DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 09-0397
Income Tax
For Tax Years 2002, 2003, and 2004

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ISSUES

I. Adjusted Gross Income Tax – Gross Receipts and Apportionment.

Authority: IC § 6-3-2-2; IC § 6-8.1-5-1; 45 IAC 3.1-1-50; 45 IAC 3.1-1-62; I.R.C. § 338; Revenue Ruling IT 99-01 (March 25, 1999).

Taxpayer protests the Department's inclusion of proceeds from a deemed asset sale in the sales factor of taxpayer's apportionment of income in Indiana.

II. Corporate Adjusted Gross Income Tax – Imposition – Throwback Sales.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-3-4-14; IC § 6-8.1-5-1; 45 IAC 1-1-119; 45 IAC 3.1-1-38; 45 IAC 3.1-1-53; 45 IAC 3.1-1-64; 45 IAC 3.1-1-110; 45 IAC 3.1-1-111; I.R.C. § 1504; Public Law 86-272 (15 U.S.C.A. § 381); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 102 S.Ct. 3103 (1982); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 103 S.Ct. 2933 (1983); Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768, 112 S.Ct. 2251 (1992); Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992); Indiana Dep't of State Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981); Wabash, Inc. v. Indiana Dep't of Revenue, 729 N.E.2d 620 (Ind. Tax Ct. 2000); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Brown Group Retail, Inc. v. Franchise Tax Bd., 44 Cal. App. 4th 823, 52 Cal. Rptr. 2d 202 (Cal. Ct. App. 1996); Appeal of Finnigan Corporation (Finnigan), Cal. St. Board of Equal., Jan 24, 1990 (88-SBE-022A); Tax Policy Directive No. 6: Apportionment Computation for Unitary Businesses (June 1, 1992).

Taxpayer protests the application of throwback sales, resulting in an increase of Taxpayer's corporate adjusted gross income tax.

III. Income Tax–Net Operating Loss.

Authority: Treas. Reg. § 1.1502-21 (as amended in 2007); Treas. Reg. § 1.1502-75 (as amended in 2006); I.R.C § 172; I.R.C. § 382; IC § 6-3-1-11; IC § 6-3-2-2.6; IC § 6-8.1-5-1.

Taxpayer protests the assessment of individual income tax.

IV. Tax Administration–Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation that designs, manufactures, sells and installs computer security systems for the control of personnel access to and within commercial and industrial facilities. Taxpayer's primary business locations reside in Indiana. Taxpayer is a subsidiary of a corporation with principal headquarters in a state other than Indiana ("Out-of-State Corporation"), which in turn is a subsidiary of a parent corporation located in Indiana ("Parent Corporation"). The Out-of-State Corporation designs, manufactures, sells, and installs heating, ventilating and air conditioning systems. During the 2002, 2003 and 2004 tax years (the "Tax Years") the Out-of-State Corporation manufactured taxpayer's printed circuit boards and shipped them to taxpayer. The Out-of-State Corporation built the circuit boards to order for taxpayer and did not maintain an inventory of taxpayer's circuit boards. Taxpayer included the printed circuit boards in the assembly of taxpayer's final products.

Another subsidiary corporation of the Parent Corporation specializes in architectural, engineering and contract management ("A & E Sub"). With headquarters outside Indiana, it had no Indiana activities during the Tax Years until 2004 when a division of another company which had Indiana sales was acquired by the Parent Corporation and merged with A & E Sub. Two other Parent Corporation subsidiaries worked jointly on contracts involving construction, sale, installation, and maintenance of railway infrastructures ("Railway Subs"). With primary business locations in states outside Indiana, these Railway Subs also did not have business activity in Indiana during the Tax Years until 2004.

Several Out-of-State Corporation employees traveled to, and worked in, Indiana during the Tax Years. The Out-of-State Corporation had Indiana sales but did not have a salesperson residing in Indiana. All of taxpayer's sales are shipped from Indiana locations.

