now embodied in 45 IAC 1.1-1-18). The Indiana Court of Appeals dealt with the proper method of calculating gross earnings in Indiana Department of State Revenue v. Food Mktg. Corp., 403 N.E.2d 1093 (Ind. Ct. App. 1980), making a very broad interpretation of Indiana Code § 6-2.1-1-4 by allowing the reduction of gross receipts by not only the cost of the goods sold but also all necessary costs in preparation of the goods for resale (including any warehousing expenses.)

Next are "grain dealers". See Indiana Code § 6-2.1-1-5 and 45 IAC 1.1-1-13. Gross earnings is equal to the gross receipts derived from the sale of whole grain and soybeans less the cost of the whole grain and soybeans, without any deductions of any other kind or character. Determining the "cost of whole grain and soybeans" was the subject of litigation in Johnson County Farm Bureau Co-op. v. Indiana Department of State Revenue, 568 N.E.2d 578 (Ind. Tax Ct. 1991), aff’d, 585 N.E.2d 1336 (1992). Again, the court broadly interpreted the statutory language and found the taxpayer could deduct the total amount incurred in order to sell the grain, the price of the grain itself, freight-in, and freight-out costs.

Another taxpayer allowed a cost reduction are "grain purchasers and sellers". See Indiana Code § 6-2.1-1-7 and 45 IAC 1.1-1-13(e). Where the United States government prescribes both the purchase and sale prices of whole grain and soybeans, gross earnings is equal to the fixed margin between the prices.

"Domestic casualty and fire insurance carriers" also benefit from a reduction to gross receipts. See Indiana Code § 6-2.1-1-6 and 45 IAC 1.1-1-14. Gross earnings for these types of carriers is equal to the total amount derived as premiums, interest, rents, and dividends less any amount used to maintain a reserve or other policy liability to the extent required by the State of Indiana.

"Various financial institutions"; i.e., anyone engaged in the business of lending money are also taxed on their gross earnings, which is interest income less net interest expense. There is no deduction for day to day operating expenses. See Indiana
The last taxpayer to benefit from the gross earnings calculation is "qualified lessors". See Indiana Code § 6-2.1-1-9 and 45 IAC 1.1-1-16. Certain taxpayers engaged solely in leasing tangible personal property may qualify under the gross earnings method. (This does not include a real estate company.) For these taxpayers, gross earnings is equal to the total rental payments received under a lease less the cost of the property so leased. In order to qualify the taxpayer must not have acquired the personal property for any purpose other than leasing it to others. In addition, the lease agreement must have a term of at least five (5) years, and the total of the lease payments should equal the cost of the property plus finance charges. Thus, a car dealer can not take cars out of inventory in order to lease them; he must have purchased them with the express purpose of leasing.

The next matter to consider is the different Indiana gross income tax rates. One of two rates is applied to gross income depending upon the particular source of receipts; i.e., the type of activity generating the receipts. These are the "low-rate" of 0.30% and the "high rate" of 1.2% effective in 1986 and locked in by the legislature in 1987. Indiana's reliance on gross income tax revenue generation prompted the legislature to maintain the 1986 rates overriding the opposition that the tax is antibusiness and inconsistent with the legislative goal to attract more business to the state.

A policy behind the application of two different Indiana gross income tax rates is the attempt to avoid the potential unfairness in applying a single rate to taxpayers with high profit margins and taxpayers with low profit margins. For instance, a single rate may be inequitable where there are equal amounts of gross revenue, one with a high cost of doing business, while the other has a relatively low cost of doing business. If the same rate was applied to both taxpayers, the one with a high cost of doing business would bear a much greater tax burden.

A list of the type of revenue producing activities properly taxed at the low rate can be found at Indiana Code § 6-2.1-2-4. The most prevalent types of activities taxed at the lower rate include "selling at retail" and "wholesale sales". A list of the types of revenue producing activities properly taxed at the high rate can be found at Indiana Code § 6-2.1-2-5. This high rate classification contains an additional "catch-all" provision; i.e., all activities not listed in Indiana Code § 6-2.1-2-4 as a low rate activity are taxed at the high rate.

An important fact to be aware of is that many Indiana Department of State Revenue corporate tax return audits have resulted in a reclassification of the taxpayer's operations from a low rate activity to a high rate activity. It only follows that certain of the low rate activities listed below are the subject of much litigation.

Activities classified under the low rate begin with "Wholesale Sales". See Indiana Code §6-2.1-2-4. "Wholesale Sales" are defined at Indiana Code § 6-2.1-2-1(c) to include: sales of tangible personal property (except capital assets or depreciable
assets) for resale in the form in which it was purchased; and, sales of tangible personal property which is to be directly consumed in direct production by a purchaser in the business of producing tangible personal property by manufacturing, processing, refining, repairing, mining, agriculture, or horticulture. Indiana Code § 6-2.1-2-1 defines "consumed" as the immediate dissipation or expenditure of property excluding obsolescence, discarding, disuse, depreciation, damage, wear, or breakage of tools, dies, equipment, etc. A wholesale sale basically involves a sale to someone who will resell the item. Many resells create a pyramiding tax effect against which a lower gross income tax rate provides some measure of relief.

As alluded to above, there has been much litigation with the Indiana Department of State Revenue over wholesale sales classifications because of the lower rate of Indiana gross income tax. A few of these cases will be highlighted beginning with Department of Treasury, Gross Income Tax Division v. Ranger-Cook, Inc., 114 Ind. App. 107, 49 N.E.2d 548 (1943). The proceeds in question here were derived from the preparation of slugs of type for later use by a printer. The taxpayer would prepare "type composition" or slugs from manuscripts submitted by various printers. The printers would later use the slugs in printing for a specific customer. The Department contended that the "slugs of type" were merely tools and equipment; i.e., not sold as a material directly consumed in direct production. The court reasoned that since the slugs could only be used once in a particular job by a printer they were directly consumed in direct production (printing) and hence, the receipts derived from the preparation of the slugs are taxable under the classification of "wholesale sales."

Note that in this particular case the typesetter and printer(s) were separate entities. Where a taxpayer both typesets and prints, the receipts derived therefrom are taxable under the classification of retail sales which is taxed at the high rate.

In Continental Roll & Steel Foundry Co. v. Department of Treasury, 117 F.2d 196 (7th Cir. 1941), the taxpayer manufactured steel rollers and equipment used by steel mills in the production process to shape steel. The useful life of much of the equipment sold was comparatively short, often as short as two weeks. The taxpayer asserted that the equipment was directly consumed in direct production by the steel mill, and therefore, its sales were taxable as wholesale sales. The court held against the taxpayer stating that the equipment did not enter into or become material or integral parts of any manufactured product, but that it was merely a means or an appliance employed in the manufacturing process.

In contrast, the taxpayer in Chrome Deposit Corp. v. Indiana Department of State Revenue, 557 N.E.2d 1110 (Ind. Tax Ct. 1990), aff'd, 578 N.E.2d 643 (Ind. 1991) manufactured chromium metal and applied it to the surface of work rollers used by steel and aluminum mills in rolling out sheets of steel and aluminum. None of the chromium surface metal was integrated into the steel and aluminum sheets. At issue was whether the taxpayer engaged in wholesale sales or whether it provided repair service on the work rolls. The court found that the taxpayer engaged in wholesale sales and thus was not subject to the higher gross
income tax rate applicable to revenues generated by service activities. The court retreated from a strict reading of Continental Roll and found it was not necessary that the chromium be directly integrated into the steel and aluminum sheets produced by the taxpayer's customers. Instead it was sufficient that the chromium metal dissipated in the production process.

"Wholesale sales" also include: sales of tangible personal property to be incorporated as a material or integral part of tangible property produced by a purchaser in the business of manufacturing, assembling, constructing, refining, or processing; and, receipts from industrial processing or servicing, including the enameling and plating of tangible personal property which is owned and is to be sold by the person for whom the servicing and processing is done, either as a complete article or incorporated as a material, or as an integral or component part of tangible personal property produced for sale by such person in the business of manufacturing, assembling, constructing, refining, or processing.

In State of Indiana Department of Revenue v. Apex Steel & Supply Co., 375 N.E.2d 598 (Ind. Ct. App. 1978) the receipts in question were derived from the taxpayer's bailing of loose scrap steel owned by Inland Steel Corp. once in a compressed form, Inland Steel could reuse the scrap steel in its manufacturing process. The Indiana Department of State Revenue contended that receipts from industrial servicing and processing were taxable at the lower gross income rate only when it involved adding some kind of tangible personal property to the property being processed. The court broadly interpreted the statute to include those operations or services performed on another's property where no tangible person property was added by the taxpayer. Note that this provision only applies where the property being serviced is to be resold by its owner in a regular course of trade or business.

In Faris Mailing Inc. v. Indiana Department of State Revenue, Sales and Use Tax Division, 512 N.E.2d 480 (Ind. Tax Ct. 1987), the Tax Court of Indiana held that income from processing or preparing items for mailing which are to be used for mailing or contained in a mailing for customers is not income from "wholesale sales." The tax court stated the wholesale sales exemption under Indiana Code § 6-2.1-2-1(c)(1) belongs to the taxpayer if the taxpayer's customer incorporates the property which the customer has purchased in some other property the customer produces. The tax court found that the taxpayer's activity was a "provision of services of any character" and receipts from the activity are taxed at the high gross income tax rate under Indiana Code § 6-2.1-2-5(9).

"Wholesale sales" also include sales of drugs, medical and dental preparations, and other similar materials to be directly consumed in professional use by doctors, hospitals, embalmers, and tonsorial parlors; sales of tangible personal property to be directly consumed by the purchaser in the business of industrial cleaning; and, the sales of tangible personal property to be directly consumed by the purchaser directly in the business of rendering public utility service. Note that the use of which the
purchaser intends to make of the article purchased will concern the seller in determining the gross income tax rate applicable to the receipts from particular sales. See Indiana Code § 6-2.1-2-1 and Indiana Code § 6-2.1-2-1.2 and 45 IAC 1.1-1-12.

