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IN THE
INDIANA TAX COURT

STARWOOD HOTELS & RESORTS WORLDWIDE, INC. (formerly STARWOOD LODGING CORPORATION),

Petitioner,

v.

INDIANA DEPARTMENT OF STATE REVENUE,

Respondent.

Cause No. 49T10-0504-TA-41

ORDER ON PETITIONER'S MOTION FOR SUMMARY JUDGMENT

NOT FOR PUBLICATION
February 16, 2006

FISHER, J.

Starwood Hotels & Resorts Worldwide, Inc. (formerly Starwood Lodging Corporation) (Starwood) appeals the final determination of the Indiana Department of State Revenue (Department) assessing it with an additional gross income tax (GIT) liability on income received by one of its subsidiaries during the 1999 tax year (year at issue). The matter is currently before the Court on Starwood's motion for summary judgment. The issue for the Court to decide is whether money received by one of Starwood's subsidiaries, Roman Entertainment, Inc. (Roman), was received in an

agency capacity and therefore not subject to GIT pursuant to Indiana Administrative Code, title 45, rule 1.1-6-10(a). *See* IND. CODE ANN. § 6-2.1-2-2 (West 1999) (repealed 2002) (imposing GIT). For the following reasons, the Court now GRANTS Starwood's motion in part and DENIES the motion in part.

FACTS AND PROCEDURAL HISTORY

Starwood is a Maryland corporation authorized to do business in Indiana. Starwood's subsidiary, Caesar's World, Inc. (Caesar's World), is the common parent of RDI/Caesars Riverboat Casino, LLC (formerly Harco Entertainment Company, LLC) (Caesars) and Roman. Caesars owned a riverboat casino in Harrison County, Indiana.

During the year at issue, Roman managed and operated the casino for Caesars.[1] The rights and responsibilities of both Caesars and Roman were set forth in the Project Development and Management Agreement (Agreement). For instance, Roman had the exclusive authority to recruit, hire, promote, discharge, and supervise all casino personnel. The Agreement also specified, however, that all employees of the casino, with the exception of certain upper level management employees, were employees of Caesars. While Roman initially paid the expenses and costs associated with the casino's employees, the expenses were treated as operating expenses of Caesars and therefore, Caesars was to reimburse Roman for the expenses on a current basis. As compensation for the performance of its duties, Roman was entitled to an annual

[1] Some of the management and operational duties included: budgeting, day-to-day financial affairs, maintaining accounting records, purchasing, repairs, and marketing. (*See* Pet'r Ex. A at 10-12.) Roman also provided for the construction and development of the casino and other various duties related to the start-up of the facility and its business.

management fee equal to four percent (4%) of the casino's adjusted gross revenue for the fiscal year.

For the year at issue, Roman paid $52,616,257.82 in payroll and benefit expenses to the casino employees.[2] In turn, Caesars reimbursed Roman on a dollar-for-dollar basis. Accordingly, Caesars paid Roman a "Payroll Management Fee" of $59,280,658.14.

Starwood included Roman in its combined 1999 Indiana corporate income tax return. On the return, Starwood reported the difference between the Payroll Management Fee and the Payroll Expense, $6,664,400.32, as taxable gross income attributable to Roman.[3] Starwood did not report the $52,616,257.82 in reimbursements as gross income, believing that amount to be excluded from gross income because it was received in an agency capacity. After an audit of the combined income tax return, however, the Department assessed GIT against the $52,616,257.82 reimbursement payment; therefore, on April 21, 2003, the Department issued a proposed assessment against Starwood in the amount of $831,594.63.[4]

Starwood timely protested the assessment. On November 4, 2004, the Department issued a Letter of Findings (LOF), denying Starwood's protest. Starwood subsequently requested a rehearing, which the Department granted on December 7,

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[2] Roman recorded a "Payroll Expense" of $52,616,257.82 on its 1999 Trial Balance Sheet (balance sheet). (Pet'r Ex. C.)

[3] On its federal tax return, Caesars deducted the same $6,664,400 as an Operator Management Fee (i.e., business expense) paid to Roman. (Pet'r Ex. B.)

[4] The assessment included: $621,711.61 in corporate income tax; $62,171.16 as a penalty; and $147,711.86 in interest. (Resp't Ex. C.)