Parent Corporation sold the stock of the Out-of-State Corporation to an unrelated party in 2004, with the parties to that sale deeming it an asset acquisition under Internal Revenue Code § 338(h)(10). As the result of an audit, the Indiana Department of Revenue ("Department") determined that the taxpayer did not include the gross proceeds from that sale in the sales factor numerator or denominator in Schedule E of its 2004 IT20 return. The audit also found that taxpayer's treatment of throwback sales was inconsistent. The Department's audit also removed A & E Sub and the Railway Subs from taxpayer's Indiana Affiliated Group with respect to taxpayer's consolidated return. After these determinations, the Department assessed additional tax, penalty and interest against Taxpayer for the 2002, 2003, and 2004 tax years.

Taxpayer disagreed with the Department's assessments and submitted a protest to that effect. An administrative hearing was conducted during which taxpayer explained the basis for its protest, and narrowed the issues. This Letter of Findings results.

DISCUSSION

I. Adjusted Gross Income Tax – Gross Receipts and Apportionment.

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.

In its proposed assessment, the Department treated the gain from the deemed asset sale of taxpayer's and Out-of-State Corporation's assets under IRC § 338(h)(10) as business income. The Department included a portion of the proceeds from the deemed sales in the consolidated group's sales factor numerator. The Department determined the amount included in the sales factor numerator by multiplying taxpayer's proceeds from its deemed asset sale by taxpayer's property factor and by multiplying Out-of-State Corporation's proceeds from the same sale by that entity's property factor.

Taxpayer admits that the gain from the deemed asset sale is business income. However, taxpayer argues that inclusion of the proceeds from the deemed sales in the numerator and denominator of the consolidated group's sales factor does not fairly reflect the location where taxpayer earned its income; that the increase in sales factor resulting from the Department's calculations operates unreasonably and arbitrarily by attributing a percentage of income to Indiana which is out of appropriate proportion to the business transacted in Indiana. Taxpayer argues that IC § 6-3-2-2(l) permits the use of an alternate apportionment method if necessary to fairly represent the taxpayer's income derived from sources within Indiana. Citing to Revenue Ruling IT 99-01 (March 25, 1999), taxpayer argues that the appropriate alternative apportionment method is to exclude the proceeds from the deemed sales from both the numerator and denominator of the consolidated group's sales factor.

Per the hearing officer's request, taxpayer submitted a copy of its federal return, along with copies of federal forms and schedules showing taxpayer's reporting of the proceeds from the deemed asset sales and the gain recognized as a result of those sales. Taxpayer also included state returns filed in states other than Indiana to show that taxpayer or the Out-of-State Corporation treated the gain from the deemed asset sale as apportionable income in those respective states.

Revenue Ruling IT 99-01 cites 45 IAC 3.1-1-50, which defines "sales" as "all gross receipts of the taxpayer which are not subject to allocation as nonbusiness income." The regulation adds that "[i]n some cases, certain gross receipts should be disregarded in determining the sales factor to effectuate an equitable apportionment." 45 IAC 3.1-1-62, also cited by Revenue Ruling IT 99-01, expands upon IC 6-3-2-2(l), providing that

> All corporations doing business in more than one state shall use the allocation and apportionment provisions described in Regulations 6-3-2-2(b)-(k) [45 IAC 3.1-1-37–45 IAC 3.1-1-61] unless such provisions do not result in a division of income which fairly represents the taxpayer's income from Indiana sources. In such case the taxpayer must request in writing or the Department may require the use of a more equitable formula for determining Indiana income. However, the Department will depart from use of the standard formula only if the use of such formula works a hardship or injustice upon the taxpayer, results in an arbitrary division of income, or in other respects does not fairly attribute income to this state or other states. It is anticipated that these situations will arise only in limited and unusual circumstances (which ordinarily will be unique and nonrecurring) when the standard apportionment provisions produce incongruous results.

Based upon the taxpayer's arguments and supplemental materials, the Department can agree that the aforementioned statutes, rules, and provisions allow the Department to depart from use of the standard formula as it applies to this limited and unusual circumstance.