Another activity classified under the low gross income tax rate is display advertising, which includes outdoor painted posters, radio and television advertising, but does not include any sale or rent of tangible property or any professional service rendered in connection with such advertising. See Indiana Code § 6-2.1-2-4(2) and 45 IAC 1.1-2-3.

The low gross income tax rate also applies to the business of dry cleaning and laundering, excluding the operation of coin operated laundry and dry cleaning equipment. See Indiana Code § 6-2.1-2-4(3) and 45 IAC 1.1-2-2 and 45 IAC 1.1-2-9.

The most important low rate activity is "selling at retail", which is defined at Indiana Code § 6-2.1-2-1(b)(1) as a "transaction in which a retail merchant in the ordinary course of his regularly conducted business transfers the ownership of tangible personal property to another, conditionally or otherwise, for consideration, if the retail merchant had previously acquired that tangible personal property for the purpose of reselling it and the transferee acquiring the property does not acquire the tangible personal property for the purpose of making a wholesale sale." This essentially involves the selling of inventory to be contrasted with the selling of fixed assets. Inventory is an asset of which the taxpayer is in business to sell; whereas, a fixed asset is used in the business. The sale of a fixed asset in such a case is a "retail sale" taxed at the high gross income tax rate.

In Walgreen Co. v. Gross Income Tax Division, 75 N.E.2d 784 (Ind. 1947), the court found that the taxpayer was properly taxed on amounts deducted from employee wages for goods so obtained by employees. The receipts constituted gross income since the taxpayer acquired the goods for the purpose of resale. The transaction also constituted a "sale at retail".

A sale must meet four standards in order to be classified as "selling at retail". See 45 IAC 1-1-13 (Reg. § 6-2-1-1(k)(O10)). First, the sale must be made by a retail merchant. Retail merchant is defined at Indiana Code § 6-2.1-1-12 and 45 IAC 1-1-11 (Reg. § 6-2-1-1(j)(O10)) as one "who is regularly and occupationally engaged in purchasing tangible personal property..." for the purpose of reselling it at an established place of business.

Second, ownership of tangible personal property is transferred conditionally or otherwise. According to Regulation 45 IAC 1-1-11 (Reg. § 6-2-1-1(j)(O10), tangible personal property refers to inventory or stock in trade intended for sale in the ordinary course of the retail seller's business. "Selling at retail" is distinguished from "retail sales at 45 IAC 1-1-14 (Reg. § 6-2-1-1(k)(O20)). While receipts from "selling at retail" are taxable at the low gross income tax rates, "retail sales" receipts are taxable at the high gross income tax rate.

Third, "selling at retail" is a transfer in the ordinary course of a merchant's regularly conducted business, whereas, retail sales are not. For instance, a sale of a retailer's old display equipment is a transaction out of the regularly conducted business and
is taxed at the high gross income tax rate as a "retail sale." 45 IAC 1-1-13 (Reg. § 6-2-1-1(k)(010).

Fourth, the sale is made either with or without the rendering of associated services. Under Indiana Code § 6-2.1-21(b)(2), gross income derived from selling at retail is calculated to include only the price of the property transferred without the rendition of any services. Any bona fide charges separately stated on the records of the transferor may be added to or included in consideration for the preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to the property transferred before the tangible personal property is delivered to the transferee or to the place of delivery designated by the transferee. The rule established by Department of Revenue v. William A. Pope Co., 367 N.E.2d 47 (Ind. Ct. App. 1977) is that any income from services performed in connection with selling at retail and before delivery of the product would be taxed as a part of the sale at the low gross income tax rates. In addition, any income from services performed in relation to the sale but after the delivery of the product would be taxed at the high gross income tax rate. Further explanation is supplied by 45 IAC 1-1-15 (Reg. § 6-2-11(k) (030)).

Another low rate activity is the business of softening and conditioning water, including the exchange of water softening and conditioning tanks in the ordinary course of business, but not including the preparation of customer's plumbing and other work incident to installing such tanks in the first instance. See Indiana Code § 6-2.1-2-4(5).

The low gross income tax rate is also applied to the renting or furnishing for periods of less than 30 days any rooms, lodgings, or any other accommodations, including booths, display spaces, and banquet facilities that are located in a place where rooms, lodgings, or any other accommodations are regularly furnished for a consideration. See Indiana Code § 6-2.1-2-4(6).

The final activity qualifying for the low gross income tax rate is the business of commercial printing that results in printed materials, excluding the business of photocopying. See Indiana Code § 6-2.1-2-4(7).

A special rule was recently enacted that exempts from gross income taxation the receipts derived from if the printed material is shipped, mailed, or delivered outside the State of Indiana. See Indiana Code § 6-2.1-3-3.5.

Since taxpayers generally prefer to classify their revenue producing activity under the low gross income tax rate, there is little need for an in-depth discussion of those activities falling under the high gross income tax rate classification. The rationale for imposing a high gross income tax rate for certain activities is that the businesses so engaged are able to absorb more tax because they enjoy higher profit margins. Those activities classified under the high gross income tax rate as found in Indiana Code § 6-2.1-2-5 include:

1. Producing, transmitting, furnishing, wholesaling, or retailing electrical energy;
2. Producing, transporting, furnishing, wholesaling, or
retailing artificial gas, natural gas, or a mixture of natural and artificial gas;

3. Operating a steam or electric railway, streetcar line, motor vehicle, steam or motorboat, or any other vehicle for the transportation of freight express, or passengers for hire;

4. Operating a pipeline for the transportation of any commodity for hire;

5. Operating a telephone or telegraph line;

6. Operating a water or sewage system;

7. Operating any other utility which is not described here;

8. Activities taxable on the gross earnings basis; and

9. Any activity which is not described under the low rate classification in Indiana Code § 6-2.1-1-4, including the provision of services of any character, sales of real estate, rentals (except rentals described in Indiana Code § 6-2.1-2-4(6)), the performance of contracts, and the investment of capital.

Some transactions contain receipts which fall under both types of rates. The general rule when a transaction has both types of receipts is that the whole is taxed at the higher gross income tax rate. However, many revenue producing activities are severable, allowing the receipts therefrom to be only partially taxed at the high gross income tax rate while the remaining portion is taxed at the low gross income tax rate. Generally, the issue is whether a given transaction can be split between a sale of property and the provision of services. The applicable rate depends upon the classification of each income generating activity and not the scope or nature of the taxpayer's general business. See Oster v. Dep't of Treasury, 37 N.E.2d 528 (Ind. 1941). A valid cost accounting system for segregating mixed transactions should be in place; separately stating a service fee on the invoice is also recommended for full audit trails.

There are 36 specific exemptions from the gross income tax of Indiana. They are listed in Indiana Code § 6-2.1-3-1, seq. First, interest paid on obligations of the federal government is exempt. See Indiana Code § 6-2.1-3-1 and Information Bulletin #79. This is the result of the constitutional prohibition against a direct income tax being assessed on federal obligations. The designation of a "direct income tax" cannot be avoided by changing a direct tax to a franchise tax. To qualify for the exemption the U.S. obligation must be a direct obligation of the U.S. government such as government bonds; Fannie Mae and others obligations guaranteed by the federal government do not qualify for an exemption. See 45 IAC 1.1-3-1. “Securities issued by the federal government” does not include securities issued by an entity sponsored by, but not a part of, the federal government, or securities guaranteed by, but not issued by, an agency of the federal government. See 45 IAC 1.1-3-1(c).

According to Information Bulletin #19, the Indiana Department of Revenue recognizes the following list of United States
obligations:

Banks for Cooperatives
Central Banks for Cooperatives
Commodity Credit Corporation
District of Columbia
Export-Import Banks of the United States
Farm Credit Banks
Farmers Home Corporation
Federal Deposit Insurance Corporation
Federal Farm Loan Corporation
Federal Financing Banks
Federal Home Loan Banks
Federal Housing Administration
Federal Intermediate Credit Banks
Federal Intermediate Credit Corporation
Federal Land Banks Association
Federal Land Banks
Federal Savings and Loan Insurance Corporation
Home Owner's Loan Corporation
Joint Stock Land Banks (farm loan bonds and mortgages)
Maritime Administration (Merchant Marine Bonds)
Production Credit Association
Student Loan Marketing Association (20 U.S.C. Section 1087-2)
Series E, F, G, ~ H Bonds
Small Business Administration
Tennessee Valley Authority (bonds only)
U.S. Government Bonds
U.S. Government Certificates
U.S. Government Notes
U.S. Housing Authority
U.S. Treasury Bills
U.S. Maritime Commission
U.S. Possessions - obligations of Puerto Rico, Virgin Islands, Guam, etc.
U.S. Postal Service (bonds)

The proportionate share of dividends or interest received from a Mutual Fund, Money Market Fund, Regulated Investment Trust or other investment fund derived from investments in direct U.S. government obligations will be allowed as a deduction in the computation of Indiana gross income tax and Indiana adjusted gross income tax. This deduction will be allowed to the extent such income is included in Indiana gross income or Indiana adjusted gross income. (For purposes of this deduction, earnings from investing in repurchase agreements are not considered to be derived from direct obligations of the U.S. government.)

The following sources of obligations are not considered United States obligations:

Building and Loan Associations
District of Columbia Armory Board
FSLIC secondary reserve prepayments
Farmer's Home Administration
Federal or State Savings and Loan Associations
Federal Home Loan Mortgage Corporation participation certificates in mortgage pools
Federal Home Loan Time Deposits
Federal National Mortgage Association (including dividends from FNMA stock)
GI Loans
Government National Mortgage Association (including participation certificates)
Inter-American Development Bank
International Bank for Reconstruction and Development (World Bank obligations)
Obligations issued under the New Commodities Act (Interstate and development bonds)
Panama Canal Bonds
Participating loans in the Federal Reserve System for member banks (Federal funds)
Philippine Bonds
Reconstruction Finance Corporation
Student Loans
U.S. Postal Service certificates and savings deposits
Repurchase Agreements

Also, interest or dividends received in the following instances is not exempt for gross income tax or adjusted gross income tax purposes:
Debentures issued to mortgage or mortgages foreclosed under the provisions of the National Housing Act.
Interest bearing certificates issued in lieu of tax exempt securities, such income losing its identity when merged with other funds
Promissory notes of a federal instrumentality
Refunds of Federal income tax
Earnings from repurchase agreements
Obligations of the State of Indiana
Any direct obligation of the State of Indiana or a political subdivision of the State of Indiana is nontaxable for purposes of the Gross Income Tax Act and the Adjusted Gross Income Tax Act.

