**DEPARTMENT OF STATE REVENUE**

02-20090675.LOF

**Letter of Findings Number: 09-0675**
**Corporate Income Tax**
**For the Tax Years 2006-2007**

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## ISSUES

**I. Adjusted Gross Income Tax–Imposition.**

**Authority:** IC § 6-3-2-2; IC § 6-8.1-5-1; 45 IAC 3.1-1-38; 15 U.S.C. § 381; Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992 ); Indiana Dep't of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981).

Taxpayer protests the imposition of adjusted gross income tax.

**II. Tax Administration–Penalty.**

**Authority:** IC § 6-3-4-4.1.

Taxpayer protests the imposition of penalty.

## STATEMENT OF FACTS

Taxpayer is a parent corporation doing business in Indiana and other states. Taxpayer has four out-of-state subsidiary corporations (hereafter "Tech Corp," "RS Corp," "MT Corp," and "N Corp"). Taxpayer filed Indiana corporate income tax returns for the 2006 and 2007 tax years on a consolidated basis and included all four of its subsidiaries because it believed that the subsidiaries had taxable nexus with Indiana. As a result of an investigation, the Indiana Department of Revenue ("Department") issued proposed assessments for additional adjusted gross income tax and interest for the 2006 and 2007 tax years and an underpayment of estimated tax penalty for the 2007 tax year. The Department determined that three of Taxpayer's subsidiaries ("RS Corp," "MT Corp," and "N Corp") did not have taxable nexus with Indiana and, therefore, did not qualify for inclusion on the consolidated returns. The Department removed the subsidiaries from the consolidated returns for the tax years in question. The Department also determined that the subsidiaries lacked taxable nexus in prior years and should not be included in the prior tax years returns either. The Department made adjustments to the Taxpayer's calculation and application of its net operating loss deductions in the tax years in question and in the prior tax years. Taxpayer protests these assessments and the net operating loss adjustments on the basis that it believes the three subsidiaries, which were removed from the returns, were eligible to be included. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as necessary.

**I. Adjusted Gross Income Tax–Imposition.**

Taxpayer protests the imposition of adjusted gross income tax for the 2006 and 2007 tax years. Taxpayer protests the Department's determination that three of the subsidiaries, listed on Taxpayer's consolidated returns, should not be included in those returns. The subsidiaries had net operating losses from prior years that reduced the amount of tax due on the consolidated returns. As a result of the Department's removal of the subsidiaries, Taxpayer was unable to claim the net operating losses and the Department determined that additional income tax was due. Taxpayer believes that the subsidiaries are eligible for inclusion in the consolidated returns because they had taxable nexus with Indiana. The Department notes that, under IC § 6-8.1-5-1(c), the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made.

On initial assessment, the Department determined that three of Taxpayer's subsidiaries ("RS Corp," "MT Corp," and "N Corp") should not be included in the returns based upon their lack of taxable nexus with Indiana. The following facts were provided on page 6 of the auditor's investigation report for each of the three excluded subsidiaries:

> This entity does not have any property or payroll in Indiana. It does not perform any services in Indiana. The sales for this entity to Indiana are shipped from outside Indiana.

Accordingly, these above listed facts demonstrated that the three subsidiaries only had tangible personal property sales to Indiana customers that were made in interstate commerce. As such, the subsidiaries are protected by Public Law 86-272 (15 U.S.C.A. § 381), and, therefore, lacked taxable nexus with Indiana for adjusted gross income tax purposes and could not be included in the consolidated returns.

The adjusted gross income tax is imposed under IC § 6-3-2-2, which provides in relevant part:

> (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;
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> (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.

In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. In the case of compensation of a team member (as defined in section 2.7 of this chapter) only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (r) is considered derived from sources within Indiana.

. . ..

Further, 45 IAC 3.1-1-38 states:

For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such 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.

As stated in Regulation 6-3-2-2(b)(010) [45 IAC 3.1-1-37], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of IC 6-3-2-2(b)-(n).

Public Law 86-272 (15 U.S.C.A. § 381) prohibits states from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within that state unless those activities exceed the mere solicitation of sales.

