DEPARTMENT OF STATE REVENUE

02-20080333R.LOF

Letter of Findings: 08-0333R
Indiana Corporate Income Tax
For the Tax Years 1996-2003

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ISSUE

I. Corporate Income Tax–Net Operating Losses.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-2.6 (as in effect during the audit period, amended effective 2004); IC § 6-3-2-12; IC § 6-8.1-5-1; Kraft General Foods, Inc. v. Iowa Dep't of Revenue and Finance, 505 U.S. 71 (1992).

Taxpayer protests that the Department erred in calculating its net operating loss deductions.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation that is doing business in Indiana. Taxpayer filed its 2001, 2002, and 2003 Indiana corporate income tax returns showing Indiana net operating losses. Taxpayer then filed amended returns for its 1996 through 1999 tax years claiming refunds based upon a reduction of corporate income taxes from carrying back the 2001 and 2002 net operating loss deductions to each of those respective years. Pursuant to an audit, the Indiana Department of Revenue ("Department") found that Taxpayer had incorrectly computed its available net operating loss deductions for the 2001, 2002, and 2003 tax years and made adjustments that lowered the amount of the deductions. Simultaneously, pursuant to an investigation, the Department denied a portion of Taxpayer's 1998 refund claim and Taxpayer's entire 1999 refund claim based upon the adjusted net operating loss deductions. Taxpayer protested the audit findings and the refund denials. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as required.

I. Corporate Income Tax–Net Operating Losses.

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 incorrectly computed its 2001, 2002, and 2003 net operating loss deductions and adjusted the deductions accordingly. The Department calculated Taxpayer's net operating losses using the formula provided in IC § 6-3-2-2.6 (as in effect during the audit period, amended effective 2004).

IC § 6-3-2-2.6 (as in effect during the audit period, amended effective 2004) required a four step process to calculate a net operating loss, as follows:

> (a) This section applies to a corporation or a nonresident person, for a particular taxable year, if the taxpayer's adjusted gross income for that taxable year is reduced because of a deduction allowed under Section 172 of the Internal Revenue Code for a net operating loss. For purposes of section 1 of this chapter, the taxpayer's adjusted gross income, for the particular taxable year, derived from sources within Indiana is the remainder determined under STEP FOUR of the following formula:
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> STEP ONE: Determine in the manner prescribed in section 2 of this chapter, the taxpayer's adjusted gross income, for the taxable year, derived from sources within Indiana, as calculated without the deduction for net operating loses provided by Section 172 of the Internal Revenue Code.
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> STEP TWO: Determine, in the manner prescribed in subsection (b), the amount of the taxpayer's net operating losses that are deductible for the taxable year under Section 172 of the Internal Revenue Code, as adjusted to reflect the modifications required by IC 6-3-1-3.5, and that are derived from sources within Indiana.
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> STEP THREE: Enter the larger of zero (0) or the amount determined under STEP TWO.
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> STEP FOUR: Subtract the amount entered under STEP THREE from the amount determined under STEP ONE.
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> (b) For purposes of STEP TWO of subsection (a), the modifications that are to be applied are those modifications required under IC 6-3-1-3.5 for the same taxable year during which each net operating loss was incurred. In addition, for the purposes of STEP TWO of subsection (a), the amount of a taxpayer's net operating losses that are derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's income derived from sources within Indiana is determined, under section 2 of this chapter, for the same taxable year during which each loss was incurred. Also for purposes of STEP TWO of subsection (a), the following procedures apply:
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> (1) The taxpayer's net operating loss for a particular tax year shall be treated as a positive number.
>
> (2) A modification that is to be added to federal adjusted gross income or federal taxable income under IC 6-3-1-3.5 shall be treated a negative number.
>
> (3) A modification this is to be subtracted from federal adjusted gross income or federal taxable income

under IC 6-3-1-3.5 shall be treated a positive number.

Taxpayer asserts that it figured its net operating loss deduction correctly by including the deduction found in IC § 6-3-2-12 in the computation. Taxpayer maintains that the deduction found in IC § 6-3-2-12 is "broadly worded" and "stands upon its own" in a way that requires its inclusion in net operating loss deduction.

IC § 6-3-2-12(b), provides:

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The amount of the deduction equals the product of:

(1) the amount of the foreign source dividend included in the corporation's adjusted gross income for the taxable year; multiplied by

(2) the percentage prescribed in subsection (c), (d), or (e), as the case may be.

Accordingly, IC § 6-3-2-12 allows a taxpayer to take a deduction from its Indiana adjusted gross income for certain foreign source dividend income that has been included in that taxpayer's Indiana adjusted gross income.

The foreign dividend deduction is a specific deduction from Indiana adjusted gross income. However, there is no similar statutory provision for such a deduction in the computation of an Indiana net operating loss deduction. As provided above, the Indiana net operating loss deduction begins with federal adjusted gross income and is modified according to the Indiana statute. The foreign source dividend deduction is not one of the modifications allowed by IC § 6-3-2-2.6 in arriving at the Indiana net operating loss deduction. Therefore, Taxpayer's inclusion of the foreign source dividend deduction in the computation of its net operating loss deduction is contrary to IC § 6-3-2-2.6.

Taxpayer further asserts that the Department, by not including the foreign dividends deduction in the net operating loss deduction calculation, is taxing foreign source dividends. However, the Department is not taxing the foreign dividends. The foreign dividend deduction is a deduction from Indiana adjusted gross income that is allowed to a Taxpayer when appropriate. In this case, the Department has simply properly calculated a new deduction allowed to the Taxpayer under IC § 6-3-2-2.6. Taxpayer's approach would result in compounding the deductions upon one another. Taxpayer has not referenced any statute or regulation which requires the Department, or allows the Taxpayer, to do so.

Additionally, Taxpayer maintains that IC § 6-3-2-2.6 discriminates against foreign commerce in violation of the United States Constitution. Taxpayer cites to Kraft General Foods, Inc. v. Iowa Dep't of Revenue and Finance, 505 U.S. 71 (1992) to support its assertion. However, the instant case is distinguishable from the Kraft case. Unlike the Iowa statutes in Kraft that did not provide for a foreign source dividends deduction, Indiana statutes have a deduction for foreign source dividends. Notwithstanding, an administrative hearing conducted by the Department of Revenue is not the proper forum to determine the constitutionality of an Indiana statute.

Lastly, Taxpayer asserts that even if the Department does not wish to address the constitutionality of the Indiana statute in an administrative hearing, IC § 6-3-1-3.5(b)(1) provides a remedy for this situation. IC § 6-3-1-3.5(b)(1), which defined adjusted gross income, provides for a "[s]ubtract[ion] [of] income that is exempt from taxation under this article by the Constitution and statutes of the United States." Since Taxpayer has not pointed to a federal tax statute that allows for an exemption, the Department assumes that Taxpayer is asserting that the Constitution provides for an exemption. Taxpayer has not provided a satisfactory analysis to explain why subtracting income that is exempt under the Constitution does not require the answering of a constitutional question. Since an administrative hearing conducted by the Department of Revenue is not the proper forum to determine the constitutionality of a state tax issue, the Department declines Taxpayer's invitation to address Taxpayer's assertion.

FINDING

Taxpayer protest is respectfully denied.

Posted: 12/17/2008 by Legislative Services Agency
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