

**Letter of Findings Number: 07-0206
Financial Institutions Tax
For the Tax Period 2002-2004**

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ISSUES

I. Financial Institutions Tax – Inclusion of Subsidiary in Combined Return.

Authority: 26 U.S.C. § 7701(a)(3); IC § 6-8.1-5-1(c); IC § 6-5.5-2-1(a); IC § 6-5.5-1-17; IC § 6-5.5-1-6; [45 IAC 17-2-2](#); [45 IAC 17-4-4](#).

The Taxpayer protests the inclusion of a subsidiary corporation in the Taxpayer's combined return.

II. Financial Institutions Tax – Apportionment of Partnership Income.

Authority: IC § 6-5.5-2-8(a); IC § 6-5.5-1-18; IC § 6-5.5-5-1; IC § 6-5.5-5-2; IC § 6-5.5-2-4; Richard C. Mynsberge v. Department of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); State ex rel. Hatcher v. Lake Super. Ct., Room Three, 500 N.E. 2d 737 (Ind. 1986).

The Taxpayer protests the method of apportioning the income of a Limited Liability Company.

STATEMENT OF FACTS

The Taxpayer is a regulated bank holding corporation. It is the reporting parent corporation for several subsidiaries. The Taxpayer's unitary group included several partnerships and limited liability companies during the audit period, 2002 - 2004. The Taxpayer's combined return included the apportioned income of the partnerships and limited liability companies. The Indiana Department of Revenue (Department) adjusted the Taxpayer's combined return by including the adjusted gross income of the partnerships and limited liability companies rather than the apportioned income. This adjustment resulted in additional financial institutions tax due for the audit period 2003 – 2004 and reduced net operating losses for the tax year 2002. The Taxpayer protested the inclusion of a particular limited liability company in the combined return and the Department's utilization of the pre-apportionment method in determining the income of a limited liability corporation to be included in the Taxpayer's combined financial institutions tax return. A hearing was held and this Letter of Findings results.

I. Financial Institutions Tax – Inclusion of Subsidiary in Combined Return.

DISCUSSION

The Department included a particular limited liability company (LLC) in the Taxpayer's combined return. The LLC had two members – a bank and a finance corporation. Both the finance corporation and the bank were subsidiaries of the bank. The LLC purchased loans, which it holds for securitization purposes. The LLC was treated as a partnership for federal tax purposes. The Taxpayer protested the inclusion of the LLC arguing that the financial institutions tax is imposed on corporations, not partnerships.

The issue to be determined is whether or not the LLC must be included in the combined return.

All tax assessments are presumed to be valid. IC § 6-8.1-5-1(c). The Taxpayer bears the burden of proving that any assessment is incorrect. *Id.*

Indiana imposes a financial institutions tax at IC § 6-5.5-2-1(a) as follows:

There is imposed on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana.

Taxpayers subject to the tax are delineated at IC § 6-5.5-1-17(a) as follows:

A corporation that is transacting the business of a financial institution in Indiana, including any of the following:

- (1) A holding company.
- (2) A regulated financial corporation.
- (3) A subsidiary of a holding company or a regulated financial corporation.
- (4) Any other corporation organized under the laws of the United States, this state, any other taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution.

IC § 6-5.5-1-6 and [45 IAC 17-2-2](#) both use the definition of a corporation found at 26 U.S.C. § 7701(a)(3) including entities taxed as corporations for federal purposes.

The LLC is not a corporation under the laws of any state or taxed as a corporation for federal purposes. As a limited liability company, the LLC is taxed in the same manner as a partnership. [45 IAC 17-4-4](#) clearly states that partnerships are not subject to the Financial Institutions Tax. This would generally be the end of the discussion of whether or not the LLC is subject to the imposition of the financial institutions tax. The issue here, however, is not whether or not the LLC is subject to the financial institutions tax as a stand-alone individual business. Rather, the issue is whether or not the LLC must be included in the Taxpayer's combined return even if it would not be

individually subject to the financial institutions tax.

Entities to be included in a financial institution's combined return are governed by IC § 6-5.5-5-2 which provides as follows:

A combined return must include the adjusted gross income of all members of the unitary group, even if some of the members would not otherwise be subject to taxation under this article.