The Effect of Government Obligations on Indiana Gross Income Tax
For Indiana gross income tax purposes, corporate taxpayers must report all interest received. The only interest exempt from this tax is that derived from direct United States Government obligations and accumulated interest on bonds of Indiana municipalities or taxing subdivisions.

Interest on bonds, notes or other obligations of states or their subdivisions) other than in Indiana is taxable for gross income tax purposes. Consequently, interest from bonds issued by public housing authorities in Indiana is nontaxable while interest from bonds issued by public housing authorities in other states is taxable.

Receipts from the issuance of corporate bonds are not subject to taxation. Receipts from the redemption of bonds are not considered to be gross income; however, any gain realized or interest accumulated at the time of redemption is taxable at the higher rate under IC 6-2.1-2-5. The only interest exempt from tax is that derived from direct United States Government obligations and accumulated interest on bonds of Indiana municipalities or taxing subdivisions.

Gross income from the sale of any bond, note or other obligation held for investment purposes is taxable as gross receipts unless the sale is exempt under IC 6-2.1-3-3 (commerce clause) of the Gross Income Tax Act. If the corporation is permitted to compute its income under the gross earnings basis as described in IC 62.1-1-8, only the gain from the sale of the securities is taxable with the exception of those nontaxable sales in interstate commerce. This would include receipts from the sale of United States Government obligations and Indiana state and municipal obligations which are taxable to the extent of any profit or gain.

The Effect of Government Obligations on Indiana Adjusted Gross Income Tax
All interest reported for federal tax purposes must be reported for Indiana adjusted gross income tax purposes. However, in determining taxable interest income for Indiana adjusted gross income tax purposes, a deduction may be taken for interest received on direct obligations of the Federal government or its agencies, as required under 31 U.S.C. Section 3124. The exemption for Government obligations is not a total exclusion, and may be limited by charging the obligations and interest thereon their fair share of related expenses. However, the deductions generated by the expenses are limited to the amount of income generated.
by the obligation.
NOTE: Although municipal bond interest (including interest on public housing bonds) and bond interest from United States government obligations are excludable, the gain derived from the sale of tax-exempt municipal bonds and United States government obligations held as investments is not exempt. The gain to be reported for Indiana tax purposes is the gain reported for Federal income tax purposes. Losses sustained are deductible, subject to capital loss limitations.

Information Bulletin #19.
Second, “gross income derived from sales to the United States Government is exempt from gross income tax to the extent the State of Indiana is prohibited by the United States Constitution from taxing that gross income.” See Indiana Code § 6-2.1-3-2. “The income from such sales is taxable even though the gross income tax is paid indirectly by the federal government, either as a reimbursement or as an inclusion in the purchase price.” See 45 IAC 1.1-3-2. However, in another state; i.e., the State of West Virginia; where the gross income tax of the State of Indiana is imposed upon the seller, sales to the United States Government are taxed. This is because the tax is not imposed against the government; rather, it is imposed against a citizen seller.

Third, income from transactions in interstate commerce is exempt, but only to the extent that the state is prohibited from taxing such income by the United States Constitution. See Indiana Code § 6-2.1-3-3. “‘Interstate commerce’ means business conducted by the taxpayer between Indiana and another state or a foreign country . . . Gross income derived from the sale of tangible personal property in interstate commerce is not subject to the gross income tax if the sale is not completed in Indiana.” See 45 IAC 1.1-3-3. 45 IAC 1.1-3-3 provides numerous examples where a sale is not completed in Indiana prior to or after shipment in interstate commerce. This exemption is the most far-reaching exemption and has been the subject of more litigation concerning the gross income tax of the State of Indiana than any other area. The two questions which are constantly raised with respect to the constitutionality (or due process requirements) of imposing the gross income tax of the State of Indiana are: first, whether a sufficient nexus or connection between the taxpayer and Indiana exists; and, second, whether the tax is confiscatory as contrary to the Commerce Clause of the United States Constitution (i.e., whether it is so burdensome that it is unfair, and whether the benefits received by the taxpayer are commensurate with the tax imposed upon it).

The exemption under Indiana Code § 6-2.1-3-3 developed as follows. During the early development of the law of taxation of gross receipts, the U.S. Supreme Court looked with disfavor upon taxes involving gross receipts from interstate transportation and communication services. The Court struck down taxes on gross receipts from interstate transportation reasoning that gross receipts received therefrom were as necessary to the commerce as the transportation itself; the tax was an attempt to regulate interstate commerce, a power reserved exclusively to Congress. See Fargo v. Michigan, 121 U.S. 230 (1887); and, Philadelphia & Southern S.S. Co. v. Pennsylvania, 122 U.S. 326 (1887). (The same reason was applied to ban the taxation of gross receipts from interstate communication services. See Western Union Tel. Co. v. Alabama, 132 U.S. 472 (1889); and,
Ratterman v. Western Union Tel. Co., 127 U.S. 411 (1888). Eventually the commerce clause was construed to bar taxes on gross receipts derived from other types of interstate commerce. Crew Levick Co. v. Pennsylvania, 245 U.S. 292 (1917).

Prior to 1938 a state of Indiana tax on gross receipts derived from interstate commerce was unlikely to survive a commerce clause attack unless the tax was levied in lieu of a property tax. As such, the tax was supposed to be a fair substitute for a property tax and the taxed gross receipts were supposed to constitute a fair measure of the value of a local activity or event. Gross receipts taxes were sustained if they amounted to no more than the ordinary tax upon property or a just equivalent thereof. Where the tax was in addition to property taxes, it generally was proscribed because of the commerce clause. New Jersey Bell Tel. Co. v. State Bd. of Taxes & Assessment of New Jersey, 280 U.S. 338 (1930); Meyer v. Wells, Fargo & Co., 223 U.S. 298 (1912). The Court also permitted gross receipts taxes which were used as a measure of the value of an activity considered by the Court as purely local, even though the receipts were generated by interstate commerce. Gross receipts taxes that were sanctioned by the Court included certain occupation taxes, See Western Union Tel. Co. v. Texas, 105 U.S. 460 (1881), and corporate franchise taxes, See Maine v. Grand Trunk Ry. Co. of Canada, 142 U.S. 217 (1891). The dominant test for taxing was the subject taxed rather than the measure of the tax.

Finally, the Court abandoned the economically empty semantics of the pre-1938 judicial approach to taxation under the Commerce Clause in Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938). The Court found that the validity of the gross receipts tax depended upon whether, in form or substance, the tax could be repeated by another state, so as to make interstate commerce bear a cumulatively greater tax burden than that borne by local business. The text recognizes that interstate commerce should pay its way. Under Western Live Stock, the tax was proper whether it was imposed upon a statutorily designated local activity or directly upon gross proceeds from interstate commerce, provided that receipts were fairly apportioned.

The Indiana gross income tax was the first gross receipts tax to fail the multiple burdens test developed in Western Live Stock. (The earlier gross income tax was statutorily imposed upon the receipt of gross income.) See J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938). In this case the tax was applied to gross receipts from the sale of machinery manufactured in Indiana, but sold out-of-state. Absent any apportionment of the gross receipts, the manufacturer was the subject of discrimination relative to local business.

Several years later the Court temporarily abandoned the "multiple burdens" doctrine. See Freeman v. Hewit, 329 U.S. 249 (1946), reh. den., 329 U.S. 832 (1947). In Freeman, the gross income tax of the State of Indiana was levied upon a sale of stock by an Indiana stockholder (trustee), where the stock was sold through brokers on the New York Stock Exchange, and the proceeds, after deducting expenses and commissions, were transmitted to the trustee-taxpayer in the State of Indiana. In
resurrecting the "direct-indirect" burdens test, Freeman established a per se violation of the Commerce Clause on this interstate sale. The Court regarded the economic effect of the tax as irrelevant in determining whether the tax was offensive to the Commerce Clause. It was not concerned with any showing of discrimination against interstate commerce.

The Court reaffirmed Freeman in the 1951 case of Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602 (1951). In this case, a fairly apportioned, nondiscriminatory net income tax was nullified by the Court on Commerce Clause grounds. The Court concluded that the statute was drafted such that the subject of the tax was the nontaxable privilege of engaging in interstate commerce, although all the taxed income was generated in the taxing state from trucking operations. It was a per se violation of the Commerce Clause no matter how fairly the tax was attributable to business done within the taxing state.

A later case, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), reh. den. 430 U.S. 976 (1977), showed the economically meaningless and formalistic nature of the test of tax validity used in Freeman and Spector. In Complete Auto Transit, a State of Mississippi tax laid for the privilege of engaging in business within the State of Mississippi was applied to a motor carrier, a foreign corporation, that transported motor vehicles by motor carrier for General Motors Corporation. General Motors Corporation shipped the vehicles by rail to Jackson, Mississippi, where they were loaded onto the taxpayer's trucks and transported by it to Mississippi dealers. The tax was imposed upon the gross proceeds paid the taxpayer for those transportation services. In upholding the tax, the Court assumed the activity producing the taxed proceeds was interstate commerce.

However, a state has significant interest in exacting from interstate commerce its fair share of the cost of government of which a taxpayer receives benefits. The Court established four standards which had to be met for such a tax to pass constitutional inspection: (1) there must be a substantial nexus of taxpayer with the taxing state; (2) the tax must be fairly apportioned to the taxing state; (3) there must be no discrimination against interstate commerce; and (4) the tax must be fairly related to the services provided by the state imposing the tax.

