DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 07-0116
Income Tax
For the Tax Years 1999-2000

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ISSUES

I. Adjusted Gross Income Tax-Inclusion of Corporations in Combined Return

Authority: IC § 6-3-2-2(l), IC § 6-3-2-2(m), IC § 6-3-2-2(p), *Norrell Services, Inc. v. Indiana Department of State Revenue*, 816 N.E.2d 517, 520 (Ind. Tax Ct. 2004); *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159, 103 S.Ct. 2933 (1983); *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 102 S.Ct. 3103 (1982).

II. Adjusted Gross Income Tax-Accounts Receivable Securitization

Authority: IC § 6-3-2-2(l), IC § 6-3-2-2(m).

STATEMENT OF FACTS

The taxpayer is a multi-media conglomerate consisting of numerous divisions, corporations, partnerships, and subsidiaries. The taxpayer is in the business of creating and expanding a global media and entertainment network, including cable television networks and programming; book and magazine publishing; recorded music and music publishing; filmed entertainment, both in motion pictures and television production; and digital media. The taxpayer filed amended returns for the 1999 and 2000 tax years, requesting refunds for each year. The Indiana Department of Revenue ("Department") conducted an investigation of the taxpayer for the respective tax periods ending December, 1999 and December, 2000. As a result of the investigation, the Department denied the taxpayer's claims for refunds. The taxpayer protested the Department's disallowance of the refunds and a hearing was held. This Letter of Findings results.

I. Adjusted Gross Income Tax-Inclusion of Corporations in Combined Return

DISCUSSION

The taxpayer protests the Department's determination that the taxpayer should have filed a combined return based upon the taxpayer's relationship with a number of affiliated corporate partners (Organizations A-Z), and those organizations' economic activity within, or connection to, Indiana. The taxpayer bases its protest principally on the taxpayer's assertion that it adjusted its filing methodology put forth in a previously issued letter of finding. That letter of finding, covering issues with respect to assessments for the 1993, 1994, and 1995 tax years, held that the taxpayer could not include corporate partners' distributive shares of partnership losses in the taxpayer's Indiana income tax returns corresponding to the aforementioned years.

The Department repeatedly requested further information and documents from the taxpayer regarding the relationship between the taxpayer and its various affiliated partners, but taxpayer did not oblige the Department's requests. Based upon the limited information provided by the taxpayer, the Department determined that Organizations A-Z represent varying interests and business endeavors directly associated with the taxpayer's global business structure. More than half of Organizations A-Z are designated as cable television networks, contributing to that aspect of taxpayer's global business structure outlined herein. Documents supplied by the taxpayer display a corporate structure in which taxpayer owns and controls hundreds of corporate partners and subsidiaries, including Organizations A-Z. Taxpayer's Indiana consolidated amended returns for the subject tax years displayed flow through income and losses from Organizations A-Z interests. The taxpayer's protest repeatedly asserts its reliance on the prior letter of finding, but does not provide any explanation or documentary support regarding the taxpayer's reliance upon its asserted non-unitary filing methodology.

Citing *Norrell Services, Inc. v. Indiana Department of State Revenue*, 816 N.E.2d 517, 520 (Ind. Tax Ct. 2004), the taxpayer asserts that the Department should honor the previous letter of findings and uphold taxpayer's filing methodology. The *Norrell* Court found that the Department may exercise its discretion to retroactively rescind or modify rulings in the following *extreme circumstances,* which are not all inclusive:

(A) There was a misstatement or omission of material facts.

(B) The facts, as developed after the ruling, were materially different from the facts on which the department based its ruling.

(C) There was a change in the, applicable statute, case law or regulation.

(D) The taxpayer directly involved in the ruling did not act in good faith.

Taxpayer asserts in its protest that the facts relating to the relationship between the taxpayer and its corporate partners remained static in the period defined between the Department's first letter of findings and the subject investigation; a period covering the time between the 1995 and 1999 tax years. The taxpayer further asserts that it has not made any omission of material facts. However, further investigation of documents

displaying the corporate structure of the taxpayer in 1995 and 2000, respectively, indicates that the taxpayer's complex relationships with its corporate partners have not remained static, but rather have evolved with taxpayer's own evolution and expansion. Seventeen of the twenty-six Organizations A-Z had undergone either a change in ownership or controlling interest, or had been dissolved by the end of the 2000 tax year. And, as a result of negotiations and subsequent merger with one of taxpayer's competitors, one of taxpayer's principal partners issued a notice of termination to taxpayer in 1999, terminating that partner's management and governance rights.

The audit information upon which the previous letter of findings was based referred to no less than nineteen corporate partners–two partnerships made up of fifteen and two corporate partners, respectively–deemed to have nexus with Indiana for Indiana gross income tax assessment purposes. Comparing those nineteen corporate partners with Organizations A-Z, the Department finds only six in common with both audit periods. Perhaps the only circumstance remaining static, based upon the limited information provided by the taxpayer, shows that each of those organizations, whether addressed in the 1993-1995 audit years, or the 1999-2000 audit years, had nexus with Indiana.

The Department, therefore, asserts that taxpayer and its circumstances fail to satisfy the *Norrell* factors. The Department is not required to rely on its previous letter of findings with respect to the investigation and subsequent denial of taxpayer's claim for refund for the subject tax years.