FINDING

Taxpayer's protest is sustained to the extent that applicable statutes and regulations allow the Department to depart from its use of the standard apportionment formula with respect to taxpayer's gross receipts and apportionment for the Tax Years, subject to review in a supplemental audit.

II. Corporate Adjusted Gross Income Tax – Imposition – Throwback Sales.

DISCUSSION

After the audit, the Department made several adjustments to taxpayer's sales factor by applying the throwback rule. The Department included in the numerator of the consolidated group's sales factor the sales into jurisdictions where the specific corporation making those sales was not subject to tax. This resulted in an increase in Taxpayer's corporate adjusted gross income tax.

Taxpayer argues that the throwback rule was not applicable, based in part on its assertion that taxpayer and the Out-of-State Corporation constitute a unitary business. Citing Tax Policy Directive No. 6: Apportionment Computation for Unitary Businesses (June 1, 1992), taxpayer asserts that sales made by a member of the unitary group to a destination in another state in which that member was not taxable should not be thrown back to

Indiana unless no member of the unitary group was taxable in the other state. Taxpayer further argues that, based upon the finding in Wabash, Inc. v. Indiana Dep't of Revenue, 729 N.E.2d 620 (Ind. Tax Ct. 2000), "[t]he spirit and intent of a consolidated adjusted gross income tax return is to treat an affiliated group as a single taxpayer."

Unitary Business Analysis

The Supreme Court has considered the issue of existence of a unitary relationship for adjusted gross income tax in several cases and with several analyses. The essential characteristic the Court requires for a unitary business is that the individual entities are functionally integrated in a common business. Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S. 768, 112 S.Ct. 2251 (1992); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 103 S.Ct. 2933 (1983); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 102 S.Ct. 3103 (1982). The Supreme Court found that unitary businesses that were functionally integrated shared many common characteristics. They had common ownership. They had centralized management with a corporate strategy including the various entities. The individual businesses were operated in such a manner as to further a common purpose.

IC § 6-3-4-14(a) provides that "[a]n affiliated group of corporations shall have the privilege of filing a consolidated return with respect to the taxes imposed by IC 6-3."

The Department's associated regulation states that "[a]n affiliated group as defined in IC 6-3-4-14(b) may file consolidated returns for Adjusted Gross Income Tax and Supplemental Net Income Tax...." 45 IAC 3.1-1-110. 45 IAC 3.1-1-111 provides that "[t]he Adjusted Gross Income Tax Act adopts the definition of 'affiliated group' contained in Internal Revenue Code Section 1504, except that no member of the affiliated group may be included in the Indiana return unless it has adjusted gross income derived from sources within the state, as that phrase is defined in IC 6-3-2-2."

I.R.C. § 1504 defines, among other things, the degree of ownership which must exist before related businesses can be considered to be members of a federal "affiliated group."

However, qualifying under I.R.C. § 1504 – standing alone – is not sufficient to qualify the related businesses to file an Indiana consolidated tax return. In this situation, taxpayer, the Out-of-State Corporation, the A & E Sub, and the Railway Subs must have received "adjusted gross income derived from sources within the state, as that phrase is defined in IC 6-3-2-2." 45 IAC 3.1-1-111.

IC 6-3-2-2(a) outlines the following parameters:

With regard to corporations and nonresident persons "adjusted gross income derived from sources within Indiana", for 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 from a trade or profession conducted in 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.

The Department's regulation provides that, for apportionment purposes:

[A] taxpayer is "doing business" in a state if it operates a business enterprise or activity in such a state including, but not limited to:

(1) Maintenance of an office or other place of business in the state
(2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
(3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
(4) Rendering services to customers in the state
(5) Ownership, rental or operation of a business or of property (real or personal) in the state
(6) Acceptance of orders in the state
(7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income.