The Court extended its decision in Complete Auto Transit to the taxation of gross receipts derived from foreign commerce in Department of Revenue v. Association of Washington Stevedoring Cos., 435 U.S. 734 (1978). It applied the four standards established in Complete Auto Transit to the taxation of gross receipts from the occupation of stevedoring, where the loading and unloading of cargo was in foreign commerce. The Court rejected arguments under both the Commerce Clause and Import-Export Clause. The Court was permissive with respect to those interstate sales where an outof-state purchaser entered the state of origin and took delivery in that state. The gross proceeds from those types of sales have been held taxable in other cases even though the goods were immediately taken out of the seller's state to a destination predetermined by the buyer and seller. See Dep't of Treasury v. Wood Preserving Corp, 313 U.S. 62 (1941), and International Harvester Co. v. Dep't of

It was considered immaterial by the Court that the goods were transported out of the state immediately after delivery. This is based on the legal theory that the transaction is not completed until the goods reach the destination state. From a business viewpoint this is ludicrous because picking up the goods in state should make no difference. The taxation of gross receipts derived from the sale of goods shipped through interstate channels to a purchaser in the taxing state to fill a prior order has also generally been sustained over commerce and due process clause attacks.

In International Harvester, the taxed Indiana gross income included proceeds from sales completed by shipment into the state of destination. The taxpayer in that case asserted that the tax would subject interstate commerce to forbidden multiple tax burdens, because the state of the seller also would likely tax the sale. The Court dismissed the argument with the statement, "It will be time to cross that bridge when we come to it."

In Norton Co. v. Department of Revenue, 340 U.S. 534 (1951), an Illinois occupation tax measured by gross receipts was imposed upon a foreign corporation, which under consent from the State of Illinois, operated a sales office and warehouse in Chicago. All orders for sales made by the taxed Norton-seller in the taxing state were accepted and filled at the taxpayer’s extra-state office. The Court held that the State of Illinois could properly tax the total gross receipts from all sales that utilized the office in the taxing state either in receiving orders, or in distributing goods to the purchasers in the taxing state. However, the State of Illinois could not constitutionally tax those gross proceeds from the sales of orders sent directly by purchasers to the taxpayer’s out-of-state office where the orders were filled, and from which office the goods were shipped directly to the customer in the taxing state.

The thrust of Norton is that when a firm enters the taxing state to do local business by state permission, and has submitted itself to the taxing power of the state, the firm can avoid taxation on sales to customers in that state "only by showing that particular transactions are dissociated from the local business, and (are) interstate in nature." See Norton at 537. "[T]he general rule, applicable here, is that the taxpayer claiming immunity from a tax has the burden of establishing his exemption." Id. Specifically, the firm must show with respect to each category of transactions that the local activities of the branch office in the taxing state were not decisive factors in the establishing and holding the market.

In Associated Milk Producers, Inc. v Indiana Department of State Revenue, 512 N.E.2d 917 (Ind. Tax Ct. 1987), the court upheld the imposition of Indiana gross income tax on receipts from the sale of cheese to an out-of-state buyer. The tax court stated the commerce clause does not prohibit the imposition of tax on proceeds derived from an interstate transaction so long as a local transaction is made the taxable event and that event is separate and distinct from the transportation or intercourse
which is interstate commerce.

More recently, the Indiana Supreme Court in *Hoosier Energy Rural Elec. Coop., Inc. v Indiana Department of State Revenue*, 572 N.E.2d 481 (Ind. 1991), cert. denied, 502 U.S. 924 (1991), declared that the constitutionality of the gross income tax is determined by the four-part test set forth in *Complete Auto Transit*. The court upheld a gross income tax on proceeds from the interstate sale of federal income tax benefits through sale-leaseback property. The taxpayer argued there was insufficient nexus between the state and the transaction which took place entirely out-of-state. Because the intangible which was sold, federal income tax benefits, could not exist separate and apart from the taxpayer and its property, the court reasoned that the taxpayer's business and commercial situs in Indiana established the required nexus.

The Supreme Court affirmed an Indiana decision that sales which are normally exempt because they were made from an out-of-state location are taxable because they were made from an Indiana location of the seller from which the orders could have been filled. See *Dep’t of Treasury v. Allied Mills, Inc*, 42 N.E.2d 34 (Ind. 1942), aff’d per curiam, 318 U.S. 740 (1943). Indiana "safety stocks" or "buffer inventories" which are held to guard against shortages (but are not large enough to fill typical orders on a regular basis) are excepted from the "like-kind goods" rule.

In *General Motors Corp. v. Washington*, 379 U.S. 875 (1964), the Court once again used an analysis of the market-creating and holding effects of local activities in the state of destination in order to sustain a gross receipts tax against General Motors. In this case, the foreign corporate taxpayer's activities in the taxing state were limited to the wholesale sale of motor vehicles, parts, and accessories to in-state dealers. The orders were then sent out-of-state where they were accepted and filled by sources outside the state. The market-creating and supporting of local activities conducted by the taxpayer in the taxing state constituted the basis for sustaining tax exaction by the state. The local activities of the taxpayer's resident employees, operated through the taxpayer's separate divisions in the state. The court found that the "bundle of corporate activity. . . [was so] enmeshed in local connections" that it was sufficient to justify a holding that the local connections were a valid basis for a tax upon the total amount of proceeds from sales by the taxpayer to dealers in the destination state.

*General Motors* lays down as its basic premise that a taxpayer "cannot channel business through a local outlet to gain the advantage of a local business and also hold the immunities of an interstate business." See also *Norton Co. v. Dep’t of Revenue*, 340 U.S. 534 (1951). Thus, where the taxpayer has a division network, each division should be examined separately to determine if a nexus exists; this also applies to product line divisions.

In the 1975 case of *Standard Pressed Steel Co. v Washington Department of Revenue*, 419 U.S. 560 (1975), the state of destination seemed to have gained yet more power to impose taxes on unapportioned gross income derived from interstate
sales. There, the only local connection of the taxpayer-seller with the taxing state consisted of a full-time employee whose primary
duty was to consult with the local buyer, Boeing Corporation (the taxpayer's principal customer) regarding its anticipated needs
and requirements, and to follow up on any difficulties in Boeing's use of the taxpayer's products following delivery. Periodically,
the taxpayer sent consulting engineers into the taxing state to confer with Boeing. Unlike Norton and General Motors, the
employee in this case solicited no orders and made no sales to Boeing. The Court concluded that the employee's "full-time" job
within the state made possible the realization and continuance of valuable contractual relations between appellant (taxpayer) and

It is worthy of note that while the taxed proceeds in Norton and General Motors resulted from some sort of transactional
nexus (the sales people were the local connection), the Court here required only a definite link between the taxpayer and the
taxing state in order to satisfy due process requirements. For a further discussion of the case law above see Commissioner’s
Directive #2.

The fourth exemption is for gross income derived from commercial printing. This special rule applies only if the printed
material is shipped, mailed, or delivered outside Indiana. See Indiana Code § 6-2.1-3-3.5 and 45 IAC 1.1-3-4.

There is another special rule regarding interstate transportation services. The providing of transportation, whether it is
passenger or freight carriage, which occurs completely in-state may be exempt from Indiana gross income tax if that
transportation is a connecting link to interstate commerce. This is a special Indiana statutory provision and is not constitutionally
required. See Indiana Code § 6-2.1-3-4 and 45 IAC 1.1-3-5. This exemption applies to the gross receipts derived from the
transportation of property by truck, motor vehicle, or rail where the transportation is an initial, intermediate or final link in the
interstate transportation. Proof of the linkage is crucial in sustaining a claim of exemption. Otherwise, income received for
transportation between two points in the State of Indiana is taxable, as gross income even if the goods are later shipped outside
the state or were shipped into the state prior to delivery to an Indiana location. See Complete Auto Transit.

In Indiana Department of Revenue v. Western Union Tel. Co., 511 N.E.2d 481 (Ind. Ct. App. 1987), the court of
appeals upheld the imposition of the Indiana gross income tax on the income generated from the transmitting of messages in
interstate commerce. The court stated even if the transaction is entirely an interstate transaction, Western Union must bear a
share of the state tax burden because its facilities, equipment, and servicing are located within the State.

To conclude this discussion on the exemption for interstate commerce, it should be noted again that this is a constitutional
requirement. The policy involved is the avoidance of discrimination against interstate commerce. Interstate commerce should
not have to bear a heavier tax burden than intrastate commerce.
The sixth exemption is for taxes collected or withheld when the holder is acting as a collection agent for either the State of Indiana or the federal government. See Indiana Code § 6-2.1-3-5. A taxpayer is not an "agent" unless the statute imposing the tax explicitly designates the taxpayer as such. Examples of taxes deductible by sellers acting as collecting agents of the state include the sales tax, motor fuel tax, cigarette tax and motor fuel use tax. If the statute does not say that the person collecting the tax is an agent, then there is no exemption. See 45 IAC 1.1-3-6.

The seventh exemption covers retailer's excise taxes imposed by the federal government solely on the retail merchant separately and in addition to the price of the goods sold, and which are properly remitted to the taxing authority. See Indiana Code § 6-2.1-3-6.

Eighth, there is exempt manufacturer's excise tax imposed by the United States on motor vehicles, motor vehicle bodies, chassis, parts, accessories, tires, tubes and tread rubber. See Indiana Code § 6-2.1-3-7.

Ninth, there are exempt gross receipts of insurance companies which pay the State of Indiana a tax in excess of one percent (1%) of premiums. See Indiana Code § 6-2.1-3-8. It should be noted that Indiana has an insurance premium tax which is administered by the Indiana Insurance Commissioner and not the Indiana Department of State Revenue. If an insurance company was incorporated in the State of Indiana it could elect to pay either the premium tax, which was 2% or the Indiana gross income tax of 1.20%. Out-of-state insurers have been required to pay the higher premium tax. This should change now that the Supreme Court in Metropolitan Life Ins. Co. v. Ward, 470 U.S. 869 (1985), ruled that an Alabama statute which imposed a lower premium tax rate upon domestic insurance companies than it did upon out-of-state insurers was unconstitutional. It was struck down as violative of the Equal Protection Clause. The same result may apply in Indiana.

