

Letter of Findings: 09-0158
Financial Institutions Tax
For 2004, 2005, and 2006

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ISSUES

I. Apportionment Method – Financial Institutions Tax.

Authority: IC § 6-5.5-2-1(a); IC § 6-8.1-5-1(c).

Taxpayer argues that the Department of Revenue's audit employed an apportionment methodology that did not correctly reflect Taxpayer's Indiana source income.

II. Net Operating Losses – Financial Institutions Tax.

Authority: IC § 6-5.5-2-1(c)(2).

Taxpayer claims that the Department failed to carry back certain net operating losses to a preceding year.

III. Interest Calculation – Financial Institutions Tax.

Authority: IC § 6-8.1-5-1(c).

Taxpayer states that the Department – in computing the amount of proposed assessment – incorrectly computed the amount of interest purportedly owed Taxpayer on that assessment.

IV. Refund Amount – Financial Institutions Tax.

Authority: IC § 6-8.1-5-1(c).

Taxpayer maintains that the amount of "Refunds to be Paid" was incorrectly stated and that amount of refund owed Taxpayer is larger.

V. Bad Debt Reserves – Financial Institutions Tax.

Authority: IC § 6-8.1-5-1(c).

Taxpayer states that the audit report failed to include a bad debt amount on line 16 of the audit report.

VI. Calculation Error – Financial Institutions Tax.

Authority: IC § 6-8.1-5-1(c).

Taxpayer states that the audit report incorrectly applied the "allocation percentage" as listed on pages 16 and 17 of the audit report.

VII. Supervisor Consultation – Financial Institutions Tax.

Authority: IC § 6-8.1-5-1(c).

Taxpayer claims that it was entitled to directly consult with the audit supervisor before the audit report was issued and that, having been denied that opportunity, the audit report should be set aside.

STATEMENT OF FACTS

For purposes of this Letter of Findings, "Taxpayer" refers to a unitary group of financial institutions which includes Community Bank One, Community Bank Two, and Holding Company. Both Community Bank One and Community Bank Two are local banks located in Indiana. Holding Company is headquartered outside Indiana but conducts business in the state.

Holding Company owns both Community Bank One and Community Bank Two. Holding Company also owns other businesses outside Indiana. Holding Company earns money from providing services to Community Bank One, Community Bank Two, and several other entities outside the state. Holding Company earns this money because it provides management, legal, accounting, tax, processing, and administrative services.

The Department of Revenue (Department) conducted an audit review of Taxpayer's returns and business records. The audit concluded that Community Bank One, Community Bank Two, and Bank Holding Company constituted a "unitary group... transacting business in Indiana." Taxpayer does not dispute this particular conclusion.

As a result of the audit, the Department assessed additional Financial Institutions Tax (FIT). Taxpayer disagreed with certain portions of the audit report, disagreed with the consequent additional assessment, and submitted a protest to that effect. The written protest contained 19 particular objections. A hearing was conducted in which Taxpayer's representatives participated in person and by conference call. During the hearing, the number of objections was consolidated and is represented here by the seven "issues" as listed above.

I. Apportionment Method – Financial Institutions Tax.

FINDING

Taxpayer objects to the audit's conclusion on the ground that the report incorrectly deviated from the standard apportionment methodology.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima evidence that the

department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Indiana imposes a Financial Institutions Tax at IC § 6-5.5-2-1(a) as follows:

There is imposed on each taxpayer a franchise tax measured by the taxpayer's apportioned income for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana. (Emphasis added).

"Taxpayer's apportioned income," is defined at IC § 6-5.5-2-4 as follows:

For a taxpayer filing a combined return for its unitary group, the group's apportioned income for a taxable year consists of: (1) the aggregate adjusted gross income, from whatever source derived, of the members of the unitary group; multiplied by (2) the quotient of: (A) all the receipts of the taxpayer members of the unitary group that are attributable to transacting business in Indiana; divided by (B) the receipts of all the members of the unitary group from transacting business in all taxing jurisdictions.

In taxpayer's case, the members of the unitary group consist of Community Bank One, Community Bank Two, and Holding Company. However, the audit concluded that the standard apportionment method did "not fairly reflect the Indiana income of the combined group." The audit's conclusion is based on the assertion that both Community Bank One and Community Bank Two were profitable businesses but that Holding Company reported \$12,000,000 in losses an amount which the audit concluded was disproportionate to the Holding Company's limited relationship to and business activities conducted within Indiana. In addition, the audit noted that the \$12,000,000 in losses were attributed to strictly interfamilial transactions between itself and its subsidiaries.

On the ground that that Community Bank One and Community Bank Two's income was "being offset by expenditures which [were] not related and do not benefit Indiana operations," the audit therefore allocated the \$12,000,000 in losses to Indiana and other locations in which Holding Company conducted business. This audit did so based on the amount of fees received by Holding Company from Indiana sources compared to the total amount of fees received by sources everywhere. Thereafter, this allocation percentage was applied to Holding Company's income and adjustments as reflected by Holding Company's federal adjusted gross income.

Taxpayer objects arguing that "any arbitrary allocation made to move income or expenses to other affiliates would distort Indiana taxable income." Taxpayer "request[s] that the audit summary be changed to reflect the standard combined filing method...."

The rule is set out in IC § 6-5.5-5-1(b) which states in part as follows:

If the department or taxpayer determines that the result of applying this section or article do not fairly represent the taxpayer's income within Indiana or the taxpayer's income within Indiana may be more fairly represented by a separate return, the taxpayer may petition for and the department may allow, or the department may require, in respect to all or a part of the taxpayer's business activity any of the following: (1) Separate accounting. (2) The filing of a separate return for the taxpayer. (3) A reallocation of tax items between a taxpayer and a member of the taxpayer's unitary group.

