DEPARTMENT OF STATE REVENUE

02-20140203.LOF

Letter of Findings Number: 02-20140203
Income Tax
For Tax Years 2007 - 2010

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

ISSUE

I. Income Tax–Research Expense Tax Credit.

Authority: IC § 6-8.1-5-1; IC § 6-3.1-4-1; IC § 6-3-4-14; IC § 6-3.1-4-4; IRC § 41; Treas. Reg. § 1.41-6; Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Associated Insurance Companies v. Indiana Dep't. of State Revenue, 655 N.E.2d 1271 (Ind. Tax Ct. 1995).

Taxpayer protests the denial of the Research Expense Tax Credit.

STATEMENT OF FACTS

Taxpayer is a corporation that is headquartered out of state. Taxpayer was audited by the Indiana Department of Revenue ("Department") for the tax years 2007, 2008, 2009, and 2010. The Audit Report states that, "In Indiana, [Taxpayer] and its affiliates maintains manufacturing, distribution, pipeline, service center, fill zone, and administrative facilities" in various locations. Taxpayer had claimed the Indiana research expense tax credit, but as a result of the Department's audit the research expense credit was "revised down to zero. . . ." Taxpayer filed a protest on the matter, and an administrative hearing was held. This Letter of Findings results from Taxpayer's protest. Further facts will be supplied as required.

I. Income Tax–Research Expense Tax Credit.

DISCUSSION

At the outset, 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 also notes that the Indiana Supreme Court has stated that, as the agency enforcing the tax laws, the Department's "reasonable interpretation of [the] statute" is entitled to deference "even over an equally reasonable interpretation of another party." Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014).

The Department's Audit Report states the following:

> The taxpayer claimed the Indiana Research Expense Tax Credit on Form IT-20REC. Indiana Code 6-3.1-4-1 gives a tax credit for increased spending on research that takes place in Indiana and follows the same guidelines as Section 41 of the Internal Revenue Code.
>
> The credit is calculated through the wages and cost of supplies used directly in the research activities that would be eligible to be expensed under Section 174 of the Internal Revenue Code []. The word "directly" for Indiana purposes means that the research work is done in Indiana.

IC § 6-3.1-4-1 states the following regarding the research expense credit:

> As used in this chapter:
> "Base amount" means base amount (as defined in Section 41(c) of the Internal Revenue Code as in effect on January 1, 2001), modified by considering only Indiana qualified research expenses and gross receipts attributable to Indiana in the calculation of the taxpayer's:
> (1) fixed base percentage; and
> (2) average annual gross receipts.
> "Indiana qualified research expense" means qualified research expense that is incurred for research conducted in Indiana.

"Qualified research expense" means qualified research expense (as defined in Section 41(b) of the Internal Revenue Code as in effect on January 1, 2001).
"Pass through entity" means:
(1) a corporation that is exempt from the adjusted gross income tax under IC 6-3-2-2.8(2);
(2) a partnership;
(3) a limited liability company; or
(4) a limited liability partnership.
"Research expense tax credit" means a credit provided under this chapter against any tax otherwise due and payable under IC 6-3.
"Taxpayer" means an individual, a corporation, a limited liability company, a limited liability partnership, a trust, or a partnership that has any tax liability under IC 6-3 (adjusted gross income tax).

In examining Taxpayer's documentation as part of the audit, the auditor found that "[T]axpayer made two errors in calculating its Indiana research credit." The first error involved the base percentage, and the second error was that Taxpayer "included in its wage base for each of the audit years wage expense for research conducted outside of Indiana." The Audit Report states that as result, "[T]axpayer's claim was revised down to zero for all of the tax years that are open . . . ."

Turning to Taxpayer's protest, Taxpayer states in relevant part:

> Per the audit report, the Department indicated two errors were made in calculating the Research Credit resulting in the adjustment. The first error was not utilizing the 3[percent] fixed based percentage in calculating the Research Credit. The second error was the inclusion of wage expense in the wage base for research conducted outside Indiana.
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> The taxpayer contends it is entitled to a Research Credit for the 2007-2010 tax year [sic] even if the two audit adjustment points noted above are conceded.

Taxpayer conceded the two errors at the hearing (and did not develop any argument regarding the errors in its protest). Taxpayer, nonetheless, argues that it is entitled to the research expense credit. Taxpayer's argument is that "the proper manner to calculate the Research Credit is on a separate company basis. [Taxpayer] is entitled to the Research Credit generated on the separate calculation for [Company S]." That company, [Company S], "is an affiliated group member that is part of the Indiana consolidated return group for the 2007-2010 tax years." Regarding IC § 6-3-4-14(a), Taxpayer states that the statute:

> [P]rovides an affiliated group of corporations are permitted to file a consolidated return for Indiana adjusted gross income tax purposes. There are no provisions in the statute that require the consolidated group of companies to calculate the Research Credit on a consolidated group basis.

