

Emergency Rule
LSA Document #06-244(E)

DIGEST

Temporarily adds provisions to implement the add back of intangible expenses and directly related intangible interest expenses for purposes of the adjusted gross income tax. Authority: HEA 1001-2006, SECTION 53. Effective July 1, 2006. *NOTE: [IC 4-22-2-37.1](#) establishes the effectiveness of an emergency rule upon filing with the Publisher. This document was filed with the Publisher on July 18, 2006.*

SECTION 1. (a) The following definitions apply throughout this SECTION:

(1) "Affiliated group" has the meaning provided in Section 1504 of the Internal Revenue Code, except that the ownership percentage in Section 1504(a)(2) of the Internal Revenue Code shall be determined using fifty percent (50%) instead of eighty percent (80%).

(2) "Directly related intangible interest expenses" means interest expenses that are paid to, or accrued or incurred as a liability to, a recipient if:

(A) the amounts represent, in the hands of the recipient, income from making one (1) or more loans; and

(B) the funds loaned were originally received by the recipient from the payment of intangible expenses by any of the following:

(i) The taxpayer.

(ii) A member of the same affiliated group as the taxpayer.

(iii) A foreign corporation.

(3) "Foreign corporation" means a corporation that is organized under the laws of a country other than the United States and would be a member of the same affiliated group as the taxpayer if the corporation were organized under the laws of the United States. The ownership percentage for a foreign corporation to qualify as a member of an affiliated group in this instance shall be fifty percent (50%).

(4) "Comprehensive income tax treaty" means a convention, or agreement, entered into by the United States and approved by Congress, with a foreign government for the allocation of all categories of income subject to taxation and/or withholding of tax on interest, dividends, and royalties, for the prevention of double taxation of the respective nations' residents, and the sharing of information.

(5) "Intangible expenses" means the following amounts to the extent these amounts are allowed as deductions in determining taxable income under Section 63 of the Internal Revenue Code before the application of any net operating loss deduction and special deductions for the taxable year:

(A) Expenses, losses, and costs directly for, related to, or in connection with the acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property.

(B) Royalty, patent, technical, and copyright fees.

(C) Licensing fees.

(D) Other substantially similar expenses and costs.

(6) "Intangible property" means patents, patent applications, trade names, trademarks, service marks, copyrights, trade secrets, and substantially similar types of intangible assets.

(7) "Interest expenses" means amounts that are allowed as deductions under Section 163 of the Internal Revenue Code in determining taxable income under Section 63 of the Internal Revenue Code before the application of any net operating loss deductions and special deductions for the taxable year.

(8) "Makes a disclosure" means a taxpayer provides the following information regarding a transaction with a member of the same affiliated group or a foreign corporation involving an intangible expense and any directly related intangible interest expense with the taxpayer's tax return on the forms prescribed by the department:

(A) The name of the recipient.

(B) The state or country of domicile of the recipient.

(C) The amount paid to the recipient.

(D) A copy of federal Form 851, Affiliation Schedule, as filed with the taxpayer's federal consolidated tax return.

(E) The information needed to determine the taxpayer's status under the exceptions listed in subsection (c).

(9) "Recipient" means:

(A) a member of the same affiliated group as the taxpayer; or

(B) a foreign corporation;

to which is paid an item of income that corresponds to an intangible expense or any directly related intangible interest expense.

(10) "Unrelated party" means a person that, with respect to the taxpayer, is not a member of the same affiliated group or a foreign corporation.

(11) "Valid business purpose" means one (1) or more transactions that have sufficient economic substance, other than the avoidance or reduction of taxes, that alone or in combination:

(A) constitute the primary motivation for a business activity; or

(B) change, in a meaningful way, the taxpayer's economic position.

A meaningful change in the taxpayer's economic position includes, but is not limited to, an increase in market share, its entry into new business markets, or its compliance with a regulatory requirement of federal, state, or local government.

(b) Except as provided in subsection (c), in determining its adjusted gross income under [IC 6-3-1-3.5\(b\)](#), a corporation subject to the tax imposed by [IC 6-3-2-1](#) shall add to its taxable income under Section 63 of the Internal Revenue Code:

(1) intangible expenses; and

(2) any directly related intangible interest expenses;

paid, accrued, or incurred with one (1) or more members of the same affiliated group or with one (1) or more foreign corporations.

(c) The addition of intangible expenses or any directly related intangible interest expenses otherwise required in a taxable year under subsection (b) is not required if one (1) or more of the following apply to the taxable year:

(1) The taxpayer and the recipient are both included in the same Indiana consolidated tax return filed under [IC 6-3-4-14](#) or in the same Indiana combined return filed under [IC 6-3-2-2\(q\)](#) for the taxable year.

