

COMMISSIONER'S DIRECTIVE # 38

OCTOBER 2009

DISCLAIMER: Commissioner's directives are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules, and court decisions. Any information that is not consistent with the law, regulations, or court decisions is not binding on either the Department or the taxpayer. Therefore, the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: Refunds to Pass-through Entities and Taxation of Shareholders/Partners/Members

EFFECTIVE: January 1, 2009 (Retroactive) and July 1, 2009

REFERENCES: IC 6-3-2-2; IC 6-8.1-9-1 and IC 6-8.1-9-2

INTRODUCTION

The purpose of this directive is to provide guidance on refund procedures for taxpayers who are similarly situated to the taxpayers involved in the Tax Court case *Riverboat Development, Inc. v. Ind. Dep't of State Revenue*, 881 N.E.2d 107 (Ind. Tax Ct. 2008). The refund procedures apply only to timely filed claims for refund for taxable years beginning before Jan. 1, 2009. The directive also provides guidance on the taxability of income to nonresident shareholders/partners/members of an out-of-state pass-through entity, where the out-of-state pass-through entity is a shareholder/member/partner of an Indiana pass-through entity.

TAXATION OF PASS-THROUGH INCOME

IC 6-3-2-2 was amended by HEA 1001-2009(ss) effective retroactive to Jan. 1, 2009, for taxable years beginning after Dec. 31, 2008, to provide that income from a pass-through entity shall be characterized in a manner consistent with the income's characterization for federal income tax purposes as provided in Section 1366(b) of the Internal Revenue Code

for S corporations and Section 702(b) of the Internal Revenue Code for partnerships. The income shall be considered Indiana source income as if the person, corporation, or pass-through entity that received the income had directly engaged in the income-producing activity in Indiana. Income that is derived from one pass-through entity and is passed through to another pass-through entity does not change the characteristics or attribution provisions of the income.

Example: An LLC treated as a partnership for tax purposes and domiciled in Indiana is engaged in manufacturing automobile parts. All sales are to another Indiana manufacturer. A nonresident S corporation is a member of the Indiana LLC. The nonresident S corporation provides a distributive share of income to its nonresident individual shareholders. The Indiana LLC's income that passes to the S corporation and then to the shareholders is income derived from the sale of automobile parts to an Indiana manufacturer and is treated as such at the S corporation and individual shareholder levels. The nonresident S corporation shall file a composite return for all of the nonresident shareholders and include the income attributable to the distributive shares from the Indiana LLC (and any other Indiana-source income of the S corporation) on the composite return with the amount of tax due being remitted by the nonresident S corporation.

ELIGIBILITY AND PROCEDURES FOR CLAIMING A REFUND

IC 6-8.1-9-2 was amended by HEA 1001-2009(ss) to establish procedures to provide a refund to a pass-through entity's nonresident partners, shareholders, or members if the overpayment arises from a determination by the Department or a court that the person's pass-through income is not includible in the person's adjusted gross income derived from sources within Indiana.

Eligibility to make a claim for refund

To be eligible for a refund, the person must file a timely claim for refund with respect to the overpayment and the overpayment must:

- apply to a taxable year beginning before Jan. 1, 2009;
- be attributable to amounts paid to the Department by:
 1. a nonresident partner, shareholder, or member of a pass-through entity;
 2. a pass-through entity on behalf of a nonresident partner, shareholder, or member of the pass-through entity as part of a composite return required under IC 6-3-4-12 or IC 6-3-4-13; or
 3. a pass-through entity on behalf of a nonresident partner, shareholder, or member of another pass-through entity as part of a composite return required under IC 6-3-4-12 or IC 6-3-4-13;
- arise from a determination by the Department or a court that the person's pass-through income is not includible in the person's adjusted gross income derived from sources within Indiana as a result of the application of IC 6-3-2-2(a)(5) and IC 6-3-2-2.2(g); and

- be reported to the Department in a form specified by the Department that identifies under penalties of perjury the home state or jurisdiction where the income subject to the refund or credit was reported as income attributable to that state or jurisdiction.

Procedures for claiming a refund

A person applying for a credit or refund because of an overpayment of taxes is required to:

- file a GA-110L Claim for Refund with the following information:
 1. in the explanation section of the GA-110L, reference "*Riverboat Development, Inc. v. Ind. Dep't of Revenue*";
 2. a list of tax years for which the overpayment applies;
 3. the amount of the overpayment;
 4. the date of the original payment;
 5. the Indiana amended return(s) for the tax years to which the claim for refund applies;
 6. copies of the Indiana K-1s and/or WH-18 verifying the amount of the distributive share of income for each year; and
 7. copies of filed returns in the home state or jurisdiction of the person proving that the income subject to the credit or refund was reported as income attributable to that state or jurisdiction. (*Subject to verification by the home state or jurisdiction*)

The GA-110L Claim for Refund and amended return(s) should be mailed to:

**Indiana Department of Revenue
RDI Claim for Refund MS #105
P.O. Box 2485
Indianapolis, IN 46206-2485**

VALID CLAIMS FOR REFUND

If the Department determines that a person's claim is valid and subsequently approved, the Department shall notify the person. If the amount of the credit is less than \$5,000, the Department shall notify the person in writing that the person will receive a one-time payment for the claim.

