DEPARTMENT OF STATE REVENUE

02-20100152.LOF

Letter of Findings: 02-20100152
Indiana Corporate Income Tax
For the Tax Year 2008

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Corporate Income Tax – Imposition.

Authority: IC § 6-3-1-19; IC § 6-3-4-10; IC § 6-3-4-11; IC § 6-8.1-5-1; 45 IAC 3.1-1-106; 45 IAC 3.1-1-153; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Five Star Concrete, L.L.C. v. Klink, Inc. 693 N.E.2d 583 (Ind. Ct. App. 1998); Riverboat Development, Inc. v. Indiana Dep't of State Revenue, 881 N.E.2d 107 (Ind. Tax Ct. 2008); Hunt Corp. v. Indiana Dep't of State Revenue, 709 N.E.2d 766 (Ind. Tax Ct. 1999).

Taxpayer protests assessment of additional corporate income tax.

II. Tax Administration – Interest.

Authority: IC § 6-8.1-10-1.

Taxpayer protests the imposition of interest.

III. Tax Administration – Underpayment Penalty and Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2; IC § 6-3-4-4.1.

Taxpayer protests the imposition of the underpayment penalty and the negligence penalty.

STATEMENT OF FACTS

Taxpayer is a C corporation, which was incorporated in Indiana in 1993 and has registered annually with the Indiana Secretary of State as a for-profit domestic corporation domiciled in Indiana. Taxpayer and one of Taxpayer's affiliates (also a C corporation, here referred to as "Affiliate") are the members of a two-member Indiana limited liability company ("Indiana LLC"). The Indiana LLC was organized in Indiana and registers annually with the Indiana Secretary of State as a for-profit domestic LLC. The Indiana LLC, in turn, wholly owns an Indiana limited liability company, which is treated as a disregarded entity for tax filing purposes. The two-member Indiana LLC, through its wholly-owned disregarded Indiana limited liability company (collectively, "Indiana LLC"), conducts its gaming business in Indiana and elected to be treated as a partnership for federal tax purposes. The Indiana LLC earns its income solely from its Indiana business activities. Taxpayer, who owns a 70 percent interest of the Indiana LLC, is the majority member and manages the Indiana LLC's daily business operation.

Taxpayer and Affiliate filed their 2008 consolidated Indiana corporate income tax return. Taxpayer and Affiliate claimed that their income from Indiana LLC as a "Foreign Source Dividends and other adjustments" deduction (the "Deduction") for the adjusted gross income tax for the 2008 tax year. After an initial review, the Indiana Department of Revenue ("Department") disallowed Taxpayer and Affiliate's claimed Deduction, resulting in additional income tax, interest, and penalties. Taxpayer and Affiliate protested the disallowance of the Deduction and the imposition of additional tax. An administrative hearing was conducted during which the representatives of Taxpayer and Affiliate explained the basis for the protest.

The dispute concerning the taxability of Affiliate's income was subsequently resolved. As a result, any issue regarding the imposition of tax, interest, and penalties on Affiliate's income has been resolved and is no longer in dispute. Subsequently, the Department issued revised notices of proposed assessment of Indiana adjusted gross income tax, interest and penalties for 2008 dated October 29, 2012, which reflected only the tax liability on Taxpayer's income. Taxpayer continues to protest the October 29, 2012 revised proposed assessments (imposition of tax, interest and penalties). This Letter of Findings addresses the issues raised by Taxpayer throughout the protest process. Further facts will be supplied as required.

I. Corporate Income Tax – Imposition.

DISCUSSION

Taxpayer filed its original 2008 Indiana income tax return, claiming the Deduction, in an amount equal to the income it reported from the "partnership" earnings of the Indiana LLC. Upon reviewing Taxpayer's 2008 return, the Department determined that Taxpayer was not entitled to the Deduction and therefore disallowed Taxpayer's claimed Deduction.

As a threshold issue, all tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East,

Inc., 963 N.E.2d 463, 466 (Ind. 2012).

IC § 6-3-1-19 provides:

(a) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this chapter, a corporation or a trust or an estate. **The term also includes a limited liability company that is treated as a partnership for federal income tax purposes.**

(b) The term "partner" means a member of a partnership. (**Emphasis added**).

45 IAC 3.1-1-106 states:

(a) A partnership is not subject to the adjusted gross income tax. The partners will include their share of partnership income whether distributed or undistributed on their separate or individual returns.

(b) An individual will report as follows:

(1) The distributive share of a resident partner will be reported in total no matter where the partnership's business is located or in which states it does business.

