DEPARTMENT OF STATE REVENUE

02-20120525.LOF

Letter of Findings: 02-20120525
Corporate Income Tax
For the Tax Periods Ending March 31, 2004, and March 31, 2005

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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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.

ISSUE

I. Adjusted Gross Income Tax – Apportionment – Property Factor.

Authority: IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1; IC § 6-8.1-9-1; 45 IAC 3.1-1-40; 45 IAC 3.1-1-41; 45 IAC 3.1-1-43; Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Sherwin-Williams Co. v. Indiana Dep't. of State Revenue, 673 N.E.2d 849 (Ind. Tax Ct. 1996); Enterprise Leasing Co. v. Indiana Dep't of State Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002).

Taxpayer protests the imposition of additional adjusted gross income tax.

STATEMENT OF FACTS

Taxpayer is a manufacturer that does business in Indiana and outside of Indiana. Taxpayer contracts with various third-party suppliers ("Suppliers") to design and manufacture component parts for Taxpayer. Before the Suppliers begin their manufacturing processes, Taxpayer inspects, accepts, and subsequently pays the Suppliers for the cost of tooling equipment Suppliers use to manufacture Taxpayer's component parts. The Suppliers then deliver the manufactured component parts to Taxpayer's designated facilities where those parts are assembled to make Taxpayer's finished products for sale. Taxpayer files its Indiana corporate income tax returns which includes the tooling equipment in the property factor (numerator and denominator) of the Indiana apportionment formula to calculate its Indiana income tax.

In 2012, pursuant to a federal audit, Taxpayer amended its 2003 (period ending March 31, 2004) and 2004 (period ending March 31, 2005) Indiana corporate income tax returns to report RAR adjustments. In its amended returns, Taxpayer also included a reduction of the property factor for apportionment purposes. Taxpayer explained that (1) it mistakenly included the tooling equipment in the property factor when the original returns were filed; (2) the amended returns removed the tooling equipment from both the numerator and the denominator of the property factor; and (3) the adjustments resulted in overpayments for both tax years, but the refunds were "barred by Statute of Limitations."

Upon receiving Taxpayer's filings, the Department processed the amended returns to reflect the federal RAR adjustments. However, the Department denied the reduction of the "property factor" stated in Taxpayer's amended returns, which resulted in additional proposed assessments for both years.

Taxpayer timely protested. Taxpayer requested that the Department address its protest based on the information available within the file and the documentation it previously provided in supporting its protest of the same issue but for a different tax year, docket number 02-20120322R. This Letter of Findings results and addresses Taxpayer's protest of the proposed assessments for 2003 and 2004 tax years. Further facts will be supplied as required.

I. Adjusted Gross Income Tax – Apportionment – Property Factor.

DISCUSSION

When Taxpayer amended its 2003 and 2004 Indiana income tax returns, Taxpayer claimed that when it filed the original returns, it mistakenly included the tooling equipment in the property factor for apportionment purposes, which resulted in an overpayment of income tax paid to Indiana. The Department disagreed and determined that "the tooling equipment in question is business property" because it is used to produce business income. Thus, the Department concluded that the tooling equipment "should remain in both the numerator and denominator of the property factor."

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).

"Indiana imposes a tax on every corporation's adjusted gross income derived from sources within Indiana. [IC § 6-3-2-1(b).] In cases where a corporation derives business income from sources both within and without Indiana, the 'adjusted gross income derived from sources within the state of Indiana' is determined by an apportionment formula." Sherwin-Williams Co. v. Indiana Dep't. of State Revenue, 673 N.E.2d 849, 851 (Ind. Tax Ct. 1996). 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(c) further provides:

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal **property owned or rented and used in this state** during the taxable year and the denominator of which is the average value of all the taxpayer's real and tangible personal property **owned or rented and used** during the taxable year. However, with respect to a foreign corporation, the denominator does not include the average value of real or tangible personal property owned or rented and used in a place that is outside the United States. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals. The average of property shall be determined by averaging the values at the beginning and ending of the taxable year, but the department may require the averaging of monthly values during the taxable year if reasonably required to reflect properly the average value of the taxpayer's property. (**Emphasis added**).

45 IAC 3.1-1-40 states:

The property factor is a fraction, the numerator of which is the average value of the taxpayer's Indiana property, and the denominator of which is the total value of the taxpayer's property everywhere. As used in this regulation [45 IAC 3.1-1-40], the word "property" includes all real and tangible personal property of the taxpayer, **whether owned or rented, which is or could be used to produce business income during the tax period**. This includes land, buildings, machinery, inventory, equipment and any other real or tangible personal property used to produce business income, but not coin, currency or intangibles. Property, the income from which is subject to allocation as nonbusiness income, is excluded from the factor. Property producing both business and nonbusiness income is included only to the extent it was used to produce business income. (**Emphasis added**).

