

**Letter of Findings: 02-20140588
Corporate Income Tax
For the Tax Years 2010-2012**

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

The Department incorrectly assessed that Company needed to file combined returns, because the Department failed to show distortion of income; therefore, Company's protest is sustained.

I. Adjusted Gross Income Tax–Combined Corporate Income Tax

Authority: IC § 6-3-2-2; IC § 6-8.1-5-1; Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 63 S.Ct. 1132 (1943); Park 100 Dev. Co. v. Indiana Dep't of State Revenue, 429 N.E.2d 220 (Ind. 1981); Sweetland v. Franchise Tax Board, 13 Cal. Rptr. 432 (Cal. Ct. App. 1961); 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); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014).

Taxpayer protests the Department of Revenue's decision to require Taxpayer and its subsidiaries to file on a combined return basis.

II. Tax Administration–Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an entity which both manufactures and sells services. Taxpayer only engages in retail services in Indiana. It does not manufacture or produce products in Indiana. In 2014, the Indiana Department of Revenue ("Department") conducted an audit for the tax years ending 2010-2012. The audit reviewed Taxpayer's business organization and financial transactions between its subsidiaries and determined that the Taxpayer engaged in intercompany transactions. The audit concluded that Taxpayer should file on a combined return basis with its subsidiaries. Taxpayer protested the assessment and the imposition of the negligence penalties. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as necessary.

I. Adjusted Gross Income Tax–Combined Corporate Income Tax.

DISCUSSION

As a threshold issue, it is the 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). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to an agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

The audit cited IC § 6-3-2-2(m) which states:

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.

In addition, the applicable version of IC § 6-3-2-2(l) states:

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

- (1) separate accounting;
- (2) the exclusion of any one or more of the factors;
- (3) the inclusion of one 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 allocation and apportionment of the taxpayer's income.

The cited statutory provision provides the Department with authority to apportion or allocate income derived from Indiana sources among commonly owned organizations in order to fairly reflect Indiana income.

Taxpayer maintains that it did not need to file a combined return because the only Indiana income reportable derived from its Indiana retail locations. Furthermore, Taxpayer argues that while the auditor did find intercompany transactions, the auditor did not show distortion.

While the audit report correctly noted that there were inter-company transactions, the audit used this as the sole basis for requiring a mandatory combined return. The audit did not present facts or otherwise demonstrate that these transactions distorted to or unfairly reflected Taxpayer's Indiana income. Based upon the facts presented in the audit there is little to indicate that Taxpayer's transactions constituted an abusive tax avoidance scheme or unfairly reflected Taxpayer's Indiana source income; the related entities neither loaned money back to Taxpayer, nor returned the money to Taxpayer in the form of dividends. Also, there is no indication that the transactions resulted in unaccounted interest or other payments to Taxpayer. Nor did the audit demonstrate that the entities' revenues and expenses were being recognized in ways which violate the "matching principle" or otherwise distorted income. Therefore, in this particular case, Taxpayer has met its statutory burden under IC § 6-8.1-5-1(c), and Taxpayer's protest is sustained.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Negligence Penalty.

Taxpayer requests that the Department abate the ten-percent negligence penalty. IC § 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation [45 IAC 15-11-2\(b\)](#) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to be determined on a case by case basis according to the facts and circumstances of each taxpayer. Id.

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation [45 IAC 15-11-2\(c\)](#) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed. . . ."

Taxpayer has demonstrated that it will not owe any of the proposed tax assessments, as discussed in Issue I. Therefore, the issue of penalty assessed pursuant to IC § 6-8.1-10-2.1 is moot.

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer's protest to the imposition of adjusted gross income tax and negligence penalty is sustained.

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