2004. On January 13, 2005, the Department issued a Supplemental LOF, again denying Starwood's protest.

On April 19, 2005, Starwood initiated an original tax appeal. On November 3, 2005, Starwood filed a motion for summary judgment. The Court held a hearing on the motion on January 13, 2006. Additional facts will be supplied as necessary.

ANALYSIS AND OPINION

Standard of Review

This Court reviews final determinations of the Department *de novo*. IND. CODE ANN. § 6-8.1-5-1(h) (West 2006). Accordingly, the Court is bound by neither the evidence nor the issues presented at the administrative level. *Galligan v. Indiana Dep't of State Revenue,* 825 N.E.2d 467, 472 (Ind. Tax Ct. 2005), *review denied*. In making a motion for summary judgment, the movant must show that there are no genuine issues of material fact and that it is entitled to judgment as a matter of law. Ind. Trial Rule 56(C). Therefore, the movant must put forth sufficient evidence to foreclose the nonmovant's reasonable inferences and eliminate any genuine factual issues. *Butler v. City of Peru*, 733 N.E.2d 912, 915 (Ind. 2000). "Once the movant has put forward evidence to establish this, the burden shifts to the nonmovant to make a showing sufficient to establish the existence of a genuine issue for trial[.]" *Id.* (citations omitted).

A genuine issue is raised when a material fact is in dispute or when the reasonable inferences flowing from undisputed material facts conflict. *Scott Oil Co. v. Indiana Dep't of State Revenue*, 584 N.E.2d 1127, 1129 (Ind. Tax Ct. 1992). To determine whether an issue exists as to a material fact, the Court must regard all facts alleged in the complaint as true except to the extent that they are negated by other

pleadings, depositions, answers to interrogatories, affidavits or other evidence presented by the opposing party. *Id.* at 1128 (citation omitted). To that end, the Court must determine the probative value of the evidence presented in connection with the motion for summary judgment. *Id.* "Summary judgment shall not be granted as of course because the opposing party fails to offer opposing affidavits or evidence, but the [C]ourt shall make its determination from the evidentiary matter designated to the [C]ourt." T.R. 56(C). Finally, "the evidence and all *reasonable inferences* which can be drawn therefrom must be considered in the light most favorable to the non-moving party." *Scott Oil Co.*, 584 N.E.2d at 1128-29 (citations omitted) (emphasis in original).

Discussion

During the year at issue, GIT was imposed upon the receipt of "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana." A.I.C. § 6-2.1-2-2(a)(2). "'[G]ross income' mean[t] all the gross receipts a taxpayer receive[d.]" IND. CODE ANN. § 6-2.1-1-2(a) (West 1999) (repealed 2002). "'Receipts[,'] as applied to a taxpayer, means the gross income in cash . . . or other property that [wa]s received by the taxpayer or a third party . . . for the taxpayer's benefit." IND. CODE ANN. § 6-2.1-1-10 (West 1999) (repealed 2002).

"Income received in an agency capacity[, however,] is not included in the agent's gross income. This is because the income was received by the agent for the principal's benefit." IND. ADMIN. CODE tit. 45, r. 1.1-6-10(a) (2001) (eff. Jan. 1, 1999).[5]

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[5] Likewise, reimbursements paid to an agent for advances to a third party under a reimbursement agreement are also excluded from gross income. *See* IND. ADMIN. CODE

Consequently, the agency exclusion to gross income only applies when (1) an agency relationship is established; and (2) the agent does not have any right, title, or interest in money or property received from the transaction. 45 IAC 1.1-6-10(b). A taxpayer qualifies as an agent of another where: (1) he or she is "under the control of another in transacting business on its behalf[;]" and (2) the taxpayer does not have any right, title or interest in money or property received from a transaction; rather "income must pass through, actually or substantially, to the principal or a third party, with the taxpayer being merely a conduit through which the funds pass between a third party and the principal." IND. ADMIN. CODE tit. 45, r. 1.1-1-2(b) (2001) (eff. Jan. 1, 1999).

