DEPARTMENT OF STATE REVENUE

02-20070607.LOF

Letter of Findings Number: 07-0607
Income Tax
For Tax Year 2004

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Adjusted Gross Income Tax–Royalty Expenses.
Authority: IC § 6-3-2-2; IC § 6-8.1-5-1.

Taxpayer protests the determination to add back royalty expenses.

STATEMENT OF FACTS

Taxpayer is a corporation doing business in Indiana and is a member of a group of related corporations doing business in Indiana and throughout the country. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed additional income tax, negligence penalty, and interest for the tax year 2004. Taxpayer protests a portion of these adjustments. Specifically, Taxpayer protests the Department's determination to add back royalty payments made from Taxpayer to a related corporation for the rights to use certain intellectual property. The addback resulted in additional income tax for 2004. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax–Royalty Expenses.

DISCUSSION

Taxpayer protests the Department's determination to add back royalty payments to its 2004 Indiana adjusted gross income tax. The Department based its determination on the fact that both Taxpayer and the company to which it paid the royalties are owned by the same ultimate parent company. This led the Department to the conclusion that the royalties distorted Taxpayer's Indiana income. The Department then determined that the proper method to fairly reflect Taxpayer's income would be to add back the royalty payments to Taxpayer's Indiana income. Taxpayer protests that the royalty payments were for valid business reasons and that adding them back to Indiana income is not proper. 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).

Taxpayer protests that the Department should not have added back royalty payments it made to a related company for the use of certain intellectual property. The Department referred to IC § 6-3-2-2(m), which states:

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 determined that the related company did not bear the costs of providing the services which gave rise to Taxpayer's income and therefore gave rise to the value of the trademarks Taxpayer used in Indiana. Therefore, the Department considered that the value of the trademarks was wholly located in Indiana and no payment outside Indiana would be required.

Taxpayer protests that the royalty payments were for valid business purposes and were paid at arm's-length rates. Taxpayer states that the related company is a valid business entity performing valid business activities. As part of this protest, Taxpayer has provided documentation and analysis in support of this position. The documentation and analysis demonstrates that Taxpayer's treatment of the royalty payments in its original return fairly reflect Taxpayer's Indiana income for the year at issue. The documentation and analysis is sufficient to meet the requirements of IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

Posted: 02/18/2009 by Legislative Services Agency
An [html](#) version of this document.