Regarding its "separate company basis" argument for the research expense credit, Taxpayer cites to IC § 6-3-4-14(c) and (d). The statute states:

> (a) An affiliated group of corporations shall have the privilege of making a consolidated return with respect to the taxes imposed by IC 6-3. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all of the provisions of this section including all provisions of the consolidated return regulations prescribed pursuant to Section 1502 of the Internal Revenue Code and incorporated herein by reference and all regulations promulgated by the department implementing this section prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.
> (b) For the purposes of this section the term "affiliated group" shall mean an "affiliated group" as defined in Section 1504 of the Internal Revenue Code with the exception that the affiliated group shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana.
> (c) For purposes of IC 6-3-1-3.5(b), the determination of "taxable income," as defined in Section 63 of the Internal Revenue Code, of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, shall be determined pursuant to the regulations prescribed under Section 1502 of the Internal Revenue Code.
> (d) Any credit against the taxes imposed by IC 6-3 which is available to any corporation which is a member of an affiliated group of corporations making a consolidated return shall be applied against the tax liability of the

affiliated group.

Taxpayer argues that "IND. CODE § 6-.1-4 [sic] et. seq make no mention how to compute the Research Credit in a consolidated return context." Taxpayer states, "IND. CODE § 6-.1-4 [sic] only incorporates by reference IRC § 43(b) and (c) [sic] with respect to "Qualified Research Expense and Base Amount." (Presumably Taxpayer is referring to IC § 6-3.1-4 and IRC § 41).

However, the Department notes that IC § 6-3.1-4-4 in fact states:

> The provisions of Section 41 of the Internal Revenue Code as in effect on January 1, 2001, and the regulations promulgated in respect to those provisions and in effect on January 1, 2001, are applicable to the interpretation and administration by the department of the credit provided by this chapter, including the allocation and pass through of the credit to various taxpayers and the transitional rules for determination of the base period.
> (Emphasis added).

Taxpayer cites to a gross income tax case, Associated Insurance Companies v. Indiana Dep't. of State Revenue, 655 N.E.2d 1271 (Ind. Tax Ct. 1995), for its interpretation of IC § 6-3-4-14. That case dealt with "[w]hether an ICHIA member may apply its ICHIA credit against the full amount of its consolidated gross income liability." Id. It did not deal with the specific issue of research expense credits. Taxpayer asserts that Associated Insurance supports its interpretation of the law. Taxpayer states that in Associated Insurance the "court found in favor of the taxpayer allowing the separate company tax credit to be applied against the consolidated gross income tax liability of the affiliated group."

The Indiana Tax Court in Associated Insurance Companies stated:

> The Department also points out that the adjusted gross income tax statute expressly permits the sharing of credits on a consolidated return, while the gross income tax consolidated filing statute does not mention credits at all. See IC 6-2.1-5-5; IC 6-3-4-14(d). The Department concludes that legislature did not intend to permit the sharing of credits on a consolidated gross income tax return. In response, AICI notes that the adjusted gross income statute was enacted nearly thirty years after the gross income tax statute. Acts 1937, ch. 117, § 9; Acts 1965, ch. 233, § 24. It concludes that the adjusted gross income statute codifies the way in which the legislature thought the gross income tax statute was being applied.
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> The court is not convinced, however, that the adjusted gross consolidated filing statute provides any clear insight into the meaning of the gross income consolidated filing statute. Each statute is structured in a fundamentally different way. The adjusted gross statute relies on federal law for defining key terms and providing regulations. In contrast, the gross income statute establishes its own definitions, and does not make any federal references. IC 6-2.1-5-5. Thus, the legislature was concerned with federal developments when it enacted the adjusted gross income statute. Indeed, it may have only mentioned the sharing of credits to prevent changes in federal law from interfering with its intention to treat an affiliated group filing a consolidated return as a single taxpayer.

Id. at 1276. (Internal footnote omitted). The Indiana Tax Court went on to hold that, "AICI and HMI are entitled under IC 27-2-8-10(n) to apply their ICHIA credit against the entire consolidated gross income tax liability of their affiliated group." Id.

Taxpayer's reliance on Associated Insurance is misplaced because the issue in Taxpayer's case is not whether the research expense credit can be applied against the consolidated group, but how to calculate the research expense credit itself. That latter question is dealt with by IC § 6-3.1-4-4, which again states in relevant part that "Section 41 of the Internal Revenue Code . . . are applicable to the interpretation and administration by the department of the credit . . . ." I.R.C. § 41(f)(1)(A)(i), in turn, states "all members of the same controlled group of corporations shall be treated as a single taxpayer . . . ." See also Treas. Reg. § 1.41-6(d)(1) ("a consolidated group whose members are members of a controlled group is treated as a single member of the controlled group and a single stand-alone entity credit is computed for the consolidated group."); I.R.S. Form 6765 ("[f]or purposes of figuring the credit, all members of a controlled group of corporations . . . and all members of a group under common control . . . are treated as a single taxpayer."). There is a specific statute that covers the issue of how to interpret and administer the credit, namely IC § 6-3.1-4-4 (and therefore I.R.C. § 41 on how to calculate the credit). Taxpayer's protest is denied.

FINDING

Taxpayer's protest is denied.

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