DEPARTMENT OF STATE REVENUE

02-20080547.LOF

Letter of Findings: 08-0547
Indiana Corporate Income Tax
For the 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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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 the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Adjusted Gross Income Tax–Imposition.

Authority: IC § 6-3-2-2; IC § 6-8.1-3-3; IC § 6-8.1-5-1; Wabash Inc. v. Indiana Dep't of State Revenue, 729 N.E.2d 620 (Ind. Tax Ct. 2000).

Taxpayer protests the Department's decision to not allow certain adjustments that Taxpayer requested on an amended return.

STATEMENT OF FACTS

Taxpayer is a multi-structured manufacturing and insurance business consisting of a parent corporation ("parent") and numerous subsidiaries. For the tax year 2004, Taxpayer filed a consolidated Indiana adjusted gross income tax return to report the parent and subsidiaries' income from Indiana activities for its two consolidated groups. Taxpayer has one consolidated group for its life insurance companies ("life group") and one consolidated group for all of its non-life insurance companies ("non-life group"). In another matter before the Department, Taxpayer asserted that it wanted to carryback a 2004 net operating loss of its life group to the 2003 tax year. The Department requested for Taxpayer to file amended returns for the 2003 and 2004 tax years reflecting this adjustment. Taxpayer's originally filed 2004 tax year return had mistakenly applied its 2004 group's net operating loss against the non-life insurance group's adjusted gross income. Thus, Taxpayer's filing of the 2004 amended tax return to reflect the carryback of the life group's net operating loss to 2003 resulted in an increase to Taxpayer's 2004 adjusted gross income. In an effort to reduce the amount of the increase to its 2004 adjusted gross income, Taxpayer included other adjustments on the 2004 amended return. However, since these other adjustments to the 2004 tax year were both unexpected and improperly supported, the Department did not allow the other adjustments. The Department issued a proposed assessment for the 2004 tax year. Taxpayer protested the assessment. An administrative hearing was held, and this Letter of Findings results.

I. Adjusted Gross Income Tax–Imposition.

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.

A. Credit Reconciliation.

Taxpayer maintains that when its adjusted gross income tax liability increased, the amount of credits it is allowed to claim increased thereby requiring a reconciliation of its credits for the 2004 tax year. Taxpayer asserts that it is now allowed a $10,000 neighborhood assistance credit and an increase of $29,692 to its research and development credits.

Taxpayer has provided sufficient information to demonstrate that its credits need to be reconciled. However, the reconciliation needs to involve the adjustment for any credits from the 2004 tax year that were unused at the time of the previous filings and were allowed as a carry over to another tax year. Therefore, Taxpayer's protest, to the extent that the Department finds that any allowable credits were not properly applied, is sustained subject to audit verification and reconciliation of the amounts allowable for each tax year in which the 2004 credits were claimed.

B. Business/Non-Business Income.

Taxpayer protests the Department's decision to disallow the Taxpayer's adjustment to reclassify its interest expense as a non-business interest expense.

Taxpayer asserts that the classification of the expense as business or non-business is not relevant. Taxpayer maintains that its adjustment to reclassify its parent's interest expense as non-business is based upon a "Departmental ruling" it received in 1985. Taxpayer claims that a letter it received from the Commissioner in 1985 relating to the protest of a refund request denial is a "Departmental ruling" that interprets a listed tax and requires the Department to follow the "removal of expired rules" procedure under IC § 6-8.1-3-3.

IC § 6-8.1-3-3 provides:

(a) The department shall adopt, under IC 4-22-2, rules governing:
(1) the administration, collection, and enforcement of the listed taxes;
(2) the interpretation of the statutes governing the listed taxes;
(3) the procedures relating to the listed taxes; and
(4) the methods of valuing the items subject to the listed taxes.

(b) No change in the department's interpretation of a listed tax may take effect before the date the change is:
(1) adopted in a rule under this section; or
(2) published in the Indiana Register under IC 4-22-7-7(a)(5), if IC 4-22-2 does not require the interpretation to be adopted as a rule; if the change would increase a taxpayer's liability for a listed tax.
(c) The department shall furnish copies of its rules and statements described in subsection (b)(2) to the public at a cost equivalent to the preparation and mailing costs of those rules or statements. However, the department shall furnish the rules or statements, on request, free of charge to governmental officials of any state or of the federal government.