In American Trucking Associations, Inc. v. Scheiner, 483 U.S. 266 (1987) the Supreme Court held that the Pennsylvania axle tax discriminated against interstate commerce because it did not pass the "internal consistency" test. The Supreme Court found that the Pennsylvania tax favored in-state business over out-of-state business for no other reason other than location and, therefore, was a threat to the free movement of interstate commerce and violative of the commerce clause.

Tenth, there are exempt insurance benefits for death or personal injury (excluding interest thereon). See Indiana Code § 6-2.1-3-9.

Eleventh, there are exempt benefits from health or disability insurance. See Indiana Code § 6-2.1-2-10.

Twelfth, there are exempt property damage insurance benefits to the extent actually used to replace the damaged property. See Indiana Code § 6-2.1-3-11.

Thirteenth, there are exempt life insurance, endowment or annuity contract benefits not to exceed the total amount paid
to the insurer for an endowment or annuity contract. See Indiana Code § 6-2.1-3-12.

Fourteenth, there are exempt encumbrances on tangible personal property received by a retail merchant in an allowable exchange. See Indiana Code § 6-2.1-3-13.

Fifteenth, there are exempt sales or reciprocal exchanges of new, untitled and unregistered motor vehicles between registered motor vehicle dealers enfranchised by the same motor vehicle manufacturer or distributor to sell or service vehicles of the same make. See Indiana Code § 6-2.1-3-14.

Sixteenth, there are exempt proceeds received from the condemnation of real estate or sale under threat of condemnation by the State of Indiana or subdivision thereof to the extent that the proceeds are used within two (2) years after receipt to obtain property of a similar kind. See Indiana Code § 6-2.1-3-15.

Seventeenth, amounts received from sales of real estate are exempt to the extent that any mortgage or other similar encumbrance exists on the real estate at the time of its sale. See Indiana Code § 6-2.1-3-16. There is substantial uncertainty about whether this exemption applies when real estate is sold without the formal assumption of debt; i.e., when the seller uses cash to pay off existing debt.

Eighteenth, there are exempt distributive shares of income from previously taxed partnerships, joint ventures or pools. See Indiana Code § 6-2.1-3-17.

Nineteenth, there are exempt distributive shares from fiduciaries to the extent that the fiduciary has already paid a gross income tax liability imposed on that gross income. See Indiana Code § 6-2.1-3-18.

Twentieth, there is exempt gross income received by a fraternity, sorority, or a student cooperative housing organization under the supervision of an exempt college, university, or other educational institution provided that no part of the gross income is used for the private gain of any member, shareholder, employee, or associate of the organization and application for exemption and annual reports are properly filed with the Department. See Indiana Code § 6-2.1-3-19 and 45 IAC 1.1-3-9 and Information Bulletin #90.

Twenty-first, there is exempt gross income received by religious, charitable, scientific, literary, educational, and civic organizations organized and operated exclusively for such purposes provided that no part of the gross income is used for the private gain of any member, trustee, shareholder, employee or associate of the taxpayer and application for exemption and annual reports are properly filed with the Indiana Department of State Revenue. See Indiana Code § 6-2.1-3-20 and 45 IAC 1.1-3-8 and Information Bulletin #90.

Twenty-second, there are exempt amounts received by a group, organization, or nonprofit corporation (which is
organized and operated for fraternal or social purposes, or as a business league or association) as contributions, tuition fees, initiation fees, membership fees, earnings on or receipts from the sale of intangible property, or receipts from a convention, trade show, or exhibition, provided no part of such receipts are for the private gain of any member, trustee, shareholder, employee, or associate (excluding reasonable compensation paid to an employee) and the application for exemption and annual reports are properly filed with the Indiana Department of State Revenue. See Indiana Code § 6-2.1-3-21 and 45 IAC 1.1-3-7. Effective July 1, 1992, a not-for-profit organization granted exemption under IC 6-2.1-3-21 as a fraternal or social organization, or as a business league or association, will be subject to gross income tax on its membership fees or contributions for which the payor receives or may expect to receive specific services or tangible personal property. See Information Bulletin #12.

A distinction should be made between wholly and partially exempt nonprofit corporations. A wholly exempt organization pays no Indiana gross income tax unless it has unrelated taxable income as defined in the Internal Revenue Code. An example would be a school which runs a manufacturing business. Only certain types of income are exempt for a partially exempt nonprofit corporation; e.g., the initiation fee and monthly dues of a country club are exempt, whereas green fees, restaurant/bar receipts and tennis court rentals are taxable.

Twenty-third, there is exempt gross income received by certain types of hospitals provided the taxpayer is not organized or operated for private profit or gain, and the application for exemption and annual reports are properly filed with the Indiana Department of State Revenue. See Indiana Code § 6-2.1-3-22.

The twenty-fourth exemption relates to Indiana Code § 6-2.119-22 above; those exemptions do not apply where the gross income is derived from an unrelated trade or business. See Indiana Code § 6-2.1-3-23 and Information Bulletin #90.

Twenty-fifth, gross income received by a corporation that is exempt from the adjusted gross income tax under Indiana Code § 63-2-2.8(2) is exempt from gross income tax. See Indiana Code § 6-2.1-3-24.

Twenty-sixth, there is exempt gross income received by a "small business" or "special corporation." See Indiana Code § 6-2.1-3-24.5 and 45 IAC 1.1-3-11. Corporations electing Subchapter S status under the Internal Revenue Code, §1361, are exempt from Indiana gross income tax. See 45 IAC 1.1-3-1 and Information Bulletin #12. A corporation is also a "Small Business Corporation" under this exemption even if one of the shareholders is a qualified trust that forms a part of an employee stock ownership plan under §401(a) of the Internal Revenue Code. (This section proves to be advantageous to corporations with operating losses which can be passed through to the stockholders, and with large sales which cannot normally escape the gross income tax of the State of Indiana.) See Information Bulletin #12.

The purpose of the exemption is to reduce the number of corporations electing to be taxed under Subchapter S of the
Internal Revenue Code at the federal level solely to get relief from the gross income tax of the State of Indiana. There was the perception that many corporations elected S status solely to avoid the gross income tax of the State of Indiana. Removing this constraint was expected to raise revenues, since corporations either forming or in existence would either not elect S status or revoke an existing election, which would result in a minimum tax rate of 7% as compared to 3% (rate for individual shareholders) for S-corporation taxpayers. This perceived gain has not been borne out, because the State of Indiana has lost revenues from the revision contained in Indiana Code § 6-2.1-3-24.

The Indiana Department of State Revenue declared that it considers the exemption to be an election, and that it will apply all federal rules for the Subchapter S election to this state exemption as well (e.g., the five-year disqualification rule for a revoked or terminated S-corporation will be applied by the state of Indiana to corporations that make the "Indiana special corporation" election and subsequently fail to meet one of the S corporation requirements). One exception however is that the Indiana Department of State Revenue does not intend to require that the election itself be made in the same manner and within the same time period as the S-corporation election. The special corporation status may be elected simply by indicating that fact in the appropriate area on the corporate income tax return when it if filed, provided that all the requirements for an S-corporation were met throughout the entire taxable year. The one exception is the passive income test. Under the Internal Revenue Code an S-corporation loses its status after four years of passive income; in the State of Indiana that period is limited to one year. Newly elected S-corporations, since October of 1983, need not worry about the passive income rule since without accumulated earnings and profits the S-corporations will not have passive income.

The taxpayer claiming the exemption under this section has the burden of showing its status as a small business corporation. See Indiana Code § 6-2.1-3-24.5(d). A corporation that meets the requirements for a Subchapter S-corporation, but which has failed to make a timely filing of the corporate income tax return, does not waive the small business corporation exemption. Caylor-Nickel Clinic, P.C. v. Indiana Dep’t of State Revenue, 569 N.E.2d 765 (Ind. Tax Ct. 1991), aff’d, 587 N.E.2d 1311 (Ind. 1992). The court in Caylor-Nickel reasoned that the legislature did not intend filing as a condition precedent to claiming the small business corporation exemption because the language of Indiana Code § 6-2.1-3-24.5(d) was inconsistent with the language of several other exemptions contained in Chapter 3 which clearly demand compliance with filing and reporting requirements.

Section 24.5(d) was amended following Caylor-Nickel and now requires the taxpayer to prove its status as a small business corporation only upon request of the Indiana Department of State Revenue. Nonetheless, Caylor-Nickel indicates that a taxpayer claiming an exemption under Chapter 3 must be cognizant of applicable filing and reporting requirements.
Twenty-seventh, there is exempt gross income received by a partnership. See Indiana Code § 6-2.1-3-25 and 45 IAC 1.1-3-12. This is now a straightforward exemption. Before 1984, if any partner was a corporation there would be no exemption - the entire partnership gross receipts would be subject to the gross income tax of the State of Indiana. As the rule currently stands a partnership can be a device to plan to minimize the gross income tax of the State of Indiana for ventures involving a corporation as a partner.

Twenty-eighth, there is exempt gross income received by a trust not defined as a corporation under Indiana Code § 6-3-1-10. See Indiana Code § 6-2.1-3-26 and 45 IAC 1.1-3-13.

Twenty-ninth, there are exempt fares collected for public transportation services by a public transportation corporation, public transportation department established by ordinance, lessee common carrier which provides public transportation services, and private corporations operating within a designated regional service area. See Indiana Code § 6-2.1-3-27.

Thirtieth, there are exempt gross receipts derived directly from a national broadcasting network for broadcasting national programs. See Indiana Code § 6-2.1-3-28.

