DEPARTMENT OF STATE REVENUE

18-20110050.LOF

Letter of Findings Number: 18-20110050
Financial Institutions Tax
For Tax Years 1999-2008

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ISSUES

I. Financial Institutions Tax–Imposition.

Authority: Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); MBNA America Bank, N.A. v. Indiana Dept. of State Rev., 895 N.E.2d 140 (Ind. Tax Ct. 2008); IC § 6-3-2-2; IC § 6-5.5-1-17; IC § 6-5.5-2-3; IC § 6-5.5-3-1.

Taxpayer protests the assessment of financial institutions tax.

II. Tax Administration–Underpayment Penalty.

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

Taxpayer protests the imposition of underpayment penalties for each year at issue.

STATEMENT OF FACTS

Taxpayer is an out-of-state financial institution. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not been reporting Indiana Financial Institutions tax ("FIT") for the tax years 1999 through 2008. The Department therefore issued proposed assessments for FIT, interest, and underpayment penalties for each year at issue. Taxpayer protests that it did not have nexus with Indiana in those years for FIT purposes. Taxpayer therefore protests the imposition of FIT and penalties. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Financial Institutions Tax–Imposition.

DISCUSSION

Taxpayer protests that it did not have nexus with Indiana for FIT purposes for the tax years 1999 through 2008. Taxpayer states that it only served Indiana customers who learned of Taxpayer's financing services when Taxpayer's related company ("Related") made sales to the Indiana customers and informed the Indiana customers of Taxpayer's services. Taxpayer argues that the result is that Related solicited business for itself and that Taxpayer did not conduct any solicitation of business in Indiana. 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 first relevant statute is IC § 6-5.5-1-17(a), which states:

"Taxpayer" means a corporation that is transacting the business of a financial institution in Indiana, including any of the following:

(1) A holding company.
(2) A regulated financial corporation.
(3) A subsidiary of a holding company or regulated financial corporation.
(4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution.

Next, IC § 6-5.5-2-3 states:

For a taxpayer that is not filing a combined return, the taxpayer's apportioned income consists of the taxpayer's adjusted gross income for that year multiplied by the quotient of:

(1) the taxpayer's total receipts attributable to transacting business in Indiana, as determined under IC 6-5.5-4; divided by
(2) the taxpayer's total receipts from transacting business in all taxing jurisdictions, as determined under IC 6-5.5-4.

Next, IC § 6-5.5-3-1 provides:

For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year only if the taxpayer:

(1) maintains an office in Indiana;
(2) has an employee, representative, or independent contractor conducting business in Indiana;
(3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
(4) regularly solicits business from potential customers in Indiana;
(5) regularly performs services outside Indiana that are consumed within Indiana;
(6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;

(7) owns or leases tangible personal or real property located in Indiana; or

(8) regularly solicits and receives deposits from customers in Indiana.

Taxpayer states that the imposition of FIT is not a fair representation of Taxpayer's services in the state and that the Supreme Court decision in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) allows that a tax would survive a Commerce Clause objection only "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." Id. at 279. Taxpayer believes that, since it argues that it does not have a presence in Indiana and could therefore not receive any services from the State, imposition of the FIT could not be fairly apportioned.

The Indiana Tax Court has addressed the applicability of the Commerce Clause to Indiana FIT in the case MBNA America Bank, N.A. v. Indiana Dept. of State Rev., 895 N.E.2d 140 (Ind. Tax Ct. 2008), in which the court explained:

> The stipulated facts in this case indicate that, during the years at issue, MBNA had an economic presence in Indiana. MBNA regularly solicited business from Indiana customers. MBNA's Indiana customers exceeded a "de minimis" number. Furthermore, MBNA regularly received interest and fees from those customers. Finally, the Court notes that MBNA's confidential FIT returns reported significant gross receipts attributable to its Indiana customers. Thus, during the years at issue, MBNA had a substantial nexus with Indiana for purposes of the FIT.
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> Id, at 144.
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> (Internal notations omitted.)

The MBNA opinion also stated, "The Commerce Clause does not require MBNA to have a physical presence in Indiana to be subject to the FIT–its economic presence is enough." Id. Regarding Taxpayer's assertion that it did not receive services from the state, the court in MBNA pointed out in a footnote that MBNA did use the Indiana court system to pursue collection lawsuits. The Indiana court system is an example of Indiana services to which Taxpayer had access in the instant case.

Taxpayer argues that it did not solicit business from Indiana customers, but rather that Related business solicited customers and then offered Taxpayer's financing services if Related's customers desired to use Taxpayer's services. The Department is not convinced that the fact that Related solicited the customers and offered Taxpayer's financing services insulates Taxpayer from the FIT. The fact remains that Taxpayer did have Indiana customers. The fact that Related did the soliciting for Taxpayer is not determinative in this case, since IC § 6-5.5-3-1(6) states that a taxpayer is transacting business in Indiana if it regularly engages in transactions with customers in Indiana that involve intangible property. Taxpayer had regular income from Indiana customers and this establishes an economic nexus with Indiana, as provided by IC § 6-5.5-3-1(6) and confirmed by the decision in MBNA.

Next, Taxpayer states that, if it is determined that it did have nexus with Indiana for FIT purposes, it should be allowed to file a consolidated or combined return with Related. Taxpayer states that filing a consolidated return is allowed under IC § 6-3-2-2(l) and that a taxpayer may petition the Department to file a combined return. The Department must disagree with Taxpayer's proposal. The consolidated or combined returns to which Taxpayer refers are applicable to entities which file adjusted gross income tax returns with the Department. Since the tax at issue in this case is financial institutions tax, Taxpayer's request cannot be granted.

In conclusion, Taxpayer had economic nexus with Indiana during the years at issue, as provided by IC § 6-5.5-3-1(6) and confirmed by the decision in MBNA. Taxpayer should have been filing FIT returns with the Department for those years. Taxpayer may not file consolidated or combined returns with Related due to the fact that the two entities file different types of taxes. Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Underpayment Penalty.

DISCUSSION

The Department issued proposed assessments for FIT and ten percent negligence penalties for the tax period in question. Taxpayer protests the imposition of penalties and requests a waiver of those penalties. Taxpayer states that it had reasonable cause to believe that it was not subject to FIT in Indiana, as described in Issue I above. Taxpayer believes that this factor establishes grounds for waiver of the ten percent penalty.

The Department refers to IC § 6-8.1-10-2.1, which states in relevant part:

> If a person:
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> (3) incurs, upon examination by the department, a deficiency that is due to negligence;
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> the person is subject to a penalty.
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> ...
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> (d) If a person subject to the penalty imposed under this section can show that the failure to file a return, pay

the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

....

(Emphasis added).

Next, 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.

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

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 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)(4). Taxpayer has affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer is denied on Issue I regarding the imposition of FIT. Taxpayer is sustained on Issue II regarding the imposition of penalty.

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