Starwood argues that the reimbursements Roman received from Caesars for payroll expenses fall within the agency exclusion and therefore were not subject to the GIT. To support its argument, Starwood presented the following evidence: (1) the Agreement; (2) an affidavit of Mr. Edward Garruto, the Vice President of Finance for Caesars during the year at issue; (3) a copy of Caesars' 1999 United States Partnership Return of Income; and (4) a copy of Roman's 1999 Trial Balance Sheet. (*See* Pet'r Mot. for Summ. J. at 1; Pet'r Ex. 1; Pet'r Ex. A-C.)

Specifically, Starwood asserts that the Agreement establishes an agency relationship between Roman and Caesars because it shows the intent of Caesars to appoint Roman as its agent, Roman's acceptance of that appointment, and Caesars' control over Roman as principal. (Pet'r Br. at 11-15.) In addition, Starwood claims that Roman had no right, title, or interest in the reimbursements because the reimbursements did not defray Roman's own expenses; indeed, without its obligations

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tit. 45, r. 1.1-6-10(a) (2001) (eff. Jan. 1, 1999). Reimbursements of a taxpayer's own expenses are not excluded from gross income. *Id.*

under the Agreement, Roman would have no reason to pay the employees for operating the casino since the employees worked exclusively for and on behalf of Caesars. (Pet'r Br. at 16-19.) Instead, Starwood argues that Roman's only beneficial interest was in the annual management fee, which was reported as taxable gross income. (Pet'r Br. at 17-19.)

The Department asserts three genuine issues of material fact that preclude Starwood's motion for summary judgment, namely, whether: (1) Roman was subject to Caesars' control; (2) Roman had a beneficial interest in the reimbursements; and (3) the employees are employees of Caesars or Roman. (Resp't Br. at 4.) The Court must first determine whether the facts in question are material – that is facts that may be dispositive of the case. *See Scott Oil Co.*, 584 N.E.2d at 1129. The Court will then address whether a genuine issue exists as to the material facts.

I. Material Fact

As mentioned, in order for the agency exclusion to apply, a taxpayer must show that it is subject to the control of a principal and did not have a right, title or interest (i.e., beneficial interest) in the money or property received from a transaction. *See* 45 IAC 1.1-6-10(b). *See also U-Haul Co. of Indiana v. Indiana Dep't of State Revenue*, 784 N.E.2d 1078, 1082-1084 (Ind. Tax Ct. 2002). Accordingly, whether Roman was subject to Caesars' control and whether Roman received a beneficial interest in the reimbursements are material facts in this case.

The determination of who actually employs the casino workers, however, is not a material fact. While the Department suggests that the determination will indicate

whether Roman had a beneficial interest in the reimbursements,[6] Roman's beneficial interest in the reimbursements, if any, would be determined by whether Roman received a benefit from the employees' labor, thereby requiring Roman to pay the employees. *See Universal Group Ltd. v. Indiana Dep't of State Revenue*, 642 N.E.2d 553 (Ind. Tax Ct. 1994) (*UGL*).

In *UGL*, a group of affiliated corporations in the food and beverage flavoring business designated one or more of its corporations to perform centralized functions on behalf of the affiliated corporations to avoid the duplication of expenses. *Id.* at 554. These functions included, *inter alia*, general accounting and data processing, general administration, sample production, and sales-related services. *Id.* Under this expense sharing arrangement, the expenses for the centralized functions were allocated among the affiliated corporations based on a formula which approximated each entity's use and benefit from the services. *Id.* The corporations reimbursed the designated corporations for expenses incurred mainly through accounting measures. *Id.*

The Court explained that "[t]he reimbursements to the corporations that performed the administrative tasks were reimbursements for those corporations' own

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[6] Starwood raised the defense of offensive collateral estoppel against the Department to preclude it from raising that argument. (Oral Argument Tr. at 26-28.) *See also* BLACK'S LAW DICTIONARY 279 (8th ed. 2004) (stating that offensive collateral estoppel is "asserted by a plaintiff to prevent a defendant from relitigating an issue previously decided against the defendant"). Starwood cites an unpublished decision of this Court in which the Department unsuccessfully raised the argument that the determination of the actual employer is a material fact. (Oral Argument Tr. at 26-28.) *See also Criterion Catalyst Co. v. Dep't of State Revenue*, No. 49T10-9612-TA-00180, slip op. at 10-12 (Ind. Tax Ct. Feb. 2, 1999) (holding that the determination was not a material fact), *review denied*.