The Indiana Supreme Court explained in Indiana Dep't. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981):

Public Law 86-272 (15 U.S.C.A. § 381), in pertinent part is as follows:

(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, 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).

Id. at 1265.

The court then explained:

We also believe that Congress perceived "solicitation" as embodying "sundry activities so long as those activities [are] closely related to the eventual sale of a product." Finally, when a corporate representative performs an "act of courtesy" in order to accommodate a customer, he has not ventured beyond the realm of "solicitation."

Id. at 1268.

The United States Supreme Court explained its standard for determining "solicitation of sales" in Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992). In Wrigley, the Court explained:

We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are entirely ancillary to requests for purchases -- those that serve no independent business function apart from their connection to the soliciting of orders -- and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. National Tires, Inc. v. Lindley,

68 Ohio App. 2d 71, 78-79 426 N.E.2d 793, 798 (1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business"). Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to requesting purchases, and cannot be converted into "solicitation" by merely being assigned to salesmen. See, e. g., Herff Jones Co. v. State Tax Comm'n, 247 Ore. 404, 412, 430 P.2d 998, 1001-1002 (1967) (no § 381 immunity for sales representatives' collection activities).

Id, at 228-30.

The Court further explained:

By contrast, Wrigley's in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which Wrigley's regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [Wrigley's] credit department communicating." App. 71, 72. It hardly appears likely that this mediating function between the customer and the central office would have been performed by some other employee --some company ombudsman, so to speak-- if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases.

Finally, Wrigley argues that the various nonimmune activities considered singly or together, are de minimis. In particular, Wrigley emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007 [percent] of Wrigley's annual Wisconsin sales, and in absolute terms amounted to only several hundred dollars a year. We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in § 381, the prohibition on net-income taxation contained in that provision was inapplicable.

Id. at 234-5.

Therefore, the Department will consider a taxpayer's Indiana activities as a whole to determine if the activities as a whole exceed the protection of Public Law 86-272.

**A. RS Corp.**

Taxpayer maintains that RS Corp should not have been excluded from the consolidated group for a lack of taxable nexus. During the course of the hearing, Taxpayer submitted repair services invoices, expense reports, and employee reimbursement documentation to demonstrate that RS Corp received revenue for repair services that were performed in Indiana. Since Taxpayer received compensation for services that were performed in Indiana, it has income from its business activities that are taxable in Indiana. See 45 IAC 3.1-1-38(4). Thus, these receipts for services performed in Indiana and its tangible personal property sales receipts are includable in Taxpayer's sales numerator. See IC 6-3-2-2(e),(f).

For the years in which RS Corp had revenues for repair services that were performed in Indiana, RS Corp had taxable nexus with Indiana. Therefore, RS Corp had income derived from Indiana sources within the meaning of IC § 6-3-2-2 and can be included in Taxpayer's Indiana consolidated returns for these years. The Audit Division shall conduct a supplemental audit–subject to Taxpayer's full cooperation–to redetermine Taxpayer's adjusted gross income and the respective net operating loss deductions.

**B. MT Corp.**

Taxpayer maintains that MT Corp should not have been excluded from the consolidated group for a lack of taxable nexus. During the course of the hearing, Taxpayer submitted repair services invoices, expense reports, and employee reimbursement documentation to demonstrate that MT Corp received revenue for repair services that were performed in Indiana. Since Taxpayer received compensation for services that were performed in Indiana, it has income from its business activities that are taxable in Indiana. See 45 IAC 3.1-1-38(4). Thus, these receipts for services performed in Indiana and its tangible personal property sales receipts are includable in Taxpayer's sales numerator. See IC 6-3-2-2(e), (f).

For the years in which MT Corp had revenues for repair services that were performed in Indiana, MT Corp had taxable nexus with Indiana. Therefore, MT Corp had income derived from Indiana sources within the meaning of IC § 6-3-2-2 and can be included in Taxpayer's Indiana consolidated returns for these years. The Audit Division shall conduct a supplemental audit–subject to Taxpayer's full cooperation–to redetermine Taxpayer's adjusted gross income and the respective net operating loss deductions.

