DEPARTMENT OF STATE REVENUE

02-20140660.LOF

Letter of Findings: 02-20140660
Corporate Income Tax
For the Years 2008, 2009, and 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 issue. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 failed to sufficiently justify excluding one of multi-state utility company's affiliates from the company's consolidated returns on the ground that the affiliate did not earn money from Indiana sources and that including the affiliate distorted the company's adjusted gross income. Company was required to add back Ohio Commercial Activity Tax in calculating its adjusted gross income.

ISSUES

I. Corporate Income Tax - Consolidated Income Tax Return.

Authority: IC § 6-3-2-1; IC § 6-3-2-2(a); IC § 6-3-2-2(f); IC § 6-3-4-14; IC § 6-3-4-14(a); IC § 6-8.1-5-1(c); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); 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); 45 IAC 3.1-1-38; 45 IAC 3.1-1-38(4); 45 IAC 3.1-1-55; 45 IAC 3.1-1-111; Letter of Findings 02-20130047 (November 27, 2013); Letter of Findings 02-20030312 (April 21, 2005).

Taxpayer argues that the Department erred in excluding one of its affiliates ("Utility Corp") from Taxpayer's consolidated income tax returns.

II. Corporate Income Tax - Ohio Commercial Activity Tax Add-back.

Authority: IC § 6-3-1-3.5(b)(3); IC § 6-8.1-5-1(c); Consolidated Coal Company v. Indiana Department of Revenue, 538 N.E.2d 309 (Ind. 1991); Miles v. Department of Treasury, 199 N.E. 372 (Ind. 1935); Aztar Indiana Gaming Corp. v. Indiana Dept. of State Revenue, 806 N.E.2d 381 (Ind. Tax Ct. 2004); Black's Law Dictionary (7th ed. 1999).

Taxpayer maintains that Indiana law does not require it to add back Ohio Commercial Activity Tax in calculating its Indiana adjusted gross income tax.

III. Tax Administration - Underpayment Penalty.

Authority: IC § 6-3-4-4.1(c); IC § 6-3-4-4.1(d); IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(2); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks the Department to exercise its discretion to abate the underpayment penalties.

STATEMENT OF FACTS

Taxpayer is an out-of-state utility company in the business of producing, transmitting, distributing, trading, and selling utility services. Taxpayer sells its utility services to customers in Indiana and outside Indiana. Taxpayer filed 2008, 2009, and 2010 Indiana consolidated income tax returns reporting the income of 17 subsidiary companies.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's tax returns and business records. The audit resulted in an assessment of additional corporate income tax. Taxpayer disagreed with the audit conclusions, disagreed with the consequent assessment, and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the

protest. This Letter of Findings results.

I. Corporate Income Tax - Consolidated Income Tax Return.

DISCUSSION

The issue is whether the Department erred in concluding that one of Taxpayer's affiliates - here designated as "Utility Corp" - should be excluded from Taxpayer's consolidated returns on the ground that "Utility Corp" did not earn adjusted gross income from Indiana sources during the years under audit and because excluding the Utility Corp would more fairly reflect Taxpayer's Indiana source income.

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 the 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.

A. Audit Result.

The Department's audit concluded that "Utility Corp" should not have been included in the consolidated returns on the ground that Utility Corp "reported minimal or no property or payroll during the audit period."

Utility Corp's disregarded entity - here designated as "Receivables LLC" - reported income from Indiana receivables along with a "small portion of revenue by accreting the value of the accounts receivable from their discounted value to their net realizable value." Receivables LLC also earned money from late fees charged to Taxpayer's Indiana utility customers.

The audit explained Receivables LLC's function. According to that report, Receivables LLC purchases all the utility receivables from Taxpayer's utility production affiliates. "The base of the receivables is then used as collateral to secure non-recourse loans from third-party financial institutions." The audit report provided Taxpayer's explanation of its collection process.

> [Taxpayer] bills its Indiana customers using its customer billing system. [Taxpayer] sells the Indiana receivables to [Receivables LLC] Since it owns the Indiana receivables under the Purchase and Sale Agreement, [Receivables LLC] has the legal right to the cash.
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> The Receivables Sales Agreement assigns the ministerial act for collecting the cash to a collection agent. Per the agreement [Collection Agent] is the designated servicer assigned to collect cash from customers, but pursuant to Receivables Sales Agreement. [Collection Agent] delegates its duty to collect the cash to [Taxpayer].
>
> [Taxpayer] collects cash from customers on behalf of [Receivables LLC] and transfers the benefit of that cash to [Receivables LLC] through an intercompany account.