While the Court takes note of Starwood's defense, the Court finds its published case law to be instructive in this matter and therefore, does not need to reach the aforementioned defense. *See Universal Group Ltd. v. Indiana Dep't of State Revenue*, 642 N.E.2d 553 (Ind. Tax Ct. 1994) (*UGL*).

expenses, such as paying their own employees' wages, not for monies advanced to third parties." *Id.* at 558. Therefore, the Court held that there was no pass through of income, but rather the designated corporations had a beneficial interest in the reimbursements. *Id.*

Pertinent to the Court's analysis in *UGL* was the fact that the designated corporations were being reimbursed for expenses they would have incurred absent the expense sharing arrangement. Indeed, the designated corporations were performing tasks which all of the affiliated corporations required. *See id.* at 554. That the designated corporations would have incurred expenses without the agreement indicates that the corporations received a benefit from the reimbursement of such expenses. Furthermore, the reimbursements were not in payment of money advanced to a third party.

In the case at bar, however, there has been no such showing. The Department does not contest that the employees of the casino were working in furtherance of Caesars business (i.e., the operation of a casino). Absent the Agreement between Roman and Caesars and the duties arising therefrom, Roman would not be obligated to pay these employees, or in other words, to advance money to a third party. The same holds true even if Roman was the actual employer. While the resolution of Caesars' employer status is improper on a motion for summary judgment, it is not a material fact in this case; therefore, such resolution is not required.[7]

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[7] Given these conclusions and the language in the Agreement concerning Caesars' employer status, the Court will treat the employees as employees of Caesars for purposes of this opinion only. (*See* Pet'r Ex. A at 7.) This treatment, however, should not be taken as a finding of that fact.

II. Genuine Issues of Material Fact

A. Control

Starwood relies on three things to establish an agency relationship. First, Starwood contends that the language of the Agreement sufficiently establishes an agency relationship through provisions such as Article 5.1. (*See* Pet'r Br. at 11-16; Pet'r Ex. A at 6.) That provision states that, "[Caesars] hereby appoints, hires and employs [Roman] as [Caesars'] exclusive agent, to supervise, manage, direct and operate the [casino] during the [t]erm of this Agreement. [Roman] hereby accepts said appointment and assignment upon and subject to the terms, conditions, covenants and provisions set forth herein." (Pet'r Ex. A at 6.) Starwood also points to several other provisions, which require Roman to obtain Caesars' approval before proceeding with certain plans and actions to show that Roman was subject to Caesars' control. (*See* Pet'r Br. at 13-16.)

Next, Starwood relies on the affidavit of Mr. Edward Garruto to show that the agency exclusion applies. Specifically, Garruto attested to the following facts:

> Pursuant to the Agreement, [Roman] managed and operated the casino riverboat for an[d] on behalf of Caesars. The operation of a riverboat casino involves thousands of individual transactions on an annual basis. [Roman] did not manage and operate Caesars' casino riverboat under [Roman's] own name.
>
> During 1999, [Roman's] only business operation in Indiana was the management and operation of Caesars' casino riverboat. For 1999, [Roman] was paid a management fee by Caesars of $6,664,400.32 for its services in managing and operating the casino riverboat. This management fee was reported as Indiana taxable gross income for 1999. This management fee was the only profit earned by [Roman] for its management and operation of Caesars' casino riverboat for 1999.

> For 1999, [Roman] received reimbursements of $52,616,257.82 from Caesars for payroll and benefits expenses advanced by [Roman.] These employees worked exclusively for and on behalf of Caesars. Caesars reimbursed [Roman] for these expenses on a dollar-for-dollar basis. [Roman] had no right, title or interest in the reimbursements that it received from Caesars. [Roman] served merely as a the conduit through which Caesars paid its employees and certain upper management employees of [Roman]. Caesars' reimbursements to [Roman] defrayed no cost that [Roman] would have incurred without the Agreement. [Roman] was not reimbursed for its own expenses.

(Pet'r Ex. 1 at 1.)