45 IAC 3.1-1-38.

The parameters outlined in this regulation construct a minimum threshold of activity in which an entity must engage to warrant inclusion in the Indiana consolidated return as activity sufficient to establish nexus with the state such that taxation would not be prohibited under P.L. 86-272 (15 U.S.C.A. § 381). The U.S. Supreme Court established that a de minimis amount of non-solicitation activity would not cause a corporation to lose the exemption from taxation afforded by P.L. 86-272. Wisconsin Dep't of Revenue v. William Wrigley, Jr. Co., 505 U.S. 214, 228-29, 112 S. Ct. 2447, 2456-57 (1992). The Court also stated that a company will lose the protection of P.L. 86-272 if it performs an activity that establishes a nontrivial additional connection with the taxing state. Id. at 231-32. The Indiana Supreme Court has stated that particular emphasis should be placed upon the totality of the business activities of a company within Indiana when interpreting P.L. 86-272. See Wabash, Inc., 729 N.E.2d at 624 (citing Indiana Dep't of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264, 1268, 275 Ind. 378, 383 (Ind.1981)).

Continuing the examination of the business activities of Out-of-State Corporation necessarily requires considering one other court's interpretation of P.L. 86-272. In Brown Group Retail, Inc. v. Franchise Tax Bd., 44 Cal. App. 4th 823, 836, 52 Cal. Rptr. 2d 202, 210 (Cal. Ct. App. 1996), the California Court of Appeals held that P.L. 86-272's exception did not apply to a taxpayer who sent two of its employees to help customers with their businesses. In addition to the Brown decision, the Department held that a taxpayer did business in Indiana where it sent its employees once or twice a year into the state in order to deliver newspapers. See Rul. IT96-03 (Jan. 7, 1997) (Pet'r. Ex. 26.)

Out-of-State Corporation's acquisition of taxpayer in 2000 indicates common ownership of the two entities during the Tax Years. Information presented during the Department's audit displayed the interdependence between taxpayer and the Out-of-State Corporation. The latter manufactured circuit boards used in taxpayer's products. Press releases announcing the sale of Out-of-State Corporation in 2004 tout the importance of the inclusion of taxpayer's assets and business contributions in the acquisition.

To support its argument that the respective entities had centralized management, taxpayer provided travel documents and details displaying Out-of-State Corporation's presence in Indiana. One of Out-of-State's executives served as interim president of taxpayer for part of 2002. Other Out-of-State Corporation executives made numerous trips to Indiana to participate in meetings regarding finance, personnel, technical, and marketing issues. The frequency and purpose of Out-of-State Corporation's employees' travel showed that Out-of-State Corporation's activities in Indiana were regular and systemic, and, therefore, were not de minimis. Thus, for the Tax Years, taxpayer has established that a unitary relationship existed between taxpayer and Out-of-State Corporation.

With respect to the A & E Sub and the Railway Subs, taxpayer did not submit evidence sufficient to overcome the Department's separation of the respective subsidiaries from the taxpayer's Indiana affiliated group for the 2002 and 2003 tax years. Taxpayer also did not submit evidence sufficient to demonstrate that the aforementioned unitary relationship included these subsidiaries. Therefore, subsequent analysis based upon a unitary relationship cannot include the A & E Sub or the Railway Subs.

Application of Throwback Rule

Indiana imposes a tax on each corporation's adjusted gross income attributable to "sources within Indiana." IC § 6-3-2-1(b). Where a corporation receives income from both Indiana and out-of-state sources, the amount of tax is determined by a three-factor apportionment established by IC § 6-3-2-2(b). That formula operates by multiplying taxpayer's total business income by a fraction composed of a property factor, a payroll factor, and a sales factor.

The "sales factor" consists of a fraction, "the numerator of which is the total sales of the taxpayer in [Indiana] during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year." IC § 6-3-2-2(e).

The Department's audit determined that taxpayer did not report any throwback sales for the 2002 tax year, but then reported throwback sales in 2003 and 2004. The Department calculated taxpayer's correct throwback sales and made the appropriate audit adjustments.

Taxpayer cites to Tax Policy Directive No. 6: Apportionment Computation for Unitary Businesses (June 1, 1992) to argue that although taxpayer did not file a unitary/combined tax return in Indiana, the Department should nevertheless make an exception to the Department's rules regarding attribution of taxpayer's sales to Indiana.