Thirty-first, there is exempt gross income received by the State of Indiana, a municipal corporation, or a political subdivision of the State of Indiana which is derived from the operation of a recreation facility, the sale or lease of real property, the occasional sale or lease of personal property, or the performance of similar governmental services. See Indiana Code § 6-2.1-3-29 and 45 IAC 1.1-3-14 and Information Bulletins #12 and #90. However, a municipality engaged in a proprietary activity, such as operating a utility, must pay the gross income tax of the State of Indiana.

Thirty-second, there are exempt gross receipts from athletic exhibitions, which are subject to the tax imposed by Indiana Code § 25-9-1. See Indiana Code § 6-2.1-3-30.

Thirty-third, there are exempt gross receipts of an international banking facility. See Indiana Code § 6-2.1-3-31.

Thirty-fourth, there is exempt qualified increased enterprise zone gross income. See Indiana Code § 6-2.1-3-32 and Information Bulletin #66. The Indiana General Assembly authorized creation of an Enterprise Zone Board to spur economic growth in underdeveloped urban areas. The Enterprise Zone Board designated six enterprise zones effective January 1, 1984. These zones include portions of Anderson, Evansville, Fort Wayne, Michigan City, Richmond and South Bend. The Board recently authorized the designation of four additional enterprise zones. Individuals living and working within the zones are entitled to several tax advantages. Individuals and businesses outside of the zones can also avail themselves of certain income tax advantages.

The base period for an enterprise zone is the twelve (12) month period immediately preceding the month in which an
enterprise zone is established. The base period for the ten enterprise zones which have been designated is the 1983 calendar year, 12 months.

Enterprise zone gross income is gross income derived from sources within an enterprise zone. Corporations receiving income from both within and without an enterprise zone are required to apportion their gross income. This apportionment is identical to the apportionment of income derived from sources both within and without the State of Indiana under the Adjusted Gross Income Tax Act.

The calculation of the qualified increased enterprise zone gross income begins with the amount of increase, which is the amount by which the taxpayer's enterprise zone gross income for the base period. Taxpayers engaged in a trade or business in an enterprise zone for only part of the base period should contact the Indiana Department of State Revenue for a determination of the amount of base period gross income. For the year in which an enterprise zone is designated, taxpayers should determine their monthly base period enterprise zone gross income by dividing their base period enterprise zone gross income by twelve (12). The increase that is exempt from gross income is determined by multiplying the monthly base period enterprise zone gross income by the number of months after the enterprise is designated that is included in the taxpayer's return and subtracting the enterprise zone gross income received during those months. Corporations doing business both within and without an enterprise zone should use the Apportionment of Enterprise Zone Income Schedule for the base period and current year in determining the increase. Taxpayers that do not or are not controlled by a taxpayer that owns, rents, or leases property outside an enterprise zone that is an integral part of its trade or business are exempt from the allocation and apportionment provisions. The increase in enterprise zone gross income should be listed as a nontaxable receipt and fully explained on Schedule G of the corporate return.

A thirty-fifth exemption is for gross income received by a conservancy district established under Indiana Code § 13-3-4; a regional water, sewage, or solid waste district established under Indiana Code § 13-3-2; a nonprofit corporation formed solely for the purpose of supplying water to the public; or a county solid waste management district or a solid waste management district established under Indiana Code § 13-9.5-2. See Indiana Code § 62.1-3-33.

Another exemption from gross income tax is for gross receipts from the sale of lottery tickets authorized by Indiana Code § 4-30. See Indiana Code § 6-2.1-3-34 and 45 IAC 1.1-3-16. “Gross income from a gambling game, as defined in [Indiana Code §] 4-33-2-9, conducted by a taxpayer that possesses a valid owner's license under [Indiana Code §] 4-33-6 is exempt from the gross income tax. 45 IAC 1.1-3-16(c). Also see Information Bulletin #84 - NOT-FOR-PROFIT SPONSORED GAMBLING ACTIVITIES (explaining what a qualifying organization is, the kinds of gambling activities permitted, the licensing requirements, the withholding and reporting requirements, and the taxation of funds raised by these activities).
Effective for taxable years beginning after December 31, 1993 there is an income tax credit available for the rehabilitation of historic property. The credit can be applied against the gross income tax, the adjusted gross income tax, and the supplemental net income tax. See Information Bulletin #87.

Chapter 4 of Indiana Code § 6-2.1 contains deductions from Indiana gross income in arriving at gross income to be taxed. A standard deduction of $1,000 is granted to each taxpayer subject to the gross income tax. See Indiana Code § 6-2.1-4-1(a). The standard deduction is prorated on a daily basis for taxpayers who were not subject to the tax for the entire taxable year. An affiliated group that files a consolidated return is entitled to only one standard deduction. A taxpayer that reports its gross income on an accrual basis is entitled to deduct bad debts from its gross income. See Indiana Code § 6-2.1-4-2.

The procedures for filing the gross income tax of the State of Indiana return and remitting the tax are as follows. Any corporation that has a Indiana gross income tax liability of at least $250 for any quarter must file quarterly the gross income tax of the State of Indiana return and pay the tax due for that quarter. The due date for each quarterly return is on or before the last day of the month immediately following the end of the quarter. An annual Indiana gross income tax return is required to be filed by any corporation which receives more than $1,000 in gross income for the taxable year. The annual return is due on or before the 15th day of the fourth month following the close of the taxable year for which it is being filed.

There are two requirements for corporations which file consolidated the gross income tax of the State of Indiana returns; i.e., the corporations must be affiliated (at least 80% of the voting stock of one corporation must be owned by another corporation in the group); and, each corporation included in the return must either be incorporated in the State of Indiana or authorized to do business in the State of Indiana. See Indiana Code § 6-2.1-4-6. An affiliated group elects at the time it files its first return how it will file (consolidated or separate) simply by the method it chooses. That is, no special permission is required when a group files its first returns separately. However, permission must be sought to file a consolidated return. The prime advantage of a consolidated return is the elimination of the gross income tax of the State of Indiana on intercompany receipts. This is not available for brother/sister type corporations.

Whenever payments are made to a nonresident contractor for the performance of any contract except contracts of sale, the gross income tax of the State of Indiana must be withheld. There is no withholding requirement for a nonresident contractor who registers with the Indiana Secretary of State. The amount to be withheld is to be computed using the high rate. "Nonresident contractor" for this purpose does not include a foreign corporation which is qualified to do business in Indiana. See Indiana Code § 6-2.1-6-1(a).

Credits Against the Gross Income Tax in General - Indiana allows credits against the tax due under the gross income tax.
These are dollar for dollar offsets against the tax due. Most of the credits are found in Articles 3 and 3.1 through 3.5 of Title 6 of the Indiana Code. A discussion of each of the various credits follows.

Indiana Code § 6-3.1-1-2 provides that tax credits to which a taxpayer is entitled shall be applied in the following order. First, credits which may not be refunded to a taxpayer nor carried over and applied against any tax liability for any succeeding taxable year. Second, the credits which may not be refunded to a taxpayer, but which may be carried over and applied against any tax liability for any succeeding taxable year. Third, credits which will be refunded to a taxpayer to the extent the credit exceeds the tax liability is to be applied against.

**Withheld Taxes** - The amount that is deducted and withheld as tax is credited by the taxpayer against the tax imposed on him. See Indiana Code § 6-3-3-1. Exempt organizations and partnerships must make withholdings of the tax for their shareholders and partners.

**Charitable Contributions to or For Indiana Institutions of Higher Education** - A taxpayer who makes a contribution directly to the Indiana institution of higher education, or to any corporation or foundation organized and operated solely for the benefit of any such institution of higher education or to the associated colleges of Indiana is entitled to a credit; the credit is limited to the least of: (1) one thousand dollars ($1,000); (2) fifty percent (50%) of the contribution; or (3) ten percent (10%) of the adjusted gross income tax. See Information Bulletin #12. The credit may be applied against the gross income tax or the adjusted gross income tax, but since it is computed on taxable adjusted gross income, no credit is allowed if there is no such income. Schedule CC-20 must be filed with the corporate return IT-20 to claim the credit. Shareholders of S corporations which make contributions are eligible for the credit since for federal purposes, there is flow through of charitable contributions to the shareholders. Exempt organizations may not claim the credit. Indiana Code § 6-3-3-5(d) provides that the "institution of higher education" must regularly grant associate bachelors, masters, or doctoral degrees, or any combination, and must be duly accredited by the North Central Association of Colleges, the Indiana Department of Public Instruction, or the American Association of Theological Schools.

**Motor Fuel Tax Credit (REPEALED)** - Taxpayers were entitled to a credit against the gross income tax for the gasoline taxes paid during the taxable year. Now there is no credit against the gross income tax but the taxpayers may obtain a refund of the gasoline taxes paid by filing a claim for refund of the taxes paid.

**Enterprise Zone Credit** - A taxpayer is entitled to a credit against the gross income tax on enterprise zone gross income for the lesser of: (A) 10% of qualified increased employment expenditures of the taxpayer for the taxable year; or (B) $1500 multiplied by the number of qualified employees employed by the taxpayer during the taxable year. See Indiana Code § 6-3-3-
"Enterprise zone adjusted gross income" is the adjusted gross income derived from sources within an enterprise zone created under Indiana Code § 4-4-6.1. The sources of adjusted gross income shall be determined similarly to that of determining income derived from sources within Indiana under Indiana Code § 6-3-2-2. "Qualified increased employment expenditure" means: (A) (for taxable years other than the year the enterprise zone is established) qualified wages to qualified employees paid or payable by taxpayer - taxpayer base period wages; (B) (for taxable year the enterprise zone is established) qualified wages paid or payable by the taxpayer during all of the full months for the taxable year after the enterprise zone was established - (taxpayers monthly base period wages x the same number of full calendar months). "Base period wages" include wages paid or payable by a taxpayer to employees during the year ending on the last day of the month preceding the month the enterprise zone is established to the extent such wages would be qualified wages (wages paid or payable to qualified employees) if no enterprise was established. Base period wages are zero if no active trade or business was conducted in an area later established as an enterprise zone. If the taxpayer engages in trade or business activity for only part of a year, the Department determines base period wages. A "qualified employee" is an individual who: (A) is employed by the taxpayer; (B) has his principal place of residence in the enterprise zone; (C) performs 90% of his services he performs for the taxpayer which are directly related to the taxpayer's trade or business in the enterprise zone; (D) performs at least 50% of his services for the taxpayer during the taxable year in the enterprise zone. See Indiana Code § 6-3-3-10 (a) .