(2) The distributive share of a nonresident partner will be reported after apportionment to determine the partnership income derived from sources within Indiana. This determination will be accomplished by use of the apportionment formula described in IC 6-3-2-2(b).

(3) A resident partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 62 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.

(4) A nonresident partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 62 of the Internal Revenue Code for taxes based on or measured by income levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States determined by use of the apportionment formula described in IC 6-3-2-2(b).

(c) **A corporate partner will report its share in accordance with section 153 of this rule**. (**Emphasis added**).

45 IAC 3.1-1-153 further illustrates:

(a) A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income.

(b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year, with the following modifications:

(1) The value of property which is rented or leased by the corporate partner to the partnership or vice versa shall, with respect to the corporate partner, be excluded from the property factor of the partnership or eliminated to the extent of the corporate partner's interest in the partnership, whichever the case may be, in order to avoid duplication.

(2) Intercompany sales between the corporate partner and the partnership shall be eliminated from the corporate partner's sales factor as follows:

(A) Sales by the corporate partner to the partnership to the extent of the corporate partner's interest in the partnership.

(B) Sales by the partnership to the corporate partner not to exceed the corporate partner's interest in all partnership sales.

(c) If the corporate partner's activities and the partnership's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows:

(1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.

(2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.

(d) A partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United

States.

(e) After determining the amount of business income attributable to Indiana under subsection (c), the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income.

In Five Star Concrete, L.L.C. v. Klink, Inc. 693 N.E.2d 583 (Ind. Ct. App. 1998), the Indiana Court of Appeals addressed the issue of whether a former LLC member, Klink Incorporated, was entitled to a cash distribution when Klink Incorporated withdrew from its membership of the LLC, Five Star Concrete, L.L.C. The Court of Appeals noted "LLCs offer the same limited liability as the corporate form of business organization, but they are treated by federal and state taxing bodies in the same way as partnerships, that is, income 'passes through' the entity and is taxed to the member, an owner of an interest in the company." Id. at 586.

Accordingly, for Indiana income tax purposes, the Indiana LLC, by definition, is a partnership and Taxpayer is a corporate partner in a partnership. The Indiana LLC, a partnership under Indiana tax law, as required by IC § 6-3-4-10, filed an Indiana partnership return, Form IT-65, reporting all of its activities as "business income" attributable to Indiana and requiring it to issue Form IT-65 IN K-1s ("Indiana K-1s") to its corporate partners.

Pursuant to IC § 6-3-4-11(a), Taxpayer, the corporate partner, is liable for the adjusted gross income tax in its separate or individual capacity and is required to report its portion of the partnership's Indiana business activity, as represented on the K-1, on Taxpayer's Indiana adjusted gross income tax return.

During the hearing, Taxpayer asserted that it was not domiciled in Indiana, but was domiciled in a state other than Indiana. Referring to Riverboat Development, Inc. v. Indiana Dep't of State Revenue, 881 N.E.2d 107 (Ind. Tax Ct. 2008), Taxpayer asserted that it "did not conduct any activity other than that related to their respective membership interests in [the Indiana LLC]." Thus, Taxpayer maintained that it did not have a duty to report and pay tax on the money earned from the Indiana LLC's Indiana business activity. Taxpayer further stated that since the Indiana corporate income tax return did not contain a line item which properly described non-taxable income in this category, Taxpayer reported this Deduction on a line item for "Foreign Source Dividends and other adjustments." Taxpayer explained that this "Foreign Source Dividends and other adjustments" line was similar to the Deduction it would have claimed because it is domiciled outside of Indiana. Thus, Taxpayer maintained that it properly claimed the Deduction.

Taxpayer is mistaken in both its presentation of fact and of law. First, Taxpayer misconstrues its connections to Indiana. Not only did Taxpayer incorporate in Indiana, Taxpayer has for each and every year since its 1993 incorporation, registered with the Indiana Secretary of State as a domestic for-profit corporation domiciled in Indiana. Taxpayer's own articles of incorporation state that "[t]he purposes for which [Taxpayer] is formed are (a) to conduct gaming operations in the State of Indiana, and (b) to engage in the transition of any or all lawful business for which corporations may now or hereafter be incorporated under the Corporation Law." Moreover, according to the LLC's articles of organization and operating agreements with Taxpayer, Taxpayer is the majority member of a member-managed Indiana LLC operating a gambling casino in Indiana. Taxpayer, in the Indiana LLC's operating agreement, dated July 15, 1999, refers to itself as an "Indiana corporation." Furthermore, Taxpayer did not register with the states in which it conducted its business as a domestic or foreign corporation.