With respect to Indiana's adjusted gross income tax statute and sales of tangible personal property, 45 IAC 3.1-1-53 provides in pertinent part:

> Gross receipts from the sales of tangible personal property (except sales to the United States Government–See Regulation 6-3-2-2(e)(050) [45 IAC 3.1-1-54] are in this state: (a) if the property is delivered or shipped to a purchaser within this state regardless of the F.O.B. point or other conditions of sales; or (b) if the property is shipped from an office, store, factory, or other place of storage in this state, and the taxpayer is not taxable in the state of the purchaser.
>
> Subsection (5) further provides:
>
> If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. Such sale is termed a "Throwback" sale.
>
> 45 IAC 3.1-1-64 defines "taxable in another state" as a situation or circumstance
>
> ... when such state has jurisdiction to subject [the taxpayer] to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and laws of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. § 381-385.
>
> And Public Law 86-272 prescribes:
>
> No State... shall have power to impose, for any taxable year..., a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on

behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)

15 U.S.C.A. § 381(a).

Expanding upon the unitary analysis provided herein, the Wrigley Court construed the above statutory language to hold that a business's in-state activities could subject it to that state's taxing jurisdiction if those activities involved more than the "mere solicitation of orders" and more than de minimis contact in connection with the solicitation of orders. The Court set forth a method of analysis by which to determine whether or not a business's in-state activities cause it to lose the tax immunity. 15 U.S.C.A. § 381 "was designed to increase... the connection that a company could have with a State before subjecting itself to tax. Accordingly, whether in-state activity other than 'solicitation of orders' is sufficiently de minimis to avoid loss of the tax immunity conferred by § 381 depends upon whether that activity establishes a nontrivial additional connection with the taxing State." Unless activities are "ancillary to" ordering product or de minimis, then a business can be taxed in another jurisdiction without that jurisdiction violating 15 U.S.C.A. § 381.

The unitary business analysis demonstrates that the Out-of-State Corporation had more than de minimis contact with Indiana. In fact, taxpayer's argument alleging a unitary relationship between itself and Out-of-State Corporation relies on such a finding. However, electing to file a consolidated return does not change the rules for attributing sales to the numerator of the sales factor. Since the attribution of such sales is done prior to the aggregation of those sales into the consolidated factor, only those tax attributes of the member are relevant.

Tax Policy Directive No. 6 "clarifies, but does not change the Department's position and stresses that in the interest of consistency the Department follows the decision of the California State Board of Equalization in the Appeal of Finnigan Corporation (Finnigan), Cal. St. Board of Equal., Jan 24, 1990 (88-SBE-022A). This Directive clearly states that Finnegan only applies to corporations that file unitary/combined returns in Indiana.

The taxpayer has not petitioned to file a combined return and the Department is not attempting to require such a return. Therefore, concepts and analysis in making such a determination in the context of a combined filing are inapplicable. Taxpayer has failed to provide evidence sufficient to contradict the Department's determination that taxpayer is required to throwback those sales made by members of the affiliated group into states in which the member did not have nexus, even though another member of the group did have nexus in that state.

FINDING

The taxpayer's protest concerning the issue of throwback sales is denied.

III. Income Tax–Net Operating Loss.

DISCUSSION

Taxpayer argues that because it allegedly incurred net operating losses in tax years subsequent to the Tax Years, it can carry back those losses to offset Indiana adjusted gross income realized in the Tax Years.

The Department adopts the provisions of the Internal Revenue Code (I.R.C.), which states:

(a) The term "Internal Revenue Code" means the Internal Revenue Code of 1986 of the United States as amended and in effect on January 1, 2007.

(b) Whenever the Internal Revenue Code is mentioned in this article, the particular provisions that are referred to, together with all the other provisions of the Internal Revenue Code in effect on January 1, 2007, that pertain to the provisions specifically mentioned, shall be regarded as incorporated in this article by reference and have the same force and effect as though fully set forth in this article. To the extent the provisions apply to this article, regulations adopted under Section 7805(a) of the Internal Revenue Code and in effect on January 1, 2007, shall be regarded as rules adopted by the department under this article, unless the department adopts specific rules that supersede the regulation.