If the Department determines that a person's claim is valid and the amount of the claim is greater than \$5,000, the person will be required to claim the credit on the person's annual return for tax years beginning after Dec. 31, 2008. The person will be informed in writing of the procedures to follow when claiming the credit.

Application of refunds/carryforward credits

After the determination has been made (by the Department or a court) that a taxpayer overpaid tax, the Department shall first apply the overpayment to the person's liability for taxes that have been assessed and are currently due. The Department will then carry forward any remaining overpayment as a credit for listed taxes due in taxable years beginning on or after Jan. 1, 2009, and ending before Jan. 1, 2019. If the person does not have sufficient liability against which to credit all the remaining overpayment in taxable years beginning on or after Jan. 1, 2009, and ending before Jan. 1, 2019, the taxpayer is not entitled to have any part of the remaining overpayment refunded, applied, or credited to the person's tax liability.

In some instances, the Department (or court) may make a determination that the taxpayer's RDI claim for refund for a particular year is valid after the taxpayer has already filed a subsequent year's return on which tax is reported and paid and for which no anticipated RDI-related credit has been taken. Had the taxpayer's RDI-related refund claim been approved prior to the subsequent year's filing, the taxpayer would have been able to apply an RDI credit to that year's return, the first available carryforward year. Under these circumstances, the Department will allow a retroactive application of the RDI credit to that already-filed year and issue a refund for the overpayment now due from the application of the credit to that one year. The refund will be issued within 90 days of the date the Department (or court) makes its determination. Any remaining overpayment credits resulting from the approved RDI-related refund claim will not be refunded but may be carried forward and applied by the taxpayer to subsequent carryforward years available through 2018.

Example: A person files a timely RDI-related claim for a refund of \$100,000 for the 2006, 2007, and 2008 tax years combined. The taxpayer also files the 2009 tax return timely by April 15, 2010, reporting and paying \$25,000 of tax due. The Department does not make a determination that the person has made a valid claim for refund and is therefore eligible for the \$100,000 carryforward credit until July 14, 2010. Within 90 days of this July 14, 2010 determination, the Department will apply the carryforward credit to the 2009 tax year and refund to the taxpayer the \$25,000 previously paid for the 2009 tax year. The remaining \$75,000 credit will be carried forward by the taxpayer and applied to subsequent tax years through 2018.

Reporting requirements for carryforward credits

The person claiming an approved credit shall include annually with his/her return a schedule approved by the Department listing the total amount of credits approved by the Department, the amount of credits applied in each of the previous taxable years, and the amount of credits applied in the current taxable year.

A person claiming a credit or refund shall submit any filed return(s) with the Department that identify, under penalties of perjury, the home state or jurisdiction where the income

subject to the credit or refund was reported as income attributable to that state or jurisdiction. IC 6-8.1-9-2(c)(3) states "A person that receives a refund or credit under this subsection shall file a report with the Department in the form and in the schedule specified by the Department that identifies, under penalties of perjury, the home state or other jurisdiction where the income subject to the refund or credit was reported as income attributable to that state or jurisdiction."

CLAIMS FOR REFUND THAT WILL BE DENIED

A nonresident shareholder/member/partner of an Indiana pass-through entity is not eligible for a refund or credit if there is not an intermediate out-of-state pass-through entity in which the individual is a shareholder/member/partner.

A shareholder/member/partner who resides in a state that does not impose an income tax on the distribution from a pass-through entity is not eligible for a refund because the person has not reported income to the state of residence. States that do not have an income tax include Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. New Hampshire and Tennessee tax only certain investment income.

PROCEDURES FOR APPEALING THE DENIAL OF A REFUND CLAIM

If the taxpayer's claim for refund is denied, the person will receive an Order Denying Refund with an attached explanation providing the reason for denial.

The Department shall, if requested by the taxpayer, hold a hearing on the claim for refund for purposes of obtaining and considering additional evidence. For purposes of requesting a hearing, the taxpayer must attach such request to a copy of the original claim for refund along with the Order Denying Refund and submit the information to the Department.

After a hearing date has been confirmed, failure to appear will result in a denial of the claim where the taxpayer has failed to provide sufficient evidence to verify the claimed overpayment. The taxpayer will receive a Final Order Denying Refund noting such failure to appear with an attached explanation of the Department's reason for denial.

If, subsequent to the hearing, the Department still denies the claim, the taxpayer will receive a Final Order Denying Refund with an attached explanation of the Department's reason for denial.

Any taxpayer in receipt of an Order Denying Refund or a Final Order Denying Refund has a statutory remedy for appeal with the Indiana Tax Court as provided in IC 6-8.1-9-1(c), which states:

(c) If the person disagrees with any part of the Department's decision, the person may appeal the decision, regardless of whether or not the person protested the tax payment or whether or not the person has accepted a refund. The person must file the appeal with the tax court. The tax court does not have jurisdiction to hear a refund appeal suit, if:

- (1) the appeal is filed more than three (3) years after the date the claim for refund was filed with the department;
- (2) the appeal is filed more than ninety (90) days after the date the Department mails the decision of denial to the person; or
- (3) the appeal is filed both before the decision is issued and before the one hundred eighty-first day after the date the person files the claim for refund with the department.

The sole remedy for an appeal of the Department's decision is with the tax court.

A handwritten signature in black ink that reads "John Eckart". The signature is written in a cursive, flowing style with a large loop at the beginning of the word "John".

John Eckart
Commissioner