DEPARTMENT OF STATE REVENUE

02-20110552.LOF

Letter of Findings: 02-20110552
Corporate Income Tax
For the 2004 through 2007 Tax Years

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ISSUES

I. Corporate Income Tax–Statute of Limitations.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-5-2; IC § 6-8.1-9-1.

Taxpayer argues that the Department's assessment of adjusted gross income tax for the 2005 and 2006 tax years are barred by the statute of limitations. Taxpayer also argues that the Department cannot deny its refund for the 2004 tax year because the Department's denial is barred by the statute of limitations.

II. Corporate Income Tax–Apportionment.

Authority: IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; 45 IAC 3.1-1-53.

Taxpayer protests the inclusion of throwback sales in the Department's Indiana adjusted gross income tax calculations.

STATEMENT OF FACTS

Taxpayer is in the health care business. Taxpayer manufactures and markets various pharmaceutical products and services. Taxpayer is involved in research and development, production, and marketing of the pharmaceuticals. Taxpayer filed amended Indiana adjusted gross income tax returns claiming refunds for the 2004, 2005, and 2006 tax years. The Department of Revenue (The Department) issued refund checks for the 2005 and 2006 tax years on April 1, 2009.

Subsequently, the Department conducted a corporate income tax audit for the 2004, 2005, 2006, and 2007 tax years. For the 2004 tax year, the audit resulted in the partial refund of the tax requested. For the 2005, 2006, and 2007 tax years, the audit resulted in the assessment of additional adjusted gross income tax. The Department granted nearly half of Taxpayer's refund for the 2004 tax year and used those refunded monies to partially offset the assessment for the 2005 tax year. Taxpayer protested, disagreeing with the assessments of tax for the 2005, 2006, and 2007 tax years and the partial refund denial for the 2004 tax year. An administrative hearing was conducted, and this Letter of Findings results. Additional facts will be supplied as required.

I. Corporate Income Tax–Statute of Limitations.

DISCUSSION

Taxpayer argues that the Department's assessment of adjusted gross income tax for the 2005 and 2006 tax years is barred by the statute of limitations. Additionally, Taxpayer argues that the decision to deny its 2004 refund was made outside of the statute of limitations. Therefore, the denial was not valid, which requires the Department to issue the refund.

A. 2005 and 2006 Tax Years.

As a threshold issue, it is the Taxpayer's responsibility to establish 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."

Taxpayer claims that the proposed assessments issued for the 2005 and 2006 are barred by the statute of limitations. Taxpayer relies on IC § 6-8.1-5-2(g) which states:

> If any part of a listed tax has been erroneously refunded by the department, the erroneous refund may be recovered through the assessment procedures established in this chapter. An assessment issued for an erroneous refund must be issued:
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> (1) within two (2) years after making the refund; or
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> (2) within five (5) years after making the refund if the refund was induced by fraud or misrepresentation.

Taxpayer points out that the Department issued the 2005 and 2006 refund checks on April 1, 2009. Under Taxpayer's application of IC § 6-8.1-5-2(g), the Department had two years – until April 1, 2011 – to retrieve what Taxpayer categorizes as an "erroneous refund under IC § 6-8.1-5-2(g)." Since the Department did not issue the proposed assessment until August 23, 2011, Taxpayer concludes that the proposed assessment is barred as untimely by IC § 6-8.1-5-2(g).

It should be noted that Taxpayer signed waivers each entitled "Agreement to Extension of Time" for the 2005 and 2006 tax years, which extended the statute of limitations for these tax years to September 30, 2011. Since the proposed assessments were issued on August 23, 2011, the assessments were issued within the statute of limitations for 2005 and 2006.

The Department is unable to agree that the 2005 and 2006 assessment is barred by IC § 6-8.1-5-2(g)

because there is no indication that the 2005 and 2006 refunds were "erroneous." There is no indication that Taxpayer filed false returns leading to the 2005 or the 2006 refunds; there is no indication that the 2005 or 2006 refunds were generated due to faulty or incorrect information contained in Taxpayer's returns; there is no indication that the 2005 and 2006 refunds were attributable to a calculation error on the part of the Department; there is no indication that the refunds were attributable to an error contained in the Department's records or its computer system. The refunds issued on April 1, 2011, were applied for and issued in the ordinary course of the Taxpayer's business and the ordinary course of the Department's business. At the time the refunds were issued, there was nothing "erroneous" about the refunds because both Taxpayer and the Department believed that the refunds were based upon a correct application of the facts and the law.