The amount of credit used may not be greater than the adjusted gross income after application of all credits except the enterprise zone credit. If the credit is greater than the taxes in the taxable year it is first claimed, the excess may be carried back for three preceding taxable years or carried forward to the ten succeeding taxable years, except that if the credit is from wages from an enterprise zone that ends in a taxable year that follows the last taxable year in which the credit carryover is allowed, then the carryover period is extended to the taxable year of the enterprise zone termination. Unused credits are not refunded. Indiana Code § 6-3-3-10(c).

**Teacher Summer Employment Credits** - A taxpayer who employs during a school summer recess a mathematics, science, or other designated shortage area teacher in a qualified position, which is a position relevant to the teacher's academic training in a shortage area and which is approved by the Commission on General Education, during a school summer recess is entitled to a credit for the lesser of: (i) $2500; or (ii) 50% of the amount the taxpayer pays to the eligible teacher. See Indiana Code § 6-3.1-2-3 and Information Bulletin #12. The credit shall be applied as follows: (i) first, against the gross income tax; (ii) second, against the adjusted gross income tax; (iii) third, against the supplemental net income tax. See Indiana Code § 6-3.1-2-5. An eligible teacher for the credit must be certified by the commission on Teacher Training and Licensing in mathematics, science
or other designated shortage area subjects and must be under contract with a school corporation in a shortage area for the regular school term. See Indiana Code § 6-3.1-2-1. If the teacher becomes employed by the taxpayer for the regular school term following the summer recess and the teacher quits teaching for the regular school term, the credit is disallowed and the taxpayer must notify the Department of such situation within 30 days after the discontinuation of the teaching duties and must pay the amount of credit allowed or the taxpayer will be liable for interest and penalties. See Indiana Code § 6-3.1-2-4.

The taxpayer must file an application for a qualified position certificate with the Commission on General Education. An approved certificate states the maximum amount of credit allowable and must be filed with the tax return. The applications are considered in chronological order of filing, but no applications will be approved after the maximum amount of credits allowable in the state's fiscal year is attained, which is $500,000. See Indiana Code § 6-3.1-2-6.

**Research Expense Credit** - Taxpayers who, for taxable years beginning after December 31, 1980 and before December 31, 1988, incur qualified research expenses, as defined in Internal Revenue Code § 44F, in Indiana and are entitled to the federal credit, are entitled to a state income tax credit determined as follows: (i) for taxpayers not subject to the apportionment rules under Indiana Code § 6-3-2-2: 5% (for taxable years beginning in calendar year 1984 up through 1988 ) x [Indiana qualified research expenses - base period Indiana research expenses - base period Indiana qualified research expenses.] The percentage rate was 2% for taxable years beginning in calendar years 1982 or 1983. Indiana Code § 6-3.1-4-2; (ii) for taxpayers who are subject to the apportionment rules the credit is for the lesser of: (a) the amount determined in (i) above for taxpayers not subject to apportionment; or (b) 5% (for taxable years 1984 through 1988, 2% for 1982 or 1983) x [total qualified research expenses - base period research expenses] x apportionment % under Indiana Code § 6-3-2-2. See Indiana Code § 6-3.1-4-2.

Qualified research is defined in Internal Revenue Code § 44F(d) and has the same meaning as "research and experimental" under Internal Revenue Code § 174 except for qualified research: (i) outside the United States; (ii) in the social sciences or humanities; or (iii) funded by grant, contract or otherwise by another person or governmental agency. Qualified research expenses, under Internal Revenue Code § 44(b) are the sum of the following expenses paid or incurred in carrying on a trade or business: (i) in house research expenses, which include: wages paid or incurred to an employee engaged in qualified research or direct supervision or support thereof; amounts paid or incurred for supplies used in qualified research; amounts paid or incurred for the right to use personal property in performing qualified research, unless the taxpayer leases identical property to others; (ii) contract research expenses, which includes 65% of the amounts paid or incurred to any person not an employee of the taxpayer for qualified research. (For corporations, the 65% includes amounts paid or incurred pursuant to a written research agreement with qualified organizations such as tax-exempt universities and colleges, and scientific organizations for
research which are not private foundations). Prepaid amounts are treated as paid or incurred in the taxable year in which the qualified research is conducted.

The Department is authorized to adopt standards in determining qualified research expenses in Indiana for the credit and may consider: the place of performance of the services; the place of residence of business of those performing the services; and the place of consumption of qualified research supplies. Base period research expenses are defined in Internal Revenue Code § 44F(c) as the average of the qualified research expenses for each year of the base period, which is the three immediately preceding taxable years from the taxable year in which the determination is to be made. The base period research expenses may not be less than 50% of the determination year's qualified research expenses. The research expense credit used in a taxable year may not be greater than the sum of the gross income tax, the adjusted gross income tax, and the supplemental net income tax after applying all credits except the research expense credit. Any excess credit may be carried over and applied against the income taxes for the 15 taxable years following the taxable year of the excess credit. No carrybacks or refunds are allowed for unused credit. The credit, as stated above, is not limited to the adjusted gross income tax and can also consume the gross income tax in a taxable year. See Indiana Code § 6-3.1-4-3.

Investment Credits (EXPIRED) - A taxpayer who purchases a qualified investment, which is new (authorized but unissued) stock or a new partnership interest (either a general or limited partnership interest purchased from a limited partnership), in a qualified entity, which is a state corporation or a corporation or a limited partnership in which the state corporation purchases new stock or interest before January 1, 1984, is entitled to a credit for investment purchases in 1981, 1982, and 1983 for the lesser of: (i) the taxpayer's state tax liability; or (ii) 3% of the consideration for all qualified investments, plus any credit carryover from prior years which results when the credit computed in this manner is greater than the taxpayer's state tax liability. Indiana Code § 6-3.1-5-4. The credit is applied as follows: (i) first, against the gross income tax; (ii) second, against the adjusted gross income tax; (iii) third, against the supplemental net income tax; (iv) fourth, against the intangibles tax; and (v) fifth, against the bank tax or savings and loan association tax; and (vi) sixth, against the insurance tax. See Indiana Code § 6-3.1-5-13.

The maximum credits may not exceed $5,000,000 in the aggregate, and the aggregate consideration for all investments in qualified entities other than the state corporation, may not exceed 5 times the state corporations' consideration in the qualified entity. See Indiana Code § 6-3.1-5-6. The credit carryover may not be used for taxable years beginning on or after January 1, 1987. See Indiana Code § 6-3.1-5-5.

The statutory provision for the formation of the state corporation is found in Indiana Code § 6-3.1-5-7 with the name
of the state corporation set out as "Corporation for Innovation Development," and the sole purpose being to raise funds to: (i) make investments in qualified entities; (ii) provide financing to Indiana business firms to encourage capital investment in Indiana; (iii) encourage establishment or expansion of business and industry; (iv) provide additional jobs; and (v) encourage research and development.

The state corporation is exempt from all state taxes except employment, county or municipal corporation taxes. See Indiana Code § 6-3.1-5-9. Exemptions include: (i) income taxable to taxpayer purchasing qualified investment by reason of owning the investment is exempt for gross income tax, adjusted gross income tax, and supplemental net income tax, unless the income is realized from the sale or disposition of the investment; (ii) taxpayers to the extent the tax is based on or measured by the qualified investment are exempt from any tax. See Indiana Code § 6-3.1-5-10 and Indiana Code § 6-3.1-5-11. A qualified investment which a qualified entity redeems within five years of purchase, shall cause the credit to be disallowed and credit previously allowed shall be paid to the Department. See Indiana Code § 6-3.1-512.

Prison Investment Credits - A taxpayer who: (i) enters into an agreement with the Commissioner of the Department of Corrections which was approved by a majority of the State Board of Correction; (ii) to invest in qualified property installed, used, or operated on Department of correction property; and (iii) employs and pays wages to inmates is entitled to a credit for the taxable year of the investment for the lesser of: (a) the taxpayer's state income tax liability, or (b) the sum of 50% of the investment in the qualified property plus 25% of the wages paid to inmates, or (c) $100,000. See Indiana Code § 6-3.1-6-2. The credit is applied by the Department as follows: (i) first, against the gross income tax, (ii) second, against the adjusted gross income tax, (iii) third, against the supplemental net income tax. See Indiana Code § 6-3.1-6-3.

Indiana Code § 6-3.1-6-1 defines qualified property as Internal Revenue Code § 38 qualified property for machinery, tools, equipment, building, structure, or other tangible property used as an "integral part of the operation contemplated by an agreement". The qualified property must be "installed, used, or operative exclusively" on property which the Department of corrections manages. If the qualified property, within three years of the taxable year for which a credit for such property was allowed, is converted to a use not agreed upon, the taxpayer is liable for a recapture tax of: (i) 75% of the credit if the conversion is not later than 1 year after the taxable year of the allowed credit; (ii) 50% of the credit if the conversion is after 1 year but not later than 2 years after the taxable year of the allowed credit; (iii) 25% of the credit if the conversion is after 2 years but not later than 3 years after the taxable year of the allowed credit. The recapture tax is reported in the year of the conversion. See Indiana Code § 6-3.1-6-4. No agreement is allowed if the community will suffer increased unemployment. The burden of proof of no increased unemployment is on the taxpayer. See Indiana Code § 6-3.1-6-5.
**Enterprise Zone Loan Interest Credit** - A taxpayer who receives interest on a qualified loan, which is one made to an entity using the proceeds either for purposes directly related to a business in an enterprise zone created under Indiana Code § 44-6.1, or for improvements increasing the real property's assessed value in such enterprise zones, is entitled to a credit for 5% of the amount of interest received on the qualified loan. See Indiana Code § 6-3.1-7-2. The credit is applied as follows: (i) first, against the gross income tax; (ii) second, against the adjusted gross income tax; (iii) third, against the supplemental net income tax; (iv) fourth, against the intangible tax; (v) fifth, against the bank tax or savings and loan association tax; and (vi) sixth, against the insurance premiums tax. If one of the above taxes is a credit or deduction in determining one of the other taxes the credit or deduction is computed without regard to the enterprise zone loan interest credit. See Indiana Code § 6-3.1-7-4. The enterprise zone interest credit used in a taxable year may not be greater than the sum of the gross income tax, the adjusted gross income tax, the supplemental net income tax, the intangibles tax, the bank tax, the savings and loan association tax, and the insurance premiums tax, after applying all credits except the enterprise zone loan interest credit and the credit for withheld taxes. Any excess credit may be carried over to the immediately following taxable years which do not begin more than 10 years after the date of the qualified loan, except that if the phase-out period of the enterprise zone ends in the taxable year following the last taxable year in which the credit carryover may be utilized, the credit may be used up to and including the taxable year in which the phase-out period ends. A carryover shall be reduced to the extent it is used to obtain the enterprise zone loan interest credit in a subsequent taxable year. See Indiana Code § 6-3.1-7-3.