The Department does not agree that the 1985 letter is subject to the provisions of IC § 6-8.1-3-3. Even if the Commissioner's 1985 letter is a "Departmental ruling" subject to the rules under IC § 6-8.1-3-3, the letter does not discuss the status of Taxpayer's interest expense, but addresses Taxpayer's apportionment method. The letter provides, as follows:

Please let this letter serve as official notification that I am ruling in favor of your client, [Taxpayer]. This ruling **allows** [Taxpayer] to combine its one-hundred percent apportioned taxable adjusted gross income with less than one-hundred percent apportioned taxable adjusted gross income of its two subsidiaries corporation. (**Emphasis added**).

Accordingly, this "Departmental ruling" gives Taxpayer the choice to report its income in a "modified stacked method," which means combining the parent's one-hundred (100) percent allocated Indiana income with its two subsidiaries' apportioned Indiana income. The Department's letter allowed Taxpayer the choice of reporting its income this way based upon Taxpayer's interpretation of IC § 6-3-2-2(b), as in effect in 1985.

IC § 6-3-2-2(b), as in effect in 1985, provided:

Except as provided in subjection (1), if business income of a corporation or a nonresident person is derived from sources within the state of Indiana and from sources without the state of Indiana, then the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three [3].

Taxpayer, in its interpretation, reasoned that since its parent corporation is located and performs its activities one hundred percent in Indiana, it is does not have income from sources within and without Indiana subjecting the income to apportionment.

Most importantly, regardless of the letter's classification, Taxpayer has not relied on this letter. Taxpayer did not follow the allowable apportionment method prescribed in the letter. Taxpayer has apportioned its parent's Indiana source income (except for the "non-business interest expense" deduction) in every year from at least 1990 to 2004. Taxpayer now wishes to have a best of both worlds approach in reporting its parent's Indiana source income. Taxpayer wishes to report any of its parent's income as apportioned to Indiana at twenty percent and its parent's interest expense as unapportioned to Indiana allocating the expense one-hundred percent to Indiana. Moreover, Taxpayer did not follow its own reasoning in its interpretation of IC § 6-3-2-2(b), as in effect in 1985. Taxpayer's returns from at least 1990 to present included all the income of its several other subsidiaries–that like its parent, were operating one-hundred percent in Indiana–in the consolidated apportionment to be apportioned, in this case at twenty percent.

Finally, the Tax Court in Wabash Inc. v. Indiana Dep't of State Revenue, 729 N.E.2d 620 (Ind. Tax Ct. 2000), addressed a similar situation that refutes Taxpayer's reasoning in interpreting IC § 6-3-2-2(b), as in effect in 1985. In Wabash, the court found that the standard apportionment method is the most appropriate method because "in a consolidated return the separate entities are disregarded; the consolidated group is reported on a single return and a single tax is paid on the total income." Id. at 625-26. The court noted that "[t]he spirit and intent of a consolidated adjusted gross income tax return is to treat an affiliated group as a single taxpayer." Id. at 626.

Accordingly, when Taxpayer is treated as a single taxpayer with the separate entities disregarded, Taxpayer has income from both sources within Indiana and without Indiana and its income is subject to apportionment. Therefore, since Taxpayer's Indiana source income should be apportioned, any Indiana source business income or expense is subject to apportionment. Since the interest expense is a business expense, it is subject to apportionment with the rest of the parent's Indiana source income.

In conclusion, the Commissioner's 1985 letter is not a ruling subject to the provisions of IC § 6-8.1-3-3. Even if that letter is a "Departmental ruling" subject to the rules under IC § 6-8.1-3-3, the letter discusses an allowable apportionment method and does not discuss the issue of interest expense presented by Taxpayer. Taxpayer has not followed the allowable apportionment method provided for in the letter; therefore, Taxpayer has not relied on the letter. Finally, the analysis provided by the Tax Court in Wabash refutes Taxpayer's reasoning in interpreting IC § 6-3-2-2(b), as in effect in 1985. See Wabash, 729 N.E.2d at 625-26.

Therefore, Taxpayer's protest is denied.

FINDING

Taxpayer's protest of subpart A is sustained subject to audit verification of the amount of credits, and Taxpayer's protest of subpart B is denied.

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