DEPARTMENT OF STATE REVENUE

02-20120008.SLOF

Supplemental Letter of Findings: 02-20120008
Corporate Income Tax
For the Tax Year 2007

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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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. Corporate Income Tax – Combined Return.

Authority: IC 6-3-2-2(l), (m); IC 6-3-2-2(p); IC 6-8.1-5-1(c); 45 IAC 3.1-1-62; Allied-Signal, Inc. v. Director, Div. Of Taxation, 112 S.Ct. 2251 (1992); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); F.W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354 (1982); Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980); 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).

Taxpayer argues that the Department of Revenue erred in determining that its affiliated entities share a unitary relationship with one another and that Taxpayer and its affiliates should file a combined return.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation that conducts business in Indiana. Taxpayer is a manufacturer of various consumer and industrial products. Taxpayer filed its Indiana adjusted gross income tax returns on a consolidated basis with its subsidiaries and affiliates. Taxpayer filed its 2007 Indiana corporate income tax return on a consolidated basis, including related companies and subsidiaries receiving income from Indiana sources.

The Indiana Department of Revenue ("Department") conducted an audit of Taxpayer for the 2007 tax year. The Department determined that Taxpayer's method of reporting did not accurately reflect income properly sourced to Indiana. As a result of the audit, the Department made several proposed adjustments which resulted in the assessment of additional income tax as well as interest. Taxpayer protested these adjustments. An administrative hearing was conducted, and a Letter of Findings was issued August 2012. Taxpayer objected to the conclusions contained within the Letter of Findings and thereafter supplied additional information in its request for a rehearing. Taxpayer's representatives explained the basis for their continuing objections. This Supplemental Letter of Findings results.

I. Corporate Income Tax – Combined Return.

DISCUSSION

Taxpayer argues that the Department's decision requiring it to file a combined return was incorrect.

In considering Taxpayer's argument and as a threshold issue, it is a taxpayer's responsibility to establish that 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." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

The Department's audit arrived at its adjustment under authority of IC 6-3-2-2(l), (m).

(l) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting;

(2) for a taxable year beginning before January 1, 2011, the exclusion of any one (1) or more of the factors, except the sales factor;

(3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(m) In the case of two (2) or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those organizations, trades, or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

IC 6-3-2-2(p) states that requiring a taxpayer to file a combined return is warranted only if necessary to "fairly" reflect the taxpayer's Indiana income.

Notwithstanding subsections (l) and (m), the department may not require that income, deductions, and credits

attributable to a taxpayer and another entity not described in subsection (o)(1) or (o)(2) be reported in a combined income tax return for any taxable year, unless the department is unable to fairly reflect the taxpayer's adjusted gross income for the taxable year through use of other powers granted to the department by subsections (l) and (m).

In addition, 45 IAC 3.1-1-62 states:

All corporations doing business in more than one state shall use the allocation and apportionment provisions described in Regulations 6-3-2-2(b)-(k) [45 IAC 3.1---37--45 IAC 3.1-1-61] (45 IAC 3.1-1) unless such provisions do not result in a division of income which fairly represents the taxpayer's income from Indiana sources. In such case the taxpayer must request in writing or the Department may require the use of a more equitable formula for determining Indiana income. However, the Department will depart from use of the standard formula only if the use of such formula works a hardship or injustice upon the taxpayer, results in an arbitrary division of income, or in other respects does not fairly attribute income to this state or other states. It is anticipated that these situations will arise only in limited and unusual circumstances (which ordinarily will be unique and nonrecurring) when the standard apportionment provisions produce incongruous results.

Accordingly, when a taxpayer's method of filing individual Indiana adjusted gross income tax returns for related corporations distorts the taxpayer's Indiana source income, the Department may require that the related entities file a combined return. The purpose of the combined return would be to fairly reflect the taxpayer's and related entities' actual Indiana income and expenses. In order to do so, the Department must first find that the entities form a unitary group. The second step is that the Department must make a finding that the taxpayer's own method of filing the adjusted gross income tax distorts the taxpayer's Indiana income and/or expenses. Lastly, the Department must be unable to fairly reflect Indiana income using other methods before requiring the combined-filing method.

The Department's audit and the 2012 Letter of Findings found that Taxpayer and its related entities shared a unitary relationship, that Taxpayer's consolidated filing did not fairly reflect its Indiana income, and that the only realistic and accurate way of reporting Taxpayer's Indiana income was to require Taxpayer and its affiliates file a combined return.

Taxpayer conducts production operations as one segment of its business; Taxpayer also conducts marketing operations as a second segment of its business. As originally filed, Taxpayer included in its consolidated return primarily its marketing entities. The Department's combined return brought in the production entities. Taxpayer objected on the ground that the production companies had "absolutely nothing to do with Indiana" and that the production companies' revenue was generated by activities and areas "far removed from Indiana."

Both the audit and the 2012 Letter of Findings found that the production and marketing entities shared a "unitary relationship" and that there was a "circular flow of monies" between these two business operations justifying a decision requiring Taxpayer and its related entities to file a combined return.

In considering Taxpayer's objection, the threshold issue is whether the production and marketing entities shared a "unitary relationship" as set out in IC 6-3-2-2(m). The issue of what constitutes a "unitary relationship" has been addressed by the United States Supreme Court. In conducting a "unitary relationship" analysis, the Court considers whether contributions to income results from functional integration, centralization of management, and economies of scale. This means that the parties exhibit common ownership, common management, and common use or operation. Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425, 438-40 (1980); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 317 (1982); F.W. Woolworth Co. v. Taxation and Revenue Dept., 458 U.S. 354, 365 (1982); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 166 (1983); Allied-Signal, Inc. v. Director, Div. Of Taxation, 112 S.Ct. 2251, 2263-64 (1992).

Taxpayer has provided documentation establishing that the production and marketing sectors conduct interdivisional transactions on an "arms-length" basis, that the transactions are financially and competitively market driven, and that the production and marketing sectors are separately managed. Taxpayer has satisfactorily established that the inter-divisional transactions are not self-serving and are not structured simply as a means of minimizing state tax obligations.

Taxpayer has provided information establishing that the Department's earlier analysis was based on incomplete information, that the two operational segments do not share a unitary relationship, and the decision requiring Taxpayer file a combined return on that basis was premature.

Taxpayer has met its burden under IC 6-8.1-5-1(c) of establishing the Department erred in requiring that Taxpayer and its affiliates file a combined return.

The Audit Division is requested to revisit the 2007 audit and to make whatever adjustments are necessary and consistent with this Supplemental Letter of Findings.

FINDING

Taxpayer's protest is sustained.

Posted: 03/26/2014 by Legislative Services Agency
An html version of this document.