

Letter of Findings Number: 09-0496
Income Tax
For Tax Years 2005-07

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ISSUE

I. Adjusted Gross Income Tax—Apportionment Sales Factor.

Authority: IC § 6-3-2-2; IC § 6-8.1-5-1; [45 IAC 3.1-1-55](#).

Taxpayer protests the imposition of income tax based on recalculation of its sales factor.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation doing business in Indiana. Taxpayer's Indiana activities consist of marketing and selling the services of its parent company. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not included all Indiana business receipts in its calculations of the sales factor of the adjusted gross income tax apportionment formula for the tax years 2005, 2006, and 2007. Accordingly, the Department added those receipts to the sales factor, recalculated Taxpayer's Indiana apportionment percentage, and issued proposed assessments for adjusted gross income tax for those years. Taxpayer protests that the sales in question are not attributable to Indiana and so protests the imposition of income tax based on the inclusion of those sales. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax—Apportionment Sales Factor.

DISCUSSION

Taxpayer protests the imposition of income tax for the tax years 2005-07. The Department recalculated Taxpayer's Indiana sales factor and apportionment percentages which resulted in additional Indiana adjusted gross income tax assessments for those years. Taxpayer states that the Department incorrectly added sales to the numerator of Taxpayer's Indiana sales factor formula. Taxpayer believes that it included the correct amount of Indiana sales in its calculations and that no additional Indiana adjusted gross income tax is due. 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).

The Indiana adjusted gross income tax is imposed under IC § 6-3-2-2, which states in relevant parts:

(a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation for labor or services rendered within this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

...

(b) Except as provided in subsection (l), 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, 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 the following:

- (1) For all taxable years that begin after December 31, 2006, and before January 1, 2008, a fraction. The:
 - (A) numerator of the fraction is the sum of the property factor plus the payroll factor plus the product of the sales factor multiplied by three (3); and
 - (B) denominator of the fraction is five (5).
- (2) For all taxable years that begin after December 31, 2007, and before January 1, 2009, a fraction. The:
 - (A) numerator of the fraction is the property factor plus the payroll factor plus the product of the sales factor multiplied by four and sixty-seven hundredths (4.67); and
 - (B) denominator of the fraction is six and sixty-seven hundredths (6.67).

...

(e) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year. Sales include receipts from intangible property and receipts from the sale or exchange of intangible property. However, with respect to a foreign corporation, the denominator does not include sales

made in a place that is outside the United States. Receipts from intangible personal property are derived from sources within Indiana if the receipts from the intangible personal property are attributable to Indiana under section 2.2 of this chapter. Regardless of the f.o.b. point or other conditions of the sale, sales of tangible personal property are in this state if:

- (1) the property is delivered or shipped to a purchaser that is within Indiana, other than the United States government; or
- (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and:
 - (A) the purchaser is the United States government; or
 - (B) the taxpayer is not taxable in the state of the purchaser.

Gross receipts derived from commercial printing as described in [IC 6-2.5-1-10](#) shall be treated as sales of tangible personal property for purposes of this chapter.

(f) Sales, other than receipts from intangible property covered by subsection (e) and sales of tangible personal property, are in this state if:

- (1) the income-producing activity is performed in this state; or
- (2) the income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

....

(Emphasis added).

Also, [45 IAC 3.1-1-55](#) states in relevant part:

Gross receipts from transactions other than sales of tangible personal property shall be included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within this state. Except as provided below if the income producing activity is performed within and without this state such receipts are attributed to this state if the greater proportion of the income producing activity is performed here, based on costs of performance.

The term "income producing activity" means the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit. Such activity does not include activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, "income producing activity" includes but is not limited to the following: (1) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service. (2) The sale, rental, leasing, or licensing the use of or other use of tangible personal property. (3) The sale, licensing the use of or other use of intangible personal property.

Income producing activity is deemed performed at the situs of real, tangible and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property.

Example: Taxpayer, a corporation whose principal business activity is the manufacture and sale of hot water heaters, obtains notes for the sale of such water heaters in connection with its Indiana business activity. The property has a business situs in this state, therefore, interest income derived from such notes is attributable to this state.

The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

If receipts from sales other than sales of tangible personal property do not constitute a principal source of business income and such receipts are included in the denominator of the receipts factor, such receipts are in this state if: (a) the income producing activity is performed wholly within this state; or (b) the income producing activity is performed both in and outside this state and a greater proportion of the income producing activity is performed in this state than in any other state, based on costs of performance.

....

(Emphasis added).

Taxpayer states that IC § 6-3-2-2(f)(2) supports its protest, since its income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in another country, based on costs of performance. Taxpayer states that its services are performed in another country and that the greatest amount of its costs occurs in that country, not in Indiana.

A review of the available materials does not support Taxpayer's statement. Taxpayer markets and sells the services of its parent company. Taxpayer has a sales office in Indiana.

As explained in the audit report, Taxpayer contracts with clients, discusses terms of the arrangement,

performs on-site analysis using its own tangible personal property such as laptop and desktop computers, extracts data from the clients, and performs any other necessary service to determine the scope of the contract and recovery that they must charge for the engagement. All of these activities occur in Indiana. There is no indication that Taxpayer's Indiana operations are affected by any activity in any other country.

While Taxpayer does engage in activities across the United States and in other countries, only those receipts attributable to Taxpayer's Indiana activities were included in the Department's calculations. The activities referred to by Taxpayer as support for its contention that its costs of performance are incurred outside of Indiana are actually the activities of its parent company. They are not Taxpayer's activities. Therefore, IC § 6-3-2-2(f)(1) is the relevant provision here. In Taxpayer's case, the income-producing activity is performed in this state. Taxpayer has not provided any documentation to rebut the Department's position and has not met the burden imposed by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

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