(c) An amendment to the Internal Revenue Code made by an act passed by Congress before January 1, 2007, that is effective for any taxable year that began before January 1, 2007, and that affects:

(1) individual adjusted gross income (as defined in Section 62 of the Internal Revenue Code);

(2) corporate taxable income (as defined in Section 63 of the Internal Revenue Code);

(3) trust and estate taxable income (as defined in Section 641(b) of the Internal Revenue Code);

(4) life insurance company taxable income (as defined in Section 801(b) of the Internal Revenue Code);

(5) mutual insurance company taxable income (as defined in Section 821(b) of the Internal Revenue Code); or

(6) taxable income (as defined in Section 832 of the Internal Revenue Code);

is also effective for that same taxable year for purposes of determining adjusted gross income under section 3.5 of this chapter.

See generally IC § 6-3-1-11.

A corporation's Indiana net operating loss deduction is determined under IC § 6-3-2-2.6(c), which provides a computation that starts with the "taxpayer's federal net operating loss for a taxable year as calculated under Section 172 of the Internal Revenue Code, derived from sources within Indiana and adjusted for the modifications required by IC 6-3-1-3.5." I.R.C. § 172 requires the application of net operating loss limitations for corporations that have acquired certain "built-in loss" corporations. See I.R.C. § 172(l)(2) (providing "[f]or special limitations on net operating loss carryovers in the case of a corporate change of ownership, see section 382"). Since I.R.C. § 172 incorporates the I.R.C. § 382 limitations into the computation of the federal net operating loss deduction and the federal net operating loss deduction as calculated under I.R.C. § 172 is the starting point for the Indiana net operating loss deduction, the I.R.C. § 382 limitations are incorporated into the Indiana net operating loss deduction. After the I.R.C. § 382 limitations are incorporated into the calculation to arrive at a taxpayer's federal net operating loss as required by I.R.C. § 172, the loss is modified and apportioned as provided in section 2 of this chapter to determine the loss derived from sources within Indiana. See IC § 6-3-2-2.6(c)-(d)(2).

While taxpayer included copies of returns filed by Parent Corporation for 2005, taxpayer did not submit evidence of its filing of any income tax returns for subsequent years. Therefore, the Department could not apply any net operating loss deduction against taxpayer's adjusted gross income for the Tax Years. Such net operating losses could only be applied in conjunction with a common parent's separate return. Taxpayer was not the common parent of the consolidated group. Also, there was no prior consolidated group of which taxpayer could become the common parent. There was only one consolidated group, and Parent Corporation was always the common parent of that group.

Because taxpayer cannot be considered the common parent of the consolidated group under Treas. Reg. § 1.1502-75(d)(3), the provision for carryback to a common parent's separate return years found at Treas. Reg. § 1.1502-21(b)(2)(ii)(B) does not apply to taxpayer.

In conclusion, because taxpayer has failed to demonstrate common parent status as described in Treas. Reg. § 1.1502-75(d)(3), taxpayer cannot carry back net operating losses to its returns filed for the Tax Years.

FINDING

Taxpayer's protest is denied.

IV. Tax Administration–Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

. . .

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

. . .

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). In the course of this protest, Taxpayer has affirmatively established that it had reasonable cause and was not negligent, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer's protest is sustained to the extent that applicable statutes and regulations allow the Department to depart from its use of the standard apportionment formula with respect to taxpayer's gross receipts and apportionment for the Tax Years, subject to review in a supplemental audit. While taxpayer has submitted evidence sufficient to demonstrate a unitary relationship existed between taxpayer and Out-of-State Corporation, taxpayer's protest is denied with respect to the Department's application of the Throwback Rule. Taxpayer is also denied with respect to its claim of entitlement to net operating loss deductions against adjusted gross income for the Tax Years. Finally, taxpayer's protest against the negligence penalty is sustained.

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