

Letter of Findings Number: 07-0526
Financial Institutions Tax
For Tax Years 2001-04

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ISSUES

I. Financial Institutions Tax—Imposition.

Authority: IC § 6-5.5-3-1; IC § 6-5.5-4-5; IC § 6-8.1-5-1; [45 IAC 17-2-1](#); [45 IAC 17-2-4](#); *Black's Law Dictionary* 1268 (7th ed. 1990).

Taxpayer protests the assessment of financial institutions tax.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-8.1-10-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a corporation located outside Indiana, with no employees or office locations in Indiana, and a wholly-owned subsidiary of a corporation which does business in Indiana. Taxpayer's parent corporation sells tangible personal property to Indiana customers. Those customers often purchased the goods without paying immediately, thereby creating accounts receivable. Taxpayer purchased those accounts receivable from its parent. As a result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer should have been paying financial institutions tax in Indiana for the tax years 2001, 2002, 2003, and 2004. Accordingly, the Department issued proposed assessments for financial institutions tax, penalty and interest for those years. Taxpayer protests that it is not subject to Indiana financial institutions tax, penalty and interest. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Financial Institutions Tax—Imposition.

DISCUSSION

Taxpayer protests the imposition of financial institutions tax. Taxpayer states that it was not involved in the business of a financial institution in Indiana and so is not subject to Indiana financial institutions tax. Taxpayer states that it purchased the accounts receivable from its parent at going market rates in arm's-length transactions and that these purchases do not qualify as doing business as a financial institution in Indiana. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The Department refers to IC § 6-5.5-3-1, which states:

For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year only if the taxpayer:

- (1) maintains an office in Indiana;
- (2) has an employee, representative, or independent contractor conducting business in Indiana;
- (3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
- (4) regularly solicits business from potential customers in Indiana;
- (5) *regularly performs services outside Indiana that are consumed within Indiana*;
- (6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;
- (7) owns or leases tangible personal or real property located in Indiana; or
- (8) regularly solicits and receives deposits from customers in Indiana.

(Emphasis added.)

Next, the Department refers to [45 IAC 17-2-1](#), which states:

(a) The Financial Institutions Tax (FIT) is intended to tax both traditional financial institutions (such as banks and savings and loans, etc.), that are transacting business within Indiana, as well as other types of businesses that are deemed to be transacting the business of a financial institution in Indiana.

(b) The FIT is a franchise tax imposed upon a corporation that:

- (1) *is transacting the business of a financial institution in Indiana*;
- (2) is a partner in a partnership that is transacting the business of a financial institution in Indiana; or
- (3) is the grantor and beneficiary of a trust that is transacting the business of a financial institution in Indiana.

(Emphasis added.)

Additionally, the Department refers to IC § 6-5.5-4-5, which states:

Interest income and other receipts from consumer loans not secured by real or tangible personal property must be attributed to Indiana if the loan is made to a resident of Indiana, whether at a place of business, by a traveling loan officer, by mail, by telephone, or by other electronic means.

Finally, the Department refers to [45 IAC 17-2-4](#), which states:

(a) The tax is also imposed upon any corporation if the corporation is organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government and the corporation is carrying on the business of a financial institution within Indiana.

(b) The corporation is deemed to be conducting the business of a financial institution and therefore subject to the FIT if eighty percent (80 [percent]) or more of the corporation's gross income during the taxable year is derived from the following activities:

- (1) *Extending credit. (Refer to subsection (e) below.)*
- (2) Leasing that is the economic equivalent of extending credit.
- (3) Credit card operations.

(c) As used in this section, "gross income" includes the income derived from activities which are performed by corporations primarily (as defined by the eighty percent (80 [percent]) test) engaged in the business of extending credit. Gross income includes income from the following:

- (1) Interest.
- (2) Fees.
- (3) Penalties.
- (4) A market discount or other type of discount.
- (5) Rental income.
- (6) The gain on a sale of intangible or other property evidencing a loan or extension of credit.
- (7) Dividends or other income received as a means of furthering any of the three (3) activities listed in subsection (b).

(d) Extraordinary income is excluded from gross income for purposes of satisfying the eighty percent (80 [percent]) test. Extraordinary income includes income which is unusual, infrequent, nonrecurring, and unrelated to the extension of credit.