The taxpayer claims the credit on the state tax return. Where the Department determines that loan proceeds are used for a purpose not stated when the credit was claimed, and the purpose which was stated was the basis for designating the loan as a qualified loan, the Department shall disallow the credit and the taxpayer must pay the amount to the Department. See Indiana Code § 6-3.1-7-6.

**Neighborhood Assistance Credit** - A person or business firm contributing to a neighborhood organization or engaging in activities to provide neighborhood assistance, job training or education for non-employees, or community services or crime prevention in an economically disadvantaged area is entitled to a credit against the gross income tax (or supplemental net income tax) for the taxable year for the lesser of: 50% of the investment in an approved program; or $25,000. See Indiana Code § 6-3.1-9-3 and Information Bulletin #22.

A "neighborhood organization" includes not for profit development corporations and other organizations performing community services in economically disadvantaged areas and which hold rulings from both the Internal Revenue Service and the Indiana Department of Revenue stating the organization is exempt from income taxes under the statutory provisions governing
the respective agencies. "Neighborhood assistance" includes the furnishing of either: (a) financial assistance, labor, material and technical advice to aid the physical or economic improvement of all or part of an economically disadvantaged area, or (b) technical advice promoting higher employment in any Indiana neighborhood. "Job training" includes any instruction allowing individuals in economically disadvantaged areas to gain vocational skills in order to become employable or able to seek higher grade employment. "Education" includes scholastic instruction or scholarship assistance to help prepare for life opportunities. "Community services" are any type of: (a) counseling and advice; (b) emergency assistance; (c) medical care; (d) recreational facilities; (e) housing facilities; (f) economic development assistance. "Crime prevention" is any activity aiding in crime reduction. An "economically disadvantaged area" is an enterprise zone or any other Indiana area so certified by the State Department of Commerce after consulting with the community services agency and after examining current indices of social and economic conditions, including but not limited to, median per capita income of the area in relation to median per capita income of Indiana of the area's standard metropolitan statistical area. See Indiana Code § 6-3.1-9-1.

The maximum credits allowed in the state's fiscal year, July 1 to June 30, may not exceed $1,000,000. Applications for the credit are considered by the State Department of Commerce in the chronological order of their filing and once the limitation is met, no more applications are approved. Priority is given to programs directly benefiting enterprise zones. It is also very important that there be strict adherence to the filing requirements for the credit since an application will not be approved if there is a failure to file the proof of payment. The next applicant would be awarded the credit. An applicant may request that the Department approve an application in whole or part for the next succeeding fiscal year. See Indiana Code § 6-3.1-9-5.

The granting of the credit is subject to the approval of the proposal of the program of the taxpayer by the director of the Department of Commerce. The proposal includes: the program to be conducted; the selected area; estimated investment amount; implementation plans. To obtain the credit, the taxpayer must file with the Department Form NC-10 to claim the credit, stating the amount of investment and claim sought. A certificate evidencing the approval of the program must be included with the application for the credit. The taxpayer is to be given prompt notification of the allowable credit and has 30 days to file a statement, including a proof of payment, with the Department stating the amount claimed has been paid or permanently set aside for the approved program. See Indiana Code § 6-3.1-9-2.

**Enterprise Zone Investment Cost Credit** - A taxpayer is entitled to a credit against the taxpayer's state tax liability for a taxable year if the taxpayer makes a qualified investment in that taxable year. A qualified investment means the purchase of an ownership interest in a business located in an enterprise zone of the purchase is approved by the department of commerce under Indiana Code § 6-3.1-10-8. See Indiana Code § 6-3.1-10-2.
The credit is calculated as follows:

If the department of commerce finds that a purchase is a qualified investment, the department shall certify the percentage credit to be allowed under this chapter based on the following: First, a percentage credit of ten percent may be allowed based upon the need of the business for equity financing, as demonstrated by the inability of the business to obtain debt financing. Second, a percentage credit of two percent may be allowed for business operations in the retail, professional, or warehouse/distribution codes of the SIC Manual. Third, a percentage credit of five percent may be allowed for business operations in the manufacturing codes of the SIC Manual. Fourth, a percentage credit may be allowed for jobs created during the twelve month period following the purchase of an ownership interest in the zone business as determined under the following table:

<table>
<thead>
<tr>
<th>JOBS CREATED</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 11 jobs</td>
<td>1%</td>
</tr>
<tr>
<td>11 to 25 jobs</td>
<td>2%</td>
</tr>
<tr>
<td>26 to 40 jobs</td>
<td>3%</td>
</tr>
<tr>
<td>41 to 75 jobs</td>
<td>4%</td>
</tr>
<tr>
<td>More than 75 jobs</td>
<td>5%</td>
</tr>
</tbody>
</table>

Fifth, a percentage credit of five percent may be allowed if fifty percent or more of the jobs created in the twelve month period following the purchase of an ownership interest in the zone business will be reserved for zone residents. Sixth, A percentage credit may be allowed for investments made in real or depreciable personal property, as determined under the following table:

<table>
<thead>
<tr>
<th>AMOUNT OF INVESTMENT</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $25,001</td>
<td>1%</td>
</tr>
<tr>
<td>$25,001 to 50,000</td>
<td>2%</td>
</tr>
<tr>
<td>$50,001 to 100,000</td>
<td>3%</td>
</tr>
<tr>
<td>$100,001 to 200,000</td>
<td>4%</td>
</tr>
<tr>
<td>More than $200,000</td>
<td>5%</td>
</tr>
</tbody>
</table>

The total percentage credit may not exceed thirty percent.

Indiana Code § 6-3.1-10-8.

The amount of the credit to which the taxpayer is entitled is the applicable percentage as determined above multiplied by the price of the qualified investment made by the taxpayer during the taxable year. Indiana Code § 6-3.1-10-6(b). If the amount of the credit for a taxable year exceeds the taxpayer's state tax liability for that taxable year, the taxpayer may carry the excess over to the following taxable years. The amount of the credit carryover from a taxable year shall be reduced to the extent that the carryover is used by the taxpayer to obtain a credit under this chapter for any subsequent taxable year. The taxpayer is not entitled to a carryback or a refund of any unused credit. Indiana Code § 6-3.1-10-7.

**Industrial Recovery Tax Credit** - A taxpayer is entitled to a credit against the taxpayer's state tax liability for a taxable year if a taxpayer makes a qualified investment during that tax year. A qualified investment is the amount of the taxpayer's expenditures for rehabilitation of property located within an industrial recovery site under a plan contained in an application approved by the board under Indiana Code § 6-3.1-11-18.

The amount of the credit is determined as follows. First, if a plant that is located on an industrial recovery site was placed
in service at least twenty years ago but less than thirty years ago, the applicable percentage is fifteen percent. Second, if a plant that is located on an industrial recovery site was placed in service at least thirty years ago but less than forty years ago, the applicable percentage is twenty percent. Third, if a plant that is located on an industrial recovery site was placed in service at least forty years ago the applicable percentage is twenty percent. See Indiana Code § 6-3.1-11-1. The actual amount of the credit is the qualified investment made by the taxpayer during the taxable year times the applicable percentage. See Indiana Code § 6-3.1-11-16(b).

If the amount of the credit exceeds the taxpayer's liability for that taxable year the taxpayer may carry the excess over to the immediately following taxable years. The amount of the credit carryover from a taxable year shall be reduced to the extent that the carryover is used by the taxpayer to obtain credit for any subsequent taxable year. A taxpayer is not entitled to a carryback or refund of any unused credit. See Indiana Code § 6-3.1-11-17.

Credit for Training the Hard-Core Unemployed - Repealed effective June 30, 1985.

Credit Against Assessments Paid to Insurance Guaranty Association - A taxpayer who is a member insurer, which is any person licensed to transact insurance in Indiana, and has paid assessments to the Indiana Life and Health Guaranty Association to provide funds for the health insurance, life insurance and annuity accounts is entitled to a credit against the insurance premium tax, the gross income tax, the adjusted gross income tax, the supplemental net income tax, or any combination thereof, or any similar tax on member insurers for 20% of the taxes due for each calendar year following the year the assessments were paid. See Indiana Code § 27-8-8-16. Unused credits may be carried over until totally offset, or may be refunded by the association. See Indiana Code § 27-8-8-16.

The type of insurance transactions to which the association applied includes: (i) direct life insurance policies; (ii) health insurance policies; (iii) annuity policies; (iv) annuity contracts; and (v) contracts supplementing life and health insurance policies. Not included are: (a) parts of variable life insurance or variable annuity contracts which the insurer does not guarantee; (b) parts of policies and contracts where the policyholder bears the risk; (c) all or part of policies or contracts which the impaired or insolvent insurer assumes under a contract of reinsurance where no assumption certificates are issued. See Indiana Code § 27-8-8-1.