45 IAC 3.1-1-41 further provides:

Property Used for the Production of Business Income. The property factor includes all property owned or rented by the taxpayer which is actually used or is available for or capable of being used to produce business income. Property held as reserves or stand-by facilities, or for a reserve source of materials, is included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are included in the factor. Property under construction during the tax period (except inventoriable goods in process) are includable only if and only to the extent it is actually used to produce business income.

45 IAC 3.1-1-43 also provides:

Property Factor-Numerator. The numerator of the property factor includes the average value of the taxpayer's Indiana property which is used to produce business income. "Indiana property" is all real and tangible personal property owned or rented and used in the state during the tax period. Property in transit between states is considered to be at destination. However, mobile or movable property which may be used in more than one state in the regular course of the taxpayer's business, i.e., rolling stock, construction equipment, lased *[sic]* electronic equipment, etc., shall be included in the numerator based on total time or miles (as applicable) used in the state.

In Enterprise Leasing Co. v. Indiana Dep't of State Revenue, 779 N.E.2d 1284 (Ind. Tax Ct. 2002), the taxpayers, Enterprise Leasing Company of Chicago and its affiliates, were in the business of leasing vehicles to residents in Indiana. The taxpayers challenged the Department's determination, which included those leased vehicles – located, titled, and registered in Indiana – in the formula for apportionment purposes under IC § 6-3-2-2. Specifically, the taxpayers asserted that, although those leased vehicles were located, titled, and registered in Indiana, they did not use those vehicles in Indiana. Thus, the taxpayers maintained that they were not required to include those leased vehicles in the property factor for apportionment purposes. Ruling in favor of the taxpayers, the Indiana Tax Court further illustrated that "it is clear that the legislature intended that property 1) be owned or rented by the taxpayer[s], and 2) be used by the taxpayer[s] in Indiana." Id. at 1294.

In this instance, Taxpayer claimed that it "receives no income from the tooling property" because "[t]he tooling property is merely provided by Taxpayer to be used by [its Suppliers] to insure the parts are manufactured to [its] specifications." Taxpayer further asserted that it did not use the tooling equipment to generate income; rather, its Suppliers used the tooling equipment to manufacture the parts for Taxpayer and received income from Taxpayer. Thus, Taxpayer maintained that the tooling property should not be included in the property factor for apportionment purposes. To support it protests, Taxpayer provided additional documentation, including sample copies of contracts with its Suppliers, purchase orders, invoices, and tooling acceptance documents.

The documentation presented by Taxpayer demonstrated that upon inspection and approval of the tooling equipment, Taxpayer paid the Suppliers for the costs of the tooling equipment and the Suppliers used the tooling to manufacture the component parts to be sold to Taxpayer. Since Taxpayer did not use the tooling equipment, the tooling equipment was not required to be included in the numerator and the denominator of the property factor for apportionment purposes pursuant to IC § 6-3-2-2(c) and the ruling of Enterprise Leasing Co. Therefore, Taxpayer is correct to amend its 2003 and 2004 returns to exclude the tooling equipment from the numerator and the denominator of the property factor.

However, Taxpayer's documentation also demonstrated that its amended returns resulted in overpayments for both tax years. Pursuant to IC § 6-8.1-9-1(a), its overpayments were subject to the three-year statute of limitations.

IC § 6-8.1-9-1(a), in relevant part, provides:

> 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) and (g), 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:
> (1) The due date of the return.
> (2) The date of payment.

In this instance, Taxpayer's original returns were filed in 2005 and 2006. However, not until 2012 did Taxpayer file the amended 2003 and 2004 returns pursuant to the RAR adjustments of the federal audit. Taxpayer's documentation failed to show that the federal audit adjustments addressed the very same issue of this protest. Thus, Taxpayer's refund claims for 2003 and 2004, if any, were barred by the three-year statute of limitations. Nonetheless, Taxpayer's 2003 overpayment should be applied to offset the proposed assessment, if any, for the same tax year. Similarly, Taxpayer's 2004 overpayment should be applied to offset the proposed assessment, if any, for the same tax year.

FINDING

Taxpayer's protest of the reduction of property factor is sustained. To the extent its amended returns demonstrate overpayments for 2003 and 2004, Taxpayer is not entitled to any refund pursuant to IC § 6-8.1-9-1(a). Nonetheless, Taxpayer's 2003 overpayment should be applied to offset the 2003 assessment, if any, and its 2004 overpayment should be applied to offset the 2004 assessment, if any.

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