Relying on its asserted adjusted filing methodology, the taxpayer argued that Organizations A-Z should not be included in a unitary return. Indiana law requires first a determination that the entities are operated as a unitary business. IC § 6-3-2-2(l) provides:

> If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or **the department may require**, in respect to all or any part of the taxpayer's business activity, if reasonable:
> (1) separate accounting;
> (2) for a taxable year beginning before January 1, 2011, the exclusion of any one (1) or more of the factors, except the sales factor;
> (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or
> **(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. (emphasis added)**

After it has been determined that the entities are unitary, the law requires that the income be reported in such a manner as to "fairly reflect" the Indiana income. IC § 6-3-2-2(m) provides:

> In the case of two (2) or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those organizations, trades, or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

The Department may also necessarily rely on IC § 6-3-2-2(p), which provides that:

> Notwithstanding subsections (l) and (m), the department may not require that income, deductions, and credits attributable to a taxpayer and another entity... be reported in a combined income tax return for any taxable year, unless the department is unable to fairly reflect the taxpayer's adjusted gross income for the taxable year through use of other powers granted to the department by subsections (l) and (m).

The Supreme Court has considered the issue of a unitary relationship for adjusted gross income tax in several cases and with several analyses. The essential characteristic the Court requires for a unitary business is that the individual entities are functionally integrated in a common business. *Allied-Signal, Inc. v. Director, Division of Taxation,* 504 U.S. 768, 112 S.Ct. 2251 (1992); *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159, 103 S.Ct. 2933 (1983); *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 102 S.Ct. 3103 (1982). The Supreme Court found that unitary businesses that were functionally integrated shared many common characteristics. They had common ownership. They had centralized management with a corporate strategy including the various entities. The individual businesses were operated in such a manner as to further a common purpose.

According to documents the taxpayer filed with the Securities & Exchange Commission (SEC), the taxpayer owned one hundred percent of its general and limited partners. Subsidiaries of the taxpayer owned one hundred percent of the capital stock of the aforementioned general and limited partners, with one of the general partners owning a majority interest in four fundamental areas of taxpayer's business: cable networks, filmed entertainment, cable television systems, and digital media; the taxpayer owned Organizations A-Z. The taxpayer derived its operating income and cash flow from its investments in its subsidiaries and corporate partners. Management decisions were made to further the common goal of creating and expanding a global media and entertainment network.

The taxpayer did not provide adequate documentation to support its adjusted filing methodology, nor did taxpayer provide adequate documentation to sustain its burden of proving that Organizations A-Z were not part of the unitary business and should, therefore, not be included in a combined return.

To both effectuate an equitable allocation and apportionment of the taxpayer's income and fairly reflect their Indiana adjusted gross income, the taxpayer and Organizations A-Z must be combined as a unitary business.

FINDING

The taxpayer's protest is denied.

II. Adjusted Gross Income Tax-Accounts Receivable Securitization

DISCUSSION

Taxpayer asserts that its asset securitization program is part of its comprehensive cash management program. Taxpayer incorporates two asset securitization programs, claiming to use a third party commercial paper conduit sponsored by a financial institution to accelerate the receipt of cash from long term receivables. The Department's investigation determined that taxpayer sells, on a revolving and nonrecourse basis, certain of its accounts receivables to a wholly owned, special purpose entity which, in turn, sells a percentage ownership interest in the accounts receivables to the aforementioned third party commercial paper conduit. Accounts receivables sold under this securitization program have been reflected as a reduction in receivables in the taxpayer's consolidated balance sheet.

The Department requested detailed information from taxpayer regarding its asset securitization program on several occasions, including during the administrative hearing. However, the taxpayer did not, and to date, has not provided the requested information. In taxpayer's protest letter, taxpayer stated that one of the securitization programs is through taxpayer's affiliates, and the other is through one of taxpayer's limited partners. Taxpayer adds that the affiliates and the limited partner received a significant amount of net proceeds from the respective asset securitization programs. Because the taxpayer denied access to those book entries and records necessary to determine whether or not the losses on the asset securitization program were self-created transactions, the Department denied those losses. Consequently, the Department added back those losses to federal taxable income.

The taxpayer states that the Internal Revenue Service (IRS) has reviewed the losses generated by the sales. In that review, the taxpayer asserts that the IRS approved the structure of the corporations and sales and has merely not determined the appropriate value to be assigned to the sold accounts receivables. Taxpayer argues that the absence of any adjustments by the IRS regarding these asset securitization programs substantiates taxpayer's argument that the programs served a valid business purpose. However, taxpayer's asset securitization programs would have virtually no federal filing effects because all the affiliates and corporate partners would be filing together, with all gains and losses netting on the consolidated federal return. Conversely, for Indiana filing purposes, taxpayer's returns would only account for those entities' losses, without the offsetting gains. In the absence of further information from the taxpayer as requested by the Department, the Department disallowed the taxpayer's reporting of losses from the sale of accounts receivables to the affiliates and limited partner because the sale was not an arms length transaction.

The taxpayer owns a majority interest in both the affiliates and the limited partner. The taxpayer and its related entities sell their accounts receivables to the affiliates and to the limited partner, respectively. Each of the related entities selling its accounts receivables recognized business losses from the sales of the receivables. These sales and the resulting claims of business losses distorted the results of the Indiana adjusted gross income of the taxpayer and its related entities. The affiliates and limited partner would normally be combined with the other members of the unitary business to fairly reflect Indiana adjusted gross income as required by IC § 6-3-2-2(l) and (m). However, the taxpayer did not provide the Department with sufficient documentation to combine the adjusted gross income tax returns. Therefore the Department disallowed the losses reported from the sales of the accounts receivables to the affiliates and limited partner.

Since the taxpayer did not provide the information to the Department as requested, the Department properly made adjustments to disallow losses reported from the sales of accounts receivables to the affiliates and limited partner.

FINDING

The taxpayer's protest to the adjustments to disallow losses reported from sales of the accounts receivables to the affiliates and limited partner is denied.

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