DEPARTMENT OF STATE REVENUE

02-20130190.LOF

Letter of Findings: 02-20130190
Corporate Income Tax
For the 2010 and 2011 Tax Years

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUE

I. Adjusted Gross Income Tax-Net Operating Losses.

Authority: I.R.C. § 172; I.R.C. § 332; I.R.C. § 381; I.R.C. § 382; I.R.C. § 701; IC § 6-3-2-2.6; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Treas. Reg. § 301.7701-3; 45 IAC 3.1-1-9.

Taxpayer protests the assessment of adjusted gross income taxes resulting from the disallowance of its net operating loss deductions.

STATEMENT OF FACTS

Taxpayer is a limited liability company with business operations in Indiana. Taxpayer claimed net operating loss deductions ("NOLs") on its adjusted gross income tax returns for the 2010 and 2011 tax years. The Indiana Department of Revenue ("Department") disallowed the net operating losses because they were originally reported by another entity, and not by Taxpayer. The Department's disallowance of the net operating losses resulted in the assessment of additional adjusted gross income tax. Taxpayer protested. An administrative hearing was conducted, and this Letter of Findings results. Additional facts will be provided as necessary.

I. Adjusted Gross Income Tax-Net Operating Losses.

DISCUSSION

Taxpayer protests the imposition of adjusted gross income tax resulting from the disallowance of its net operating loss deduction carryovers.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. 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).

A corporation, which is required to file the Indiana corporate income tax return, is entitled to a net operating loss deduction. IC § 6-3-2-2.6(a). A corporation's Indiana net operating loss deduction is determined under IC § 6-3-2-2.6(c), which provides a computation that starts with the "taxpayer's federal net operating loss for a taxable year as calculated under Section 172 of the Internal Revenue Code, derived from sources within Indiana and adjusted for the modifications required by IC 6-3-1-3.5." I.R.C. § 172 requires the application of net operating loss limitations for corporations that have acquired certain "built-in loss" corporations. See I.R.C. § 172(k)(1) (providing "[f]or treatment of net operating loss carryovers in certain corporate acquisitions, see section 381"). See also I.R.C. § 172(k)(2) (providing "[f]or special limitations on net operating loss carryovers in case of a corporate change of ownership, see section 382"). Thus, pursuant to I.R.C. §§ 381 and 382, when an "ownership change" or "corporate acquisition" has occurred, the post-change and acquiring corporations generally are allowed to carry over and use the pre-change and pre-acquisition NOLs. These statutes also impose conditions which limit the amount of the pre-change NOLs and the time period for the pre-acquisition NOLs to be carried over.

Accordingly, if a business is deemed to have acquired a predecessor's net operating loss for federal tax purposes, then the net operating loss is treated as passing to the successor business for Indiana purposes as well. See 45 IAC 3.1-1-9 (explaining that "[w]hen a corporate merger takes place . . . , the Department follows the guidelines of the Internal Revenue Code as to the treatment of net operating losses sustained by any of the corporations involved").

In this instance, Taxpayer timely filed its 2010 and 2011 corporate income tax returns. Upon its initial review of the returns and the NOLs as claimed by Taxpayer in the returns, the Department disallowed the NOLs on the grounds that the Department's records showed that the net operating losses were originally reported by other entities, and not by Taxpayer.

The NOLs, in question, were generated in tax years 2003, 2005, and 2007 and were reported by what was, at the time, two C corporations ("Corp A" and "Corp B") that were the two members of Taxpayer, a limited liability company. For the 2003, 2005, and 2007 tax years, Taxpayer elected to file its income tax returns as a partnership and, thus, as a pass-through entity, it passed its income and losses to Corp A and Corp B, which reported Taxpayer's income and losses on their tax returns. See Treas. Reg. § 301.7701-3(a) (providing that "[a]n eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership . . . "). See also I.R.C. § 701 (explaining that partnerships are not subject to income tax, but each of the partners is liable for the income tax from the partnership's activities and will report the income and losses from the partnership in each of the partner's returns).

In December of 2009, Taxpayer filed a timely and accepted form with the IRS making an election to change its filing status from a partnership to a C corporation for income tax purposes effective December 29, 2009. Then, pursuant to a plan of reorganization, on December 30, 2009, Corp B merged into Corp A, and on December 31, 2009, Corp A merged into Taxpayer. After the reorganization, as of December 31, 2009, Taxpayer, which is now filing as a C Corporation, was the surviving entity.

Taxpayer argues that through its conversion from a partnership to a C corporation–which is a "deemed liquidation" for I.R.C. § 332 purposes–and its reorganization merging Corp A and Corp B into Taxpayer, Taxpayer is the successor-in-interest to Corp A's and Corp B's corporate attributes under I.R.C. § 381(a), (c)(1), which includes the NOLs in question. For these reasons, under I.R.C. §§ 381 and 382, Taxpayer is entitled to claim net operating loss deductions resulting from Corp A's and Corp B's net operating losses on its 2010 and 2011 returns.

Treas. Reg. § 301.7701-3(g) states that when an entity elects to change its filing status from a partnership to a corporation, "the following is deemed to occur: The partnership contributes all of its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter, the partnership liquidates by distributing the stock of the association to the partners." Under I.R.C. § 332, a "complete liquidation" occurs when, pursuant to a "plan of liquidation" that is completed within three years, a corporation distributes of all of its property to another corporation that owns at least eighty percent of the that corporation in "complete cancellation or redemption" of its stock. Therefore, a change in entity filing status from a partnership to a corporation meeting these requirements would qualify as a "complete liquidation" under I.R.C. § 332.

Under I.R.C. § 381(a), when a corporation has acquired all of the assets of another corporation in a "complete liquidation" under I.R.C. § 332 or in a "corporate reorganization" under I.R.C. § 368(a)(1)(A), (C), (D), (F), or (G), the "acquiring corporation" will become a "successor in interest" to certain corporation attributes that are listed in subsection (c). Pursuant to I.R.C. § 381(c)(1)(A), an acquiring corporation can carryover the pre-acquisition NOLs of the acquired corporation beginning with the "first taxable year ending after the date of distribution or transfer."

Upon review, Taxpayer's supporting documentation demonstrates that, Taxpayer had pre-acquisition NOLs from Corp A and Corp B; and that the pre-acquisition NOLs were available to be carried over by Taxpayer beginning in tax year 2010, subject to I.R.C. §§ 381 and 382 limitations. Thus, Taxpayer's protest is sustained pending audit verification concerning the amount of the pre-acquisition NOLs available to be carried forward and utilized beginning in the tax year 2010.

In short, Taxpayer has provided sufficient documentation to demonstrate that it had pre-acquisition NOLs from Corp A and Corp B that are available to be carried forward subject to limitations in I.R.C. §§ 381 and 382. The Department's Audit Division will review Taxpayer's documentation to verify the amount of the NOLs, which Taxpayer can utilize in the 2010 and 2011 tax years pursuant to I.R.C. §§ 381 and 382.

FINDING

Taxpayer's protest of the imposition of tax resulting from the disallowance of the NOLs is sustained to the extent that Taxpayer has pre-acquisition NOLs from Corp A and Corp B subject to the relevant I.R.C. §§ 381 and 382 limitations. The Department will verify the amount of NOLs that Taxpayer can carry forward and utilize on its 2010 and 2011 income tax returns.

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