Lastly, Starwood suggests that an agency relationship is evidenced by the existence of the facts delineated in Indiana Administrative Code title 45, rule 1.1-6-10(e). That regulation states: "[t]he mere execution of an agency contract will not create an agency relationship. If the agent takes title to the products, operates under its own name, and cannot bind the principal in contracts, an agency relationship has not been established." 45 IAC 1.1-6-10(e). Starwood explains that the Agreement establishes that Roman could bind Caesars to contracts, and that Caesars maintained title to the casino. (*See* Oral Argument Tr. 15-20; Pet'r Ex. A. at 7, 23, 31.) Starwood relies on the affidavit to establish that Roman did not operate the casino under its own name. (Pet'r Ex. 1 at 1.)

Given this evidence, Starwood asserts that Roman acted as a general agent for Caesars, managing the day-to-day affairs of the casino, which consisted of thousands of transactions annually. Therefore, Caesars maintained control consistent with a general agency relationship in that it would defeat the purpose of having Roman as its

agent if it had to control and supervise its every action. (*See* Oral Argument Tr. at 16-21.) *See also* BLACK'S LAW DICTIONARY 69 (8th ed. 2004) (stating that a general agent is one "authorized to transact all the principal's business of a particular kind or in a particular place . . . [one that] is an integral part of the principal's business and does not need fresh authorization for each separate transaction").

The Department claims, however, that the Agreement does not establish the requisite control for an agency relationship; rather, the terms of the Agreement indicate that Roman was an independent contractor. (Resp't Br. at 9-17 (citing *Western Adjustment & Inspection Co. v. Indiana Gross Income Tax Div*., 142 N.E.2d 630, 634 (Ind. 1957) (stating that an independent contractor agrees to accomplish a certain result without being controlled in the details, manner or method of performing a task; whereas, an agent is controlled in the details of its work)).) *See also* BLACK'S LAW DICTIONARY 785 (8th ed. 2004) (an independent contractor is one "entrusted to undertake a specific project but who is left free to do the assigned work and to choose the method for accomplishing it"). To support its claim, the Department points to several provisions of the Agreement to show that Roman is not controlled in the details of its work. (Resp't Br. at 9-17.) For instance, the Department highlights Article 6.11 of the Agreement, which states:

> [s]ubject to . . . the approval requirements specifically recited herein, [Roman] shall have the absolute discretion and authority to determine operating policies and procedures, standards of operation, credit policies, complimentary policies, win payment arrangements, standards of service and maintenance, food and beverage quality and service, pricing, and other policies affecting the [casino], or the operation thereof, to implement all such policies and procedures, and to perform any act on behalf of [Caesars] which [Roman] deems necessary or desirable for the

> operation and maintenance of the [casino] on behalf and for the account and at the expense of [Caesars.]

(Resp't Ex. A at 10-11; Resp't Br at 10.)

In addition, the Department relies on Article 6.1.2, which gives Roman the sole authority to hire, promote, discharge and supervise all personnel. (Resp't Ex. A at 7; Resp't Br. at 10.) The Department also points to Article 6.5 which concerns Roman's budgeting duties and Caesars' review of the budget, which specifically states that, "[i]n the event [Caesars and Roman] cannot agree on a final budget within sixty (60) days after [Caesars] receives the initial proposed budget, then either party may cause the disputed items to be submitted to arbitration . . . which decision shall be final." (Resp't Ex. A at 9; Resp't Br. at 14.) Therefore, the Department argues that there are conflicting inferences as to the Agreement and its establishment of the control requirement of an agency relationship. The Court agrees.

It is a longstanding rule that the existence of an agency relationship is a question of fact. *See e.g., Policy Mgmt. Sys. Corp. v. Indiana Dep't of State Revenue*, 720 N.E.2d 20, 24 (Ind. Tax Ct. 1999), *review denied*. In this case, Starwood relies primarily on the Agreement to establish an agency relationship. The presence or absence of contract language, however, is not controlling in determining whether that relationship exists. *See Indiana Dep't of Revenue, Gross Income Tax Div. v. Waterfiled (sic) Mortgage Co.*, 400 N.E.2d 212, 214 (Ind. Ct. App. 1980); *see also* 45 IAC 1.1-6-10(e). While Starwood believes the existence of the facts referenced in 45 IAC 1.1-6-10(e) prove that Roman was Caesars' agent, the regulation's mention of those facts does not eliminate the requirement of control. Nor do those facts necessarily establish control.