Second, Taxpayer's reliance on Riverboat Development is misplaced. Riverboat Development is not relevant because in that case the Tax Court addressed an out-of-state S-Corporation's duty to withhold on behalf of its non-resident shareholders' receipts from what the Tax Court classified as "intangibles;" "intangibles" are not at issue here. Most importantly, the Tax Court has addressed the circumstances of a corporate partner reporting its corporate partnership income in Hunt Corp. v. Indiana Dep't of State Revenue, 709 N.E.2d 766, 773 (Ind. Tax Ct. 1999) (noting that as of "January 1, 1984... corporate partnerships are treated like any other partnerships" for Indiana tax purposes). The Tax Court found that in order to determine income attributable to Indiana, the first question is "whether the income sought to be attributed is business or non-business income." Id. at 771. "If the income is business income, the [amount of] income attributable to Indiana is calculated by using a three-factor apportionment formula." Id. The Tax Court determined that when a corporate partner is in a unitary relationship with the partnership, the only income that can be removed from the apportionable base is non-business income. Id. at 778.

Taxpayer's supporting documentation demonstrates that it has been the majority member of the Indiana LLC which controls and manages the Indiana LLC's daily business operation. The Indiana LLC conducts its business activities solely in Indiana, and thus, its income (revenue) is business income attributable to Indiana. Likewise, Taxpayer, as the majority member of the Indiana LLC (the corporate partner of the partnership), earned its income solely from the Indiana LLC's business operation; its income from "partnership" earnings of the Indiana LLC, was attributable to Indiana and subject to Indiana corporate income tax.

In conclusion, pursuant to the above mentioned statute, regulation, and the ruling of Hunt Corp., Taxpayer's income–which it reported from "partnership" earnings of the Indiana LLC–was subject to Indiana income tax and, thus, its claimed deduction was properly disallowed.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Interest.

DISCUSSION

The Department assessed interest on the tax liabilities. Taxpayer protests this imposition of interest.

IC § 6-8.1-10-1(a) provides, as follows:

If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on the person's return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

Pursuant to IC § 6-8.1-10-1(e), the Department does not have the authority to waive the interest. Therefore, Taxpayer's protest is denied.

FINDING

Taxpayer's protest to the imposition of interest is respectfully denied.

III. Tax Administration – Underpayment Penalty and Negligence Penalty.

DISCUSSION

Taxpayer protested the imposition of the underpayment penalty and negligence penalty.

A. Underpayment Penalty.

The Department imposed an underpayment penalty because Taxpayer failed to timely remit its estimated payments of adjusted gross income tax under IC § 6-3-4-4.1(d).

IC § 6-3-4-4.1(d) states:

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 (c) or (f). However, no penalty shall be assessed as to any estimated payments of adjusted gross income tax which equal or exceed:

(1) the annualized income installment calculated under subsection (c); 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 [percent]) of the corporation's final adjusted gross income tax liability for such taxable year.

In this case, the Department takes no position as to whether the underpayment penalty should be calculated based on what Taxpayer reports on its original return or whether the penalty should ever be calculated based upon the amount for which Taxpayer is ultimately found liable. However, the Department's records showed that, previously, Taxpayer made estimated payments for tax year 2007 and self-reported a substantial amount of tax due for tax year 2007. But, for tax year 2008, the Department's records showed that Taxpayer did not make any estimated payments. Given the totality of the circumstances, in the absence of other supporting documentation, an underpayment penalty is properly imposed because Taxpayer failed to make any estimated payments as statutorily required for tax year 2008.

In short, based upon the nature of the tax, the amount of tax involved, and Taxpayer's failure of making any estimated payments for tax year 2008, the imposition of the underpayment penalty is appropriate pursuant to IC § 6-3-4-4.1(d).

B. Negligence Penalty.

Taxpayer also protested the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

(1) fails to file a return for any of the listed taxes;

(2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;

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

(4) fails to timely remit any tax held in trust for the state; or

(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

45 IAC 15-11-2(b) further 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.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), in part, as follows:

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. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;
(2) judicial precedents set by Indiana courts;
(3) judicial precedents established in jurisdictions outside Indiana;
(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer did not provide sufficient documentation to demonstrate that its failure to pay tax was not due to negligence.

FINDING

Taxpayer's protest of the underpayment penalty and negligence penalty is respectfully denied.

SUMMARY

For the reasons discussed above, Taxpayer's protest of the disallowance of its "Foreign Source Dividends" deduction is respectfully denied. Taxpayer's protest of the imposition of interest is respectfully denied. Taxpayer's protest of the underpayment penalty and negligence penalty is also respectfully denied.

Posted: 03/27/2013 by Legislative Services Agency
An html version of this document.