**C. N Corp.**

Taxpayer maintains that N Corp should not have been excluded from the consolidated group for lack of taxable nexus. During the course of the hearing, Taxpayer submitted invoices for tangible personal property sales.

Based upon the information provided by the taxpayer and the information provided by the Department's investigation report, N Corp's activity fails to establish a nontrivial connection with Indiana to overcome its exemption from taxation under P.L. 86-272. Therefore, N Corp lacked taxable nexus with Indiana, does not have income derived from Indiana sources within the meaning of IC § 6-3-2-2, and cannot be included in the Taxpayer's Indiana consolidated returns.

Accordingly, Taxpayer's protest to the exclusion of N Corp for the consolidated return is denied.

**FINDING**

Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest of the imposition of adjusted gross income tax from the exclusion of RS Corp and MT Corp is sustained in part subject to the results of the supplemental audit. Taxpayer's protest of the imposition of adjusted gross income tax from the exclusion of N Corp is respectfully denied.

**II. Tax Administration–Penalty.**

The Department found that based upon Taxpayer's failure to make sufficient estimated payments, Taxpayer was subject to the penalty under IC § 6-3-4-4.1 for the 2007 tax year. Taxpayer protests the imposition of the penalty.

IC § 6-3-4-4.1, in relevant part, provides:

(d) Every corporation subject to the adjusted gross income tax liability imposed by this article shall be required to report and pay an estimated tax equal to twenty-five percent (25 [percent]) of such corporation's estimated adjusted gross income tax liability for the taxable year. A taxpayer who uses a taxable year that ends on December 31 shall file the taxpayer's estimated adjusted gross income tax returns and pay the tax to the department on or before April 20, June 20, September 20, and December 20 of the taxable year. If a taxpayer uses a taxable year that does not end on December 31, the due dates for filing estimated adjusted gross income tax returns and paying the tax are on or before the twentieth day of the fourth, sixth, ninth, and twelfth months of the taxpayer's taxable year. The department shall prescribe the manner and forms for such reporting and payment.

(e) The penalty prescribed by IC 6-8.1-10-2.1(b) shall be assessed by the department on corporations failing to make payments as required in subsection (d) or (g). However, no penalty shall be assessed as to any estimated payments of adjusted gross income tax which equal or exceed:

(1) twenty percent (20 [percent]) of the final tax liability for such taxable year; or

(2) twenty-five percent (25 [percent]) of the final tax liability for the taxpayer's previous taxable year.

In addition, the penalty as to any underpayment of tax on an estimated return shall only be assessed on the difference between the actual amount paid by the corporation on such estimated return and twenty-five percent (25%) of the corporation's final adjusted gross income tax liability for such taxable year.

A penalty is imposed under IC § 6-3-4-4.1(d) for the underpayment of estimated tax when a taxpayer fails to make the requisite estimated payments. Under IC § 6-3-4-4.1(e), the penalty is assessed on the amount by which the taxpayer underestimated its tax liability. IC § 6-3-4-4.1 does not contain a negligence standard. Rather, IC § 6-3-4-4.1(e) simply states that the penalty "shall be assessed by the department on corporations failing to make payments as required...." Based upon the Department's initial assessment, Taxpayer failed to make the required estimated payments. Therefore, Taxpayer was subject to penalty. However, since Taxpayer's tax liability will likely be redetermined pursuant to the supplemental audit, as discussed in Issue I, the issue is moot at this point. After Taxpayer's tax liability has been redetermined, the Department will apply the statutory calculation at which time a new determination will be made of whether the penalty is applicable to Taxpayer's situation.

**FINDING**

Taxpayer's protest of the imposition of penalties is respectfully denied.

**CONCLUSION**

Taxpayer's protest is sustained in part and denied in part. Taxpayer's protest of the imposition of adjusted gross income tax from the exclusion of RS Corp and MT Corp is sustained in part subject to the results of the supplemental audit, as discussed in Issue I subparts A & B. Taxpayer's protest of the imposition of adjusted gross income tax from the exclusion of N Corp is respectfully denied, as discussed in Issue I subpart C.

Taxpayer's protest of the imposition of penalty is respectfully denied, as discussed in Issue II.

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