DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 08-0024
Financial Institutions Tax
For the Tax Period 2001

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ISSUE

I. Financial Institutions Tax–Income from Sources Outside the United States.

Authority: IC § 6-5.5-1-2; IC § 6-8.1-5-1; I.R.C. § 862.

Taxpayer protests the "subtraction" of Taxpayer's "taxable income" from sources outside the United States to arrive at "adjusted gross income" for Financial Institutions Tax purposes.

STATEMENT OF FACTS

Taxpayer is a regulated bank holding corporation. It is the reporting parent corporation for several subsidiaries. Pursuant to an audit, the Indiana Department of Revenue (Department) assessed additional Financial Institutions Tax and interest for the 2001 tax year. The Department found that Taxpayer had "subtracted" its "gross foreign source income" instead of its federal "taxable income" from sources outside the United States to arrive at "adjusted gross income" for Financial Institutions Tax purposes. The Taxpayer protested the assessment. An administrative hearing was held, and this Letter of Findings results.

I. Financial Institutions Tax–Income from Sources Outside the United States.

DISCUSSION

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

The Department found that Taxpayer had "subtracted" its "gross foreign source income" instead of its "federal taxable income" from sources outside the United States to arrive at "adjusted gross income" for Financial Institutions Tax purposes.

IC § 6-5.5-1-2(a) defines "adjusted gross income" for the Financial Institutions Tax, as follows:

Except as provided in subsections (b) through (d), "adjusted gross income" means *taxable income* as *defined in Section 63 of the Internal Revenue Code*, adjusted as follows:

(1) Add the following amounts:

(A) An amount equal to a deduction allowed or allowable under Section 166, Section 585, or Section 593 of the Internal Revenue Code.

(B) An amount equal to a deduction allowed or allowable under Section 170 of the Internal Revenue Code.

(C) An amount equal to a deduction or deductions allowed or allowable under Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by a state of the United States or levied at the local level by any subdivision of a state of the United States.

(D) The amount of interest excluded under Section 103 of the Internal Revenue Code or under any other federal law, minus the associated expenses disallowed in the computation of taxable income under Section 265 of the Internal Revenue Code.

(E) An amount equal to the deduction allowed under Section 172 or 1212 of the Internal Revenue Code for net operating losses or net capital losses.

(F) For a taxpayer that is not a large bank (as defined in Section 585(c)(2) of the Internal Revenue Code), an amount equal to the recovery of a debt, or part of a debt, that becomes worthless to the extent a deduction was allowed from gross income in a prior taxable year under Section 166(a) of the Internal Revenue Code.

(G) Add the amount necessary to make the adjusted gross income of any taxpayer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made under Section 168(k) of the Internal Revenue Code to apply bonus depreciation to the property in the year that it was placed in service.

(H) Add the amount necessary to make the adjusted gross income of any taxpayer that placed Section 179 property (as defined in Section 179 of the Internal Revenue Code) in service in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election for federal income tax purposes not been made for the year in which the property was placed in service to take deductions under Section 179 of the Internal Revenue Code in a total amount exceeding twenty-five thousand dollars ($25,000).

(I) Add an amount equal to the amount that a taxpayer claimed as a deduction for domestic production

activities for the taxable year under Section 199 of the Internal Revenue Code for federal income tax purposes.

(2) Subtract the following amounts:

(A) Income that the United States Constitution or any statute of the United States prohibits from being used to measure the tax imposed by this chapter.

(B) *Income that is derived from sources outside the United States, as defined by the Internal Revenue Code.*

(C) An amount equal to a debt or part of a debt that becomes worthless, as permitted under Section 166(a) of the Internal Revenue Code.

(D) An amount equal to any bad debt reserves that are included in federal income because of accounting method changes required by Section 585(c)(3)(A) or Section 593 of the Internal Revenue Code.

(E) The amount necessary to make the adjusted gross income of any taxpayer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made under Section 168(k) of the Internal Revenue Code to apply bonus depreciation.

(F) The amount necessary to make the adjusted gross income of any taxpayer that placed Section 179 property (as defined in Section 179 of the Internal Revenue Code) in service in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election for federal income tax purposes not been made for the year in which the property was placed in service to take deductions under Section 179 of the Internal Revenue Code in a total amount exceeding twenty-five thousand dollars ($25,000).