The Department is unable to agree that the audit's conclusion was necessarily arbitrary or – on its face – incorrect. The audit may have departed from the standard allocation methodology, but that decision was based on demonstrable concerns that failing to do so would not equitably reflect Taxpayer's Indiana source income and that IC § 6-5.5-5-1(b) provided a statutory framework to address that concern.

Taxpayer may disagree with the audit's decision but Taxpayer has not demonstrated that it was ill-considered or contrary to law. Under IC § 6-8.1-5-1(c), Taxpayer has not established that the audit's decision – applying an alternative methodology authorized under IC § 6-5.5-5-1(b) – was "wrong."

FINDING

Taxpayer's protest is respectfully denied.

II. Net Operating Losses – Financial Institutions Tax.

DISCUSSION

Taxpayer objects to the audit's computation of its net operating loss complaining that it was denied the opportunity to "carry back" a claimed loss to a previous year.

IC § 6-5.5-2-1(c)(2) provides that "A net operating loss for any taxable year is a net operating loss carryover to each of the fifteen (15) taxable years that follow the taxable year in which the loss occurred." However, Taxpayer errs in arguing that it was entitled to carry back any net operating loss. The statutory provision allows Taxpayer to carry forward the loss up to fifteen years but does not authorize Taxpayer to carry back the loss.

FINDING

Taxpayer's protest is respectfully denied.

III. Interest Calculation – Financial Institutions Tax.

Taxpayer maintains that the audit miscalculated the amount of interest attributable to the proposed assessment of additional tax. Specifically, Taxpayer states that "if the audit was completed 11/13/08 with a net refund, why [was] it calculated through 1/14/09."

Taxpayer has failed to raise an issue which may – or should – be resolved by means of an administrative hearing. Taxpayer is silent as to the origin of the purported error or in what manner the error should be corrected. Because there is no discernable issue of either fact or law, Taxpayer has failed to meet its burden of

demonstrating, under IC § 6-8.1-5-1(c), that the assessment of interest is "wrong."

FINDING

Taxpayer's protest is respectfully denied.

IV. Refund Amount – Financial Institutions Tax.

DISCUSSION

Taxpayer states its 2004 refund "does not get applied until 12/12/08, therefore distorts the interest calculation." Presumably, it believes that if the Department assessed interest on the amount of additional tax, then Taxpayer should receive interest on the 2004 refund. As Taxpayer writes, "Should there be interest received for the overpayment as well?"

Taxpayer poses an academic accounting question but, as stated previously has not raised a question appropriate for the hearing process. There is neither a question of law or fact present. Under IC § 6-8.1-5-1(c), Taxpayer has failed to demonstrate that the calculation of interest either owed or owing is "wrong."

FINDING

Taxpayer's protest is respectfully denied.

V. Bad Debt Reserves – Financial Institutions Tax.

DISCUSSION

Taxpayer objects to "Page 2 of the Audit Summary." According to Taxpayer, "Line 16... should have a value of \$23,172."

Taxpayer makes a bare assertion that the particular audit entry should be changed. However, Taxpayer misapprehends the remedies available to it by means of an administrative hearing and the burden of proof necessary to overcome what is purportedly an entry error. Taxpayer may indeed be correct; line 16 should indeed perhaps contain a different amount but Taxpayer has not met its burden of proof of demonstrating that the original entry is incorrect. Pursuant to IC § 6-8.1-5-1(c), Taxpayer's protest must be denied.

FINDING

Taxpayer's protest is respectfully denied.

VI. Calculation Error – Financial Institutions Tax.

DISCUSSION

Taxpayer argues that the audit report contains calculation errors and, in this particular instance, Taxpayer has provided a factual issue which can be addressed within the hearing process. In particular, Taxpayer points to pages 16 and 17 of the audit report indicating that application of the "Allocation Percentage" listed for each of 2004, 2005, and 2006 results in numbers different than that stated. For example, Taxpayer points out that the allocation percentage listed for 2004 is 3.58 percent and this number multiplied by the immediately preceding number – the subtotal of federal adjusted gross income – does not precisely equal the subsequent number labeled entity's "Allocated Federal Adjusted Gross Income."

Taxpayer is correct. On their face, each calculation is slightly off. However, in reviewing the preceding calculations, the reason becomes clear. In the example cited above, the "3.58" indicated percent is simply a "rounded" version from the actual percentage used to determine the "Allocated Federal Adjusted Gross Income." In each case, the underlying mathematics is correct; the printed representation of the percentage is oversimplified.

Pursuant to IC § 6-8.1-5-1(c), Taxpayer's protest is denied.

FINDING

Taxpayer's protest is respectfully denied.

VII. Supervisor Consultation – Financial Institutions Tax.

DISCUSSION

Taxpayer maintains that the audit should be set aside because it was denied the opportunity to directly consult with the audit supervisor before the audit report was issued. Taxpayer is correct in noting that, at some point during the time the audit was conducted, Taxpayer sought an opportunity to participate in a conference with both the auditor and the audit supervisor. However, Taxpayer has failed to demonstrate that further discussion of the issues involved would have produced a different result. In addition, there is every indication in the record that the issues implicated in the audit report were fully aired with Taxpayer and Taxpayer's objections were reasonably and thoroughly considered by the auditor, the audit supervisor, and that person's manager. Pursuant to IC § 6-8.1-5-1(c), Taxpayer has failed to meet its burden of demonstrating that the failure to conduct a conference with the audit supervisor produced an incorrect final result such that the audit report should be set aside.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

In all respects, taxpayer's protests are denied.

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