B. 2004 Tax Year.

Taxpayer claims that the Department's partial denial of its refund is barred by the statute of limitations. Taxpayer states:

> The Department did not review the 2004 amended return until the audit began in April 2009. At the completion of the audit at the time the assessments were issued for the 2005, 2006, and 2007 tax years, i.e., [August, 23, 2011] the auditor denied the refund claim for 2004. This denial was outside the statute of limitations, and thus, the Department has no choice but to issue the refund claim for the 2004 year since a waiver to extend the 2004 statute was not executed by the Taxpayer.

It appears that Taxpayer argues that the Department is required to issue a refund within the three year statute of limitations for issuing assessments provided in IC § 6-8.1-5-1 and the three year time period a taxpayer has to file its refund claim.

However, the statute governing refunds is IC § 6-8.1-9-1, which in relevant parts, provides:

> (a) If a person has paid more tax than the person determines is legally due for a particular taxable period, the person may file a claim for a refund with the department. Except as provided in subsections (f), (g), and (h), in order to obtain the refund, the person must file the claim with the department within three (3) years after the latter of the following:
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> (1) The due date of the return.
>
> (2) The date of payment.
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> For purposes of this section, the due date for a return filed for the state gross retail or use tax, the gasoline tax, the special fuel tax, the motor carrier fuel tax, the oil inspection fee, or the petroleum severance tax is the end of the calendar year which contains the taxable period for which the return is filed. The claim must set forth the amount of the refund to which the person is entitled and the reasons that the person is entitled to the refund.
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> (b) After considering the claim and all evidence relevant to the claim, the department shall issue a decision on the claim, stating the part, if any, of the refund allowed and containing a statement of the reasons for any part of the refund that is denied. The department shall mail a copy of the decision to the person who filed the claim. If the person disagrees with a part of the decision, the person may file a protest and request a hearing with the department. The department shall mail a copy of the decision to the person who filed the protest. If the department allows the full amount of the refund claim, a warrant for the payment of the claim is sufficient notice of the decision.
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> (c) If the person disagrees with any part of the department's decision, the person may appeal the decision, regardless of whether or not the person protested the tax payment or whether or not the person has accepted a refund. The person must file the appeal with the tax court. The tax court does not have jurisdiction to hear a refund appeal suit, if:
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> (1) the appeal is filed more than three (3) years after the date the claim for refund was filed with the department;
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> (2) the appeal is filed more than ninety (90) days after the later of the date the department mails:
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> (A) the decision of denial of the claim to the person; or
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> (B) the decision made on the protest filed under subsection (b); or
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> (3) the appeal is filed both before the decision is issued and before the one hundred eighty-first day after the date the person files the claim for refund with the department.
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> (d) The tax court shall hear the appeal de novo and without a jury, and after the hearing may order or deny any part of the appealed refund. The court may assess the court costs in any manner that it feels is equitable. The court may enjoin the collection of any of the listed taxes under IC 33-26-6-2. The court may also allow a refund of taxes, interest, and penalties that have been paid to and collected by the department.
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> ...
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> (g) If an agreement to extend the assessment time period is entered into under IC 6-8.1-5-2(h), the period during which a person may file a claim for a refund under subsection (a) is extended to the same date to which the assessment time period is extended.

Accordingly, the statute is silent on how long the Department has to issue a refund, but does provide a three-year limit for a taxpayer to claim its refund within three years of the later of the date of the tax payment or the due date of the tax return. The statute contains a second limitation that a taxpayer must appeal to Tax Court

within three years of requesting its refund claim. The statute gives a taxpayer the right to appeal to Tax Court if the Department has not made a decision on the refund claim within one hundred and eight days of receiving the claim. Thus, when the Department has not responded after one hundred and eighty days, but before three years have expired, a taxpayer can consider its refund claim "deemed denied" and appeal to Tax Court. This is the remedy that the statute provides. The statute does not automatically deem a refund granted. In fact, under Taxpayer's logic, all a taxpayer would have to do is file its refund request on the last date it is allowed, the Department would not be able to investigate the claim, and the Department would be required to issue the refund. The Department does not agree with Taxpayer's logic and acted appropriately issuing the partial denial of Taxpayer's refund in its audit report dated July 22, 2011.