(e) *For purposes of satisfying the eighty percent (80 [percent]) test, corporations which are in the business of a financial institution must be conducting the activities of extending credit, leasing that is the economic equivalent of the extension of credit, or credit card operations, as follows:*

(1) *Making, acquiring, selling, or servicing loans or extensions of credit. For the purpose of this subdivision, loans and extensions of credit include secured or unsecured consumer loans; installment obligations; mortgage or other secured loans on real estate or tangible personal property; credit card loans; secured and unsecured commercial loans of any type; letters of credit and acceptance of drafts; loans arising in factoring; and any other transactions with a comparable economic effect. The following are examples of extending credit:*

(A) A corporation is a manufacturer of widgets. In 19x9, the corporation received one million dollars (\$1,000,000) in gross income from the sale of widgets. In selling such widgets, the corporation makes available an installment obligation plan whereby its customers buy widgets over an extended period of time. In 19x9, the corporation received one hundred thousand dollars (\$100,000) in interest and fees from such installment obligations. Because only ten percent (10 [percent]) of the corporation's total receipts from all sources is derived from extending credit, the corporation is not considered a taxpayer for purposes of the FIT.

(B) Corporation A is primarily engaged in the business of a collection agency. Various other corporations enter into contracts with Corporation A for purposes of having delinquent loan monies collected. Corporation A does not originate or acquire the loans. Corporation A receives income from the various corporations based upon the percentage of payments collected. Corporation A is not a taxpayer for purposes of the FIT. Although one hundred percent (100 [percent]) of Corporation A's income is from servicing loans, Corporation A is not extending credit.

(2) Leasing or acting as an agent, broker, or advisor, in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes. If the lease is the economic equivalent of the extension of credit, and the lease is not treated as a lease for federal income tax purposes, the income derived from the lease is included in gross income for purposes of satisfying the eighty percent (80 [percent]) test whether the corporation is leasing its own real or personal property or is the lessor of real or personal property owned by another.

(3) Operating a credit card, debit card, charge card, or similar business. If eighty percent (80 [percent]) of a corporation's total gross income is derived from:

- (A) extending credit;
- (B) leasing; or

(C) credit card operations;
the corporation is subject to the FIT.
(*Emphasis added.*)

In reaching its determination, the Department considered the items which Taxpayer purchased from the parent company to be loans which the parent had made to its customers. Therefore, the Department considered Taxpayer to be conducting the business of a financial institution as described in [45 IAC 17-2-4\(e\)](#).

Of relevance here, "Receivable" is defined in *Black's Law Dictionary* 1268 (7th ed. 1990) as:

That which is due and owing a person or company (e.g. account receivable). In bookkeeping, the name of an account which reflects a debt due.

Next, *Black's* defines "Loan" in relevant part as:

A lending. Delivery by one party to and receipt by another party of a sum of money upon agreement, express or implied, to repay it with or without interest. Anything furnished for temporary use to a person at his request, on condition that it shall be returned, or its equivalent in kind, with or without compensation for its use. Bailment without reward, consisting of the delivery of an article by the owner to another person, to be used by the latter gratuitously, and returned, either *in specie* or in kind. A borrowing of money or other personal property by a person who promises to return it.

"Loan" includes: (1) the creation of debt by the lender's payment of or agreement to pay money to the debtor or to a third party for the account of the debtor; (2) the creation of debt by a credit to an account with the lender upon which the debtor is entitled to draw immediately; (3) the creation of debt pursuant to a lender credit card or similar arrangement; and (4) the forbearance of debt arising from a loan.

(*Id.* at 936. *Emphasis in original.* Internal citations omitted.)

Here, Taxpayer has provided sufficient documentation to establish that it purchased "accounts receivable," as defined in *Black's*. A straightforward account receivable is clearly different from a loan. An account receivable involves routine payment for a purchase, while a loan involves the return of something, either money or property, from the lendee to the lender with or without interest. In the instant case, nothing is being returned. Rather, the Parent corporation sold the right to collect payment from Parent's customer's purchases to Taxpayer and the Parent's customers are paying Taxpayer for their purchases. There is no evidence in the protest file which indicates that Taxpayer was extending any kind of credit or loans or that it was purchasing accounts which were extensions of credit or loans. Purchasing and collecting on an account receivable is not among those activities constituting the activities of a financial institution, as defined in [45 IAC 17-2-4](#). Since Taxpayer was not conducting the business of a financial institution in Indiana, it is not subject to Indiana financial institutions tax. Therefore, Taxpayer has met its burden under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax year in question. Taxpayer protests the imposition of penalty and interest. As provided by IC § 6-8.1-10-1(e), the Department may not waive interest. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part: If a person:

...
(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...
the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer did not incur the deficiency which the Department initially believed was due. Taxpayer has affirmatively established that there was no failure to pay a deficiency, as required by [45 IAC 15-11-2\(c\)](#). Also, while the Department may not waive interest, since Taxpayer was sustained in Issue I, there is no base tax due

and therefore no interest due.

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer is sustained on Issue I regarding the imposition of financial institutions tax. Taxpayer is sustained on Issue II regarding the imposition of penalty and interest.

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