DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 02-20130023
Adjusted Gross Income Tax
For Tax Years 2006 through 2010

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ISSUE

I. Adjusted Gross Income Tax–Business/Non-Business Income.

Authority: IC § 6-3-1-20; IC § 6-8.1-5-1; 45 IAC 3.1-1-29; 45 IAC 3.1-1-30; May Dep't Store Co. v. Indiana Dep't of State Revenue, 749 N.E.2d 651 (Ind. Tax Ct. 2001).

Taxpayer protests the reclassification of income from non-business income to business income.

STATEMENT OF FACTS

Taxpayer is a corporation that is engaged in the business of leasing tank cars and container cars. Taxpayer has two shareholders which are corporations. Taxpayer is also affiliated with a larger group of corporations, but does not join with that group in the filing of a state or federal consolidated income tax return because of ownership constraints. The minority shareholder is not a member of the group. However, the majority shareholder ("Corporation A") owns approximately 79 percent of Taxpayer and is a member of the larger group of corporations. Until it was sold in 2008, Taxpayer owned a tank car manufacturing plant that was leased to Corporation A, which manufactured the tank cars. Taxpayer reported the rental income and property of the tank car manufacturing plant as business property for all years of the taxpayer's ownership of the plant.

Taxpayer filed Indiana adjusted gross income tax returns reporting its Indiana activity. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had adjusted gross income tax liabilities for 2006, 2007, 2008, 2009, and 2010 and issued proposed assessments for the additional adjusted gross income tax. The Department reclassified certain of Taxpayer's reported income from non-business to business income. Taxpayer protested the reclassification of its income from the 2008 sale of the tank car manufacturing plant. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax–Business/Non-Business Income.

DISCUSSION

The Department reclassified certain of Taxpayer's reported income from non-business to business income. Specifically, the Department determined that the income from the tank car manufacturing plant was business income that is subject to apportionment.

Taxpayer protests the reclassification of the income from the sale of the tank car manufacturing plant from non-business income to business income. Taxpayer maintains that the sale of the plant represents non-business income. Taxpayer states that the sale was not conducted as part of Taxpayer's normal business operations. Taxpayer states that its main line of business is leasing tank cars and containers cars and the lease income from the plant is only five percent of its total leasing revenue. Taxpayer states that it only acquired the plant real estate (land and building) to provide capital in Taxpayer's purchase of an affiliate. Additionally, Taxpayer, citing to two Illinois court cases, claims that its disposition of the property constituted a "partial liquidation" which results in non-business income. Taxpayer maintains that since the proceeds from the plant sale were not reinvested in its business but were "distributed . . . to its parent company," the sale is deemed a "partial liquidation" resulting in proceeds that are non-business income.

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 Department refers to 45 IAC 3.1-1-29, which states:

> "Business Income" is defined as income from transactions and activity in the regular course of the taxpayer's trade or business, including income from tangible and intangible property if the acquisition, management, or disposition of the property are integral parts of the taxpayer's regular trade or business.
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> Nonbusiness income means all income other than business income.
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> The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, non-operating income, etc., is of no aid in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business.

The Department also refers to 45 IAC 3.1-1-30, which states:

For purposes of determining whether income is derived from an activity which is in the regular course of the taxpayer's trade or business, the expression "trade or business" is not limited to the taxpayer's corporate charter purpose of its principal business activity. A taxpayer may be in more than one trade or business and derive business therefrom depending upon but not limited to some or all of the following:

(1) The nature of the taxpayer's trade or business.

(2) The substantiality of the income derived from activities and transactions and the percentage that income is of the taxpayer's total income for a given tax period.

(3) The frequency, number, or continuity of the activities and transactions involved.

(4) The length of time the property producing income was owned by the taxpayer.

(5) The taxpayer's purpose in acquiring and holding the property producing income.

Also of relevance is IC § 6-3-1-20, which provides:

The term "business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.

Further guidance in determining business income under Indiana law is found in May Dep't Store Co. v. Indiana Dep't of State Revenue, 749 N.E.2d 651 (Ind. Tax Ct. 2001), in which the Indiana Tax Court determined that IC § 6-3-1-20 provides for both a transactional test and a functional test in determining whether income is business or non-business in nature. Id. at 662-3. Taxpayer states that the sale of its subsidiary does not meet either the transactional test or functional test and that the income from the sale is therefore non-business income.

In May, the court looked to 45 IAC 3.1-1-29 and 30 for guidance in determining whether income is business or non-business income under the transactional test. 45 IAC 3.1-1-29 "states that the 'critical element in determining whether income is 'business income' or 'nonbusiness income' is the identification of the transactions and activity which are the elements of a particular trade or business.'" May, 749 N.E.2d at 664. 45 IAC 3.1-1-30 lists several factors in making this determination. Id. These include the nature of the taxpayer's trade or business; substantiality of the income derived from activities and relationship of income derived from activities to overall activities; frequency, number or continuity of the activities and transactions; length of time income producing property was owned; and taxpayer's purpose in acquiring and holding the property producing income. 45 IAC 3.1-1-30. In May, the court found that the transactional test was not met when a retailer sold a retailing division to a competitor because the taxpayer was not in the business of selling entire divisions. May, 749 N.E.2d at 664.

The functional test focuses on the property being disposed of by the taxpayer. Id. Specifically the functional test requires examining the relationship of the property at issue with the business operations of the taxpayer. Id. In order to satisfy the functional test the property generating income must have been acquired, managed, and disposed of by the taxpayer in a process integral to taxpayer's regular trade or business operations. Id. The court in May defined "integral" as "necessary or essential to complete the whole." Id. at 664-5. The court held that May's sale of one of its retailing divisions was not "necessary or essential" to May's regular trade or business because the sale was executed pursuant to a court order that benefited a competitor and not May. In essence, the court determined that because May was forced to sell the division in order to reduce its competitive advantage, the sale could not be integral to May's business operations. Therefore, the proceeds from the sale were not business income under the functional test.

During the hearing, Taxpayer was asked to provide documentation–that is board minutes, security and exchange commission filings, press releases, etc–that would support its assertions that the sale was not necessary or essential to its regular trade or business–i.e., the plant in question was not acquired, managed, and disposed of by Taxpayer in a process integral to Taxpayer's regular trade or business. Notwithstanding that Taxpayer has cited to Illinois law, which is merely persuasive authority, Taxpayer did not provide documentation that supports its assertions. Taxpayer provided a "consent resolution of the board of directions" documenting that the board authorized the sales and two sets of bank statements. The "consent resolution" provides that the board consented to the sale. The bank statements do not show that the money from the sale was given to Taxpayer's parent company, but show that the money was deposited in the bank account of the corporation which is in charge of group's "cash sweeping" program and which also holds a promissory note from Taxpayer. Therefore, Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c) to establish that the sales of the plant in question did not meet either the transactional test or the functional test as provided in May.

FINDING

Taxpayer's protest is respectfully denied.

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