(2) The taxpayer makes a disclosure and, at the request of the department, can establish by a preponderance of the evidence that:

(A) the item of income corresponding to the intangible expenses and any directly related intangible interest expenses was included within the recipient's income that is subject to tax in:

(i) a state or possession of the United States where the recipient does not file a combined or consolidated income tax report with the taxpayer or another affiliated entity; or

(ii) a country other than the United States;

that is the recipient's commercial domicile, that imposes a net income tax, a franchise tax measured, in whole or in part, by net income, or a value added tax and that has a comprehensive income tax treaty with the United States;

(B) the transaction giving rise to the intangible expenses and any directly related intangible interest expenses between the taxpayer and the recipient was made at a commercially reasonable rate and at terms comparable to an arm's-length transaction; and

(C) the transactions giving rise to the intangible expenses and any directly related intangible interest expenses between the taxpayer and the recipient did not have Indiana tax avoidance as a principal purpose.

(3) The taxpayer makes a disclosure and, at the request of the department, can establish by a preponderance of the evidence that:

(A) the recipient regularly engages in transactions involving intangible property with one (1) or more unrelated parties on terms substantially similar to those of the subject transaction; and

(B) the transaction giving rise to the intangible expenses and any directly related intangible interest expenses between the taxpayer and the recipient did not have Indiana tax avoidance as a principal purpose.

(4) The taxpayer makes a disclosure and, at the request of the department, can establish by a preponderance of the evidence that:

(A) the payment was received from a person or entity that is an unrelated party and, on behalf of that unrelated party, paid that amount to the recipient in an arm's-length transaction; and

(B) the transaction giving rise to the intangible expenses and any directly related intangible interest expenses between the taxpayer and the recipient did not have Indiana tax avoidance as a principal purpose.

(5) The taxpayer makes a disclosure and, at the request of the department, can establish by a preponderance of the evidence that:

(A) the recipient paid, accrued, or incurred a liability to an unrelated party during the taxable year for an equal or greater amount that was directly for, related to, or in connection with the same

intangible property giving rise to the intangible expenses; and
(B) the transactions giving rise to the intangible expenses and any directly related intangible interest expenses between the taxpayer and the recipient did not have Indiana tax avoidance as a principal purpose.

(6) The taxpayer makes a disclosure and, at the request of the department, can establish by a preponderance of the evidence that:

(A) the recipient is engaged in:

- (i) substantial business activities from the acquisition, use, licensing, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property; or
- (ii) other substantial business activities separate and apart from the business activities described in item (i);

as evidenced by the maintenance of a permanent office space and an adequate number of full-time, experienced employees;

(B) the transactions giving rise to the intangible expenses and any directly related intangible interest expenses between the taxpayer and the recipient did not have Indiana tax avoidance as a principal purpose; and

(C) the transactions were made at a commercially reasonable rate and at terms comparable to an arm's-length transaction.

(7) The taxpayer and the department agree, in writing, to the application or use of an alternative method of allocation or appointment under section 2(l) (to fairly represent taxpayer's income derived from sources in Indiana) or 2(m) (to fairly reflect income derived from sources in Indiana in the case of two (2) or more taxpayers) of [IC 6-3-2](#).

(8) Upon request by the taxpayer, the department determines that the adjustment otherwise required by this SECTION is unreasonable.

(d) For purposes of this SECTION, intangible expenses or directly related intangible interest expenses shall be considered to be at a commercially reasonable rate or at terms comparable to an arm's-length transaction if the intangible expenses or directly related intangible interest expenses meet the arm's-length standards of United States Treasury Regulation 1.482-1(b).

(e) If intangible expenses or directly related intangible expenses are determined not to be at a commercially reasonable rate or at terms comparable to an arm's-length transaction for purposes of this SECTION, the adjustment required by subsection (b) shall be made only to the extent necessary to cause the intangible expenses or directly related intangible interest expenses to be at a commercially reasonable rate and at terms comparable to an arm's-length transaction.

(f) For purposes of this SECTION, transactions giving rise to intangible expenses and any directly related intangible interest expenses between the taxpayer and the recipient shall be considered as having Indiana tax avoidance as the principal purpose if:

- (1) there is not one (1) or more valid business purposes that independently sustain the transaction notwithstanding any tax benefits associated with the transaction; and
- (2) the principal purpose of tax avoidance exceeds any other valid business purpose.

SECTION 2. This document expires July 1, 2007.

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