FINDING

Taxpayer's protest to the imposition of tax for the 2005 and 2006 tax years and to the partial denial of its claim for refund for the 2004 tax year based upon the expiration of statute of limitation is respectfully denied.

II. Corporate Income Tax–Apportionment.

DISCUSSION

The Department made several adjustments to Taxpayer's sales factor. The Department attributed to Indiana certain of the sales made to locations in other states. The Department treated these sales as "throwback" sales attributed to Indiana. IC § 6-3-2-2(e), (n). The decision resulted in an increase in Taxpayer's corporate adjusted gross income tax. Taxpayer protests the Department's assessment of adjusted gross income tax for the 2005, 2006, and 2007 tax years and the Department's denial of its refund for the 2004 tax year based upon these adjustments to its sales factor. Taxpayer maintains that the throw-back rule is not warranted for sales to a number of states.

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 formula 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 determined that, for purposes of calculating taxpayer's Indiana tax liability, the receipts from sales to out-of-state customers should be thrown back to Indiana because the sales were made within jurisdictions where the taxpayer did not have nexus with the state. The audit based its decision on Example 5 of 45 IAC 3.1-1-53 which states that "[i]f the taxpayer is not taxable in the state of the purchaser, the sale is attributed to [Indiana] if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state." Such sales are designated as "throw-back" sales. Id.

The basic rule is found at IC § 6-3-2-2. IC § 6-3-2-2(e) provides that "[s]ales of tangible personal property are in this state if... (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and... (B) the taxpayer is not taxable in the state of the purchaser." IC § 6-3-2-2(n) provides that "[f] or purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." Therefore, in order to properly attribute income to a foreign state, taxpayer must show that one of the taxes listed in IC § 6-3-2-2(n)(1) has been levied against him or that the state has the jurisdiction to impose a net income tax regardless of "whether, in fact, the state does or does not." Id.

Again, it is the taxpayer's responsibility to establish that the existing sales 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."

Taxpayer asserts that it has nexus in several states and, therefore, the throw-back rule is not applicable. Taxpayer maintains that in addition to its sales force in these states, it has employees that supervise clinical trials that are being conducted by independent investigator/physicians. Taxpayer states that these supervisory duties give it nexus in these states where the clinical trials were conducted.

During the protest, Taxpayer provided additional documentation–including supervisors' travel documentation, lists of the clinical trial locations, and supervisors' log sheets. Based upon this documentation, Taxpayer has established that in these states where the clinical trials are located it has "nexus" and, therefore, was subject to "a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax," sales to customers in these states should not be thrown back to Indiana. Thus, Taxpayer's protest is sustained in part to the extent that sales to these states where Taxpayer presented documentation that clinical trials were being conducted have been thrown back to Indiana. However, Taxpayer's protest is denied to the extent that sales to these states where Taxpayer failed to present documentation of the conducting of the

clinical trials. The file will be returned to the audit division where they are requested to review the submitted documentation and make whatever adjustments it deems appropriate.

FINDING

Taxpayer's protest is sustained in part and denied in part subject to results of an audit review of the submitted documentation.

SUMMARY

Taxpayer's protest to the imposition of tax for the 2005 and 2006 tax years and to the partial denial of its claim for refund for the 2004 tax year based upon the expiration of statute of limitation is respectfully denied. Taxpayer's protest to the imposition of tax and to denial of its refund from the inclusion of certain throwback sales in the Department's Indiana adjusted gross income tax calculations is sustained in part and denied in part. Taxpayer's protest is sustained to the extent that the sales to the states where Taxpayer has presented documentation that clinical trials were being conducted have been thrown back to Indiana. However, Taxpayer's protest is denied to the extent that the sales to the states where Taxpayer had failed to present documentation of the clinical trials. The file will be returned to the audit division where they are requested to review the submitted documentation and make whatever adjustments it deems appropriate.

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