This is especially true where, as Starwood points out, an independent contractor can also serve as an agent of a principal. (*See* Oral Argument Tr. at 22-23.) *See also Sword v. NKC Hospitals, Inc.*, 714 N.E.2d 142, 148 n.5 (Ind. 1999) ("In the agency context, both a servant and an independent contractor can be an agent of the principal . . . while an independent contractor cannot be a servant, and vice versa, they can both be agents"). Because the Agreement lends itself to conflicting inferences as to Roman's relationship with Caesars and the facts attested to in the affidavit do not sufficiently foreclose on the Department's reasonable inference, a genuine issue exists as to Caesars' control over Roman.

B. Beneficial Interest

Starwood claims that Roman did not have a beneficial interest in the reimbursements because (1) the employees were working exclusively for Caesars' business; (2) without the Agreement, Roman had no obligation to pay the employees; and (3) the reimbursements were paid to Roman on a dollar-for-dollar basis. (*See* Pet'r Br. at 16-18; Pet'r Ex. 1 at 1; Pet'r Ex A. at 7.) The Department, however, argues that Roman received a direct benefit from the success of the casino, because Roman's management fee was determined based on a percentage of adjusted gross revenue. In turn, the Department argues that the success of the casino was directly related to the employees' labor. Based on these arguments, the Department asserts that Roman received a benefit from the employees' labor and thus payment of the employees'

salaries and benefits provided a direct benefit to Roman.[8] (*See* Resp't Br. at 18-19 (footnote added).) The Department's inference, however, is unreasonable.

Roman was paid a management fee for its services in connection with the Agreement. (*See* Pet'r Ex. 1 at 1.) While the employees were working for the success of the casino, that success was of *Caesars'* casino. Therefore, the employees were working for Caesars' benefit. The fact that Roman's management fee was based on a percentage of adjusted gross revenue does not mean that it had a beneficial interest in the reimbursement of the employees' salaries and benefits. Rather, Roman's interest lies in its management fee. *See U-Haul Co. of Indiana*, 784 N.E.2d at 1083-1084 (holding that taxpayer did not have any right or beneficial interest in the rental income it collected for its principal; instead, the taxpayer's interest was in its contractually specified percentage of the income). Therefore, no genuine issue exists as to whether Roman received a beneficial interest in the reimbursements.

CONCLUSION

Based on the foregoing conclusions, the Court finds that a genuine issue of material fact exists only as to whether Roman was subject to Caesars' control. Therefore, the Court DENIES Starwood's motion for summary judgment with respect to the issue of control; the Court, however, GRANTS summary judgment in favor of

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[8] To support its claims, the Department submitted the following evidence: a copy of the Agreement; Roman's 1999 Trial Balance Sheet; the Department's proposed assessment of GIT; and a Corporate Income Tax Report for Starwood and its subsidiaries. (Resp't Ex. A-D.)

Starwood with respect to the other issues.[9] Accordingly, the Court will, in a separate order, set this matter for further proceedings.

SO ORDERED this 16th day of February, 2006.

Thomas G. Fisher, Judge
Indiana Tax Court

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[9] Starwood asserts two alternate arguments in support of its motion. First, Starwood argues that the Department changed its interpretation of the regulations in a manner that retroactively increased Starwood's gross income tax liability for the year at issue. (Pet'r Br. at 24.) The Court reserves judgment on this issue pending the resolution of the remaining issue of fact.

Secondly, Starwood argues that assuming *arguendo*, it owes the proposed GIT, the 10% penalty assessed against Starwood should be waived pursuant to Indiana Code § 6-8.1-10-2.1(d). *See* IND. CODE ANN. § 6-8.1-10-2.1(d) (West 2006) (allowing waiver of penalty where failure to pay deficiency was due to reasonable cause and not willful neglect). (*See also* Pet'r Br. at 27.) Given that the Court has not concluded that Starwood owes the tax at this point, the Court's decision today need not reach this argument either.