(*Emphasis Added*.)

Accordingly, to determine a taxpayer's "adjusted gross income" for Financial Institutions Tax purposes the Department starts with federal "taxable income" as defined by the Internal Revenue Code and make certain enumerated adjustments.

Federal "taxable income" includes the "taxable income" from sources outside the United States as defined at I.R.C. § 862(b), as follows:

From the items of gross income specified in subsection (a) there *shall* be *deducted the expenses, losses, and other deductions* properly apportioned or allocated thereto, and a ratable part of any expense, losses, or other deduction which cannot definitely be allocated to some item or class of gross income. The *remainder, if any, shall be treated in full as taxable income from sources without the United States*....

(*Emphasis Added*.)

Therefore, it is this gross income net of "expenses, losses, and other deductions" amount that is included in Taxpayer's federal "taxable income." Plainly stated, only those amounts of foreign source income that are greater than the expenses, losses, and other deductions related to that income–as defined in the internal revenue code–are treated as federal taxable income. Thus, pursuant to IC § 6.5.5-1-2(a)(2)(B), it is this "net of expenses, losses, and other deductions" amount, defined as "taxable income" from foreign sources, that is subtracted from Taxpayer's federal "taxable income" to arrive at the Taxpayer's Indiana "adjusted gross income" for Financial Institutions Tax purpose.

A. "Taxable Income" From Sources Outside the United States.

Taxpayer asserts that it had properly "subtracted" its "gross foreign source income." Taxpayer, in support of its assertion, cited the FIT-20 instruction booklet, which states to "subtract income derived from sources outside the United States as defined in the Internal Revenue Code and *included in federal income*." (*Emphasis Added*.) Taxpayer has missed a key point as emphasized. This instruction states to "subtract" the amount of foreign source income that is included in "federal income," which by definition is only the foreign source income that remains after all of the foreign source expense, losses, and other deductions have been deducted from it. I.R.C. § 862(b).

In addition, in support of its assertion, Taxpayer refers to IC § 6-5.5-1-2(a)(1)(D), which makes a specific reference to expenses being deducted from the amount of "tax-exempt interest" that is an "addition" to the "federal taxable income." However, within the statutory scheme "additions" to the federal "taxable income" would need to be different than "subtractions" to arrive at "adjusted gross income" for Financial Institutions Tax purposes. When a taxpayer is to "add" an amount that is outside of the federal taxable income, which is the starting point, the method to arrive at that specific number needs to be identified and specifically defined. Conversely, in this situation, when a taxpayer is to "subtract" the foreign source "taxable income," which is a number that is already included in the federal "taxable income," the amount to be subtracted is already identifiable and needs no further clarification.

Therefore, the Department properly "subtracted" the federal "taxable income" that was derived from foreign sources to arrive at the Taxpayer's "adjusted gross income" for Financial Institutions Tax purposes.

B. "Actual Expenses."

Taxpayer maintains that if expenses and deductions are to be "subtracted," then the "actual expenses" should be used and not a percentage or allocation of expenses. Taxpayer further maintains that "foreign dividend

gross-up" is not an "actual receipt"; therefore, it would not have any "actual expenses" attributed to it and the method the Department uses should take that into account.

First, the Department in its assessment did not use a percentage, but–as discussed above–used the amount of foreign source federal "taxable income," which is the gross income less of expenses, losses, and other deductions as reported by the Taxpayer on its federal income tax return. Second, the definition of "taxable income" for income from foreign source as provided in I.R.C. § 862(b), states "there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expense, losses, or other deduction which cannot definitely be allocated to some item or class of gross income." The Department does compute the amount of expenses, but uses those expenses, losses, and deductions that are required to be deducted and reported to arrive at "taxable income" from source outside the United States on Taxpayer's federal income tax return as provided in I.R.C. § 862(b). Thus, the Department is only "subtracting" what Taxpayer has reported as foreign source federal "taxable income" and nothing more or nothing less.

Therefore, the Department properly "subtracted" the federal "taxable income" that was derived from foreign sources to arrive at the Taxpayer's "adjusted gross income" for Financial Institutions Tax purposes.

FINDING

Taxpayer's protest is denied.

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