

# *Indiana – Revenue from information services delivered to Indiana customers is Indiana source income*

October 14, 2013

## ***In brief***

An Indiana Letter of Findings (LOF) determined, under Indiana's income producing activity provisions, that revenue from information services delivered to Indiana customers was Indiana source income even when Taxpayer's predominant direct costs included out-of-state research and support. The LOF concluded that the only relevant income producing activity was performed at the location of the Indiana customer.

Indiana service providers, especially those with opposite facts – e.g., those that incur significant Indiana costs when delivering services to out-of-state customers -- may look to this LOF for guidance concerning how to source service revenue. [Letter of Findings, Indiana Department of Revenue, [No. 02-20130238](#) (9/25/13)]

## ***In detail***

### ***Facts***

For the 2007-2010 tax years, Taxpayer provided electronic information services to Indiana customers. Taxpayer excluded information service revenue from its Indiana sales factor numerator on its 2007-2010 income tax returns. On audit, the Department of Revenue disagreed with Taxpayer's exclusion. Taxpayer submitted a protest with the Department challenging the audit conclusions.

### ***Indiana's costs of performance rule***

Indiana generally provides that revenue from sales other than

sales of tangible personal property are sourced to Indiana if: (1) the income-producing activity is performed in Indiana, or (2) the income-producing activity is performed both within and without Indiana and a greater proportion of the income-producing activity is performed in Indiana than in any other state, based on costs of performance.

### ***Taxpayer's costs of performance argument***

Taxpayer asserted that the direct costs of performing its information services were: (1) staffing, which includes editorial, research, analysts, and systems and database

managers; and (2) information technology, which includes computers, servers, software development, and maintenance. Taxpayer provided that the majority of these costs were incurred outside of Indiana and therefore revenue associated with information services should not be included in Taxpayer's Indiana sales factor numerator.

### ***Income producing activity is performed in Indiana***

The Department concluded that Taxpayer's actual 'income producing activity' is performed in Indiana because the acts

directly engaged in for the ultimate purpose of obtaining gains or profit occur in Indiana. Taxpayer does not earn money from its out-of-state research. Rather, Taxpayer earns money because it “conducts research and sells the results of that research to Indiana customers. The money earned from those Indiana sales transactions constitutes Indiana source income.”

### ***The takeaway***

This Letter of Findings appears to contradict the statute, which sources income from sales of other than tangible personal property based on

where costs are incurred. It is the latest in a series of decisions that appear to adopt a market-based sourcing approach within a costs of performance statutory construction. In *AT&T Corp. v. Dep’t of Revenue*, the Oregon Tax Court found that costs of providing long distance telecommunication services were sourced to the location of the customer. Additionally, a Florida *Technical Assistance Advisement* found that the income producing activity relating to licensing and advertising revenue occurs where the service is delivered to the customer.

This Indiana LOF presents a similar fact pattern – Taxpayer incurs significant out-of-state costs necessary to deliver its services. Nevertheless, the state finds that the only relevant costs are those incurred to deliver the service to the customer. Indiana service providers, especially those with opposite facts – e.g., those that incur significant Indiana costs when delivering services to out-of-state customers -- may look to this LOF for guidance concerning how to source service revenue.

### ***Let’s talk***

If you have questions about this Letter of Findings, please contact:

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