The members of the unitary group are designated by the statute at IC § 6-5.5-1-18(a) as follows:

"Unitary business" means business activities or operations that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution. *The term may be applied within a single legal entity or between multiple entities and without regard to whether each entity is a corporation, a partnership, a limited liability company, or a trust, provided that each member is either a corporation that conducts the business of a financial institution under [IC 6-5.5-1-17\(d\)\(2\)](#), or any other entity, regardless of its form, that conducts activities that would constitute the business of a financial institution under [IC 6-5.5-1-17\(d\)\(2\)](#) if the activities were conducted by a corporation. The term "unitary group" includes those entities that are engaged in a unitary business transacted wholly or partially within Indiana. However, the term does not include an entity that does not transact business in Indiana. (emphasis added).*

The LLC at issue here is a member of the Taxpayer's group of related businesses. The LLC is in the business of purchasing loans, which it holds for securitization purposes. This qualifies as the transaction of a business activity subject to the financial institutions tax. The LLC is owned by the Taxpayer and a subsidiary of the bank which is included in the Taxpayer's combined return. The LLC transacts the business of a financial institution both within and without Indiana. The statute governing unitary status for financial institution tax purposes specifically states that a unitary business can include partnerships and other noncorporate entities even if they would not individually be subject to the financial institutions tax. As a business entity that has a unitary relationship with the Taxpayer and transacts business of a financial institution both within and without Indiana, the LLC must be included in the Taxpayer's combined return.

FINDING

The Taxpayer's protest is respectfully denied.

II. Financial Institutions Tax – Apportionment of Partnership Income.

DISCUSSION

The Department combined the adjusted gross income of the two members in the LLC discussed in the first issue to determine the adjusted gross income of the LLC. The Department then took the total LLC adjusted gross income and apportioned it to determine the amount of Indiana adjusted gross income. The Taxpayer protested this pre-apportionment method of determining the Indiana income subject to the financial institutions tax. The Taxpayer contended that each individual member's income should have been apportioned between Indiana income and non-Indiana income before the Indiana amounts were utilized in the LLC's income for inclusion in the Taxpayer's combined return.

The issue to be determined is whether or not the LLC should determine its Indiana income by using the post-apportionment or pre-apportionment method.

The apportionment method is governed by IC § 6-5.5-2-8(a) as follows:

If a corporation is:

- (1) transacting the business of a financial institution (as defined in [IC 6-5.5-1-17\(d\)](#)); and
- (2) is a partner in a partnership or the grantor and beneficiary of a trust transacting business in Indiana and the partnership or trust is conducting in Indiana an activity or activities that would constitute the business of a financial institution if transacted by a corporation;

the corporation is a taxpayer under this article and shall, in calculating the corporation's tax liability include in the corporation's *adjusted or apportioned income* the corporation's percentage of the partnership or trust *adjusted gross income or apportioned income* (emphasis added).

This statute states that the Taxpayer should use either the adjusted or apportioned income. A decision must be made as to which method to be used. The statute is unclear on how taxpayers and the Department are to determine which method of apportionment to use. Therefore, to determine the correct statutory construction, one must consider the intent of the legislature. *Richard C. Mynsberge v. Department of State Revenue*, 716 N.E.2d 629, 631 (Ind. Tax Ct. 1999). To do this, one must look at the entire statutory scheme. That entire statutory scheme suggests the proper interpretation. Finally, one must assume that the statutory scheme is logical and the interpretation will not bring about an absurd result. *State ex rel. Hatcher v. Lake Super. Ct., Room Three*, 500 N.E.2d 737, 739 (Ind. 1986.) Understanding and effectuation of the entire statutory scheme in a logical fashion prevails over a strict and literal reading of any one provision. *Id.*

The members of the unitary group include any and all entities engaged in the unitary financial institutions business. IC § 6-5.5-1-18. The unitary group must file a combined return that covers all the operations of the unitary business and covers all the members of the unitary group. IC § 6-5.5-5-1. Each combined return must include the adjusted gross income of all the members of the unitary group, even if some of the members would not otherwise be subject to taxation under this article. IC § 6-5.5-5-2. The apportioned income for the unitary

group is the aggregate adjusted gross income, from whatever source derived, of the members of the unitary group multiplied by the Indiana apportionment percentage. IC § 6-5.5-2-4.

Read together, the statutory scheme requires that the adjusted gross income of corporate members of the LLC be used to determine the LLC's total income prior to the apportionment into Indiana and non-Indiana income. Therefore, the adjusted gross income and receipts of the LLC, multiplied by each member corporation's ownership of the LLC, are added to the corporation's adjusted gross income and receipts. After this addition, the Taxpayer's adjusted gross income tax figure is to be multiplied by the appropriate percentage to determine the Taxpayer's Indiana adjusted gross income to be included in the Taxpayer's combined return. This is the pre-apportionment method used by the Department in determining the Taxpayer's proper financial institutions tax liability.

The Department properly used the pre-apportionment method in determining the LLC's Indiana adjusted gross income to be included in the Taxpayer's combined financial institutions tax return.

FINDING

The Taxpayer's protest is respectfully denied.

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