

Letter of Findings: 02-20100739
Corporate Income Tax
For the Years 2007, 2008, and 2009

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ISSUE

I. Extended Warranty Business – Income Tax.

Authority: IC § 6-3-2-1(b); IC § 6-3-2-2(b); IC § 6-3-2-2(r); IC § 6-8.1-5-1(c).

Taxpayer argues that the Department of Revenue erred when it concluded that Taxpayer's warranty business was that of a "service provider" and not that of an insurance business.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation and a wholly owned subsidiary of a merchant. Taxpayer files federal income tax returns as a member of a consolidated group but files Indiana income tax returns on a separate company basis.

Taxpayer sells extended warranty contracts for such items as kitchen appliances and consumer electronic equipment. The contracts provide for repair, replacement, and preventative maintenance.

The Indiana Department of Revenue (Department) conducted an audit review of Taxpayer's income tax returns and concluded that Taxpayer was a "service provider." Taxpayer objected arguing, in part, that it was in the insurance business. Taxpayer submitted a protest to that effect, and a telephone hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Extended Warranty Business – Income Tax.

DISCUSSION

The Department's audit concluded that Taxpayer was a service provider. That determination resulted in the assessment of Indiana adjusted gross income tax. Taxpayer argues that it is an insurance company and not a service provider.

In arriving at its decision, the audit relied on the fact that, "Taxpayer has informed the Indiana Department of Insurance that it is not an insurance company, but a service provider...." In addition the audit report quoted from Taxpayer's own customer contract which stated that, "this Agreement is not an insurance policy and is not regulated by the Departments of Insurance for the states of Indiana and [second state]."

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 facie 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 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 typically determined by a three-factor apportionment formula set out in 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. IC § 6-3-2-2(b).

However, Indiana law contains an apportionment scheme specific to life insurance companies and insurance companies subject to federal tax.

This subsection applies to 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. The corporation's adjusted gross income that is derived from sources within Indiana is determined by multiplying the corporation's adjusted gross income by a fraction:

- (1) the numerator of which is the direct premiums and annuity considerations received during the taxable year for insurance upon property or risks in the state; and
- (2) the denominator of which is the direct premiums and annuity considerations received during the taxable year for insurance upon property or risks everywhere.

The term "direct premiums and annuity considerations" means the gross premiums received from direct business as reported in the corporation's annual statement filed with the department of insurance. IC § 6-3-2-2(r) (Emphasis added).

The issue is whether Taxpayer is "an insurance company subject to [federal] tax under Section 831 of the Internal Revenue Code."

Taxpayer has provided a copy of a "Private Letter Ruling" issued by the IRS in approximately 2009. The document concludes that "based on [Taxpayer's] representations, we conclude that, under § 1-801-3(a)(1) of the regulations, [Taxpayer] qualifies as an 'insurance company' for purposes of § 831 of the Code." In addition to the

federal ruling, Taxpayer has provided copies of its federal 1120-PC "U.S. Property and Casualty Insurance Company Income Tax Return."

Taxpayer has met its burden of demonstrating that it is an "insurance company that is subject to tax under Section 831 of the Internal Revenue Code" and that its income should be apportioned pursuant to IC § 6-3-2-2(r).

However, it should be noted that this Letter of Findings does not address any of the remaining issues initially raised in Taxpayer's protest letter. Having found that Taxpayer's income should be apportioned pursuant to IC § 6-3-2-2(r), other questions of apportionment, reinsurance agreements, transfer pricing studies, and such are irrelevant.

FINDING

Taxpayer's protest is sustained.

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