Taxpayer filed Indiana consolidated income tax returns pursuant to IC § 6-3-4-14 which provides as follows:

> 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 [FN1] 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. IC § 6-3-4-14(a).

In determining that Utility Corp should have been excluded from Taxpayer's consolidated return, the audit relied on the Department's regulation, 45 IAC 3.1-1-111, which states, in part:

> The Adjusted Gross Income Tax Act adopts the definition of "affiliated group" contained in Internal Revenue Code section 1504, except that no member of the affiliated group may be included in the Indiana return unless it has adjusted gross income derived from sources within the state, as that phrase is defined in IC 6-3-2-2. For purposes of this subsection, "Adjusted Gross Income derived from sources within the state" means either income or losses derived from activities within the state. (Emphasis added).

The audit report found that Utility Corp did not have "adjusted gross income derived from sources within the state" as required by the Department under 45 IAC 3.1-1-111. As explained in the audit report:

> The Indiana receipts reported in the apportionment factor were late payment fees earned by [Receivables LLC]. Based on the [Taxpayer's] explanation . . . , [Receivables LLC] does not collect money directly from customers. In this context, income from receivables is an intangible which is taxed in the state of commercial domicile following 45 IAC 3.1-1-55. [Receivables LLC's] commercial domicile is not in Indiana; therefore this entity does not have Indiana gross receipts. An adjustment is made to exclude this company's income and apportionment factors from the consolidated filing for the audit years following 45 IAC 3.1-1-111 . . . . In addition due to the minimal or no property, no payroll or Indiana receipts (since the receipts are intangible income), the inclusion of this company in the consolidated filing would not fairly reflect Indiana income following 45 IAC 3.1-1-62. Since the taxpayer has no Indiana payroll, the large expenses deducted on the federal return which created large losses are not performed in Indiana. IC § 6-3-2-2(l), (m) and (p) explain the alternatives that may used if the allocation and apportionment provisions do no fairly represent Indiana income.

Therefore, the audit excluded Utility Corp for two reasons. According to the audit report, (1) Receivables LLC - and by extension, Utility Corp - did not have Indiana income earned from sources within the state and, (2) including Utility Corp in the consolidated return would not fairly reflect Taxpayer's Indiana source income.

B. Taxpayer's Response.

Taxpayer argues that the audit erred in determining that Utility Corp did not have Indiana adjusted gross income during the audit periods. Taxpayer explains that Utility Corp's income from Receivable LLC's customer accounts "constituted Indiana adjusted gross income because [Receivables LLC] was doing business in Indiana and the receivables had acquired business situs in the State."

As did the audit, Taxpayer cites to IC § 6-3-4-14 as the basis for filing Indiana consolidated returns. In addition, Taxpayer also cited Department's regulation, 45 IAC 3.1-1-111, in particular pointing to that regulation's provision stating that, "'Adjusted Gross Income derived from sources within the state' means either income or losses derived from activities within the state."

Taxpayer points to 45 IAC 3.1-1-38 which explains that "doing business" in a state "if it operates a business enterprise or activity in such state . . . ."

Taxpayer argues that the receivables constitute an Indiana business situs under 45 IAC 3.1-1-55 which provides in part:

> Gross receipts from transactions other than sales of tangible personal property shall be included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within this state.
>
> . . . .
>
> Income producing activity is deemed performed at the situs of real, tangible and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is

> localized in connection with a trade or business so that substantial use or value attaches to the property. Example: Taxpayer, a corporation whose principal business activity is the manufacture and sale of hot water heaters, obtains notes for the sale of such water heaters in connection with its Indiana business activity. The property has a business situs in this state, therefore, interest income derived from such notes is attributable to this state. (Taxpayer's emphasis).

Taxpayer explains:

> [Taxpayer] properly included [Utility Corp] in its consolidated Indiana income tax return. [Utility Corp] was a member of [Taxpayer's] federal affiliated group. [Utility Corp's] income from . . . . Indiana customer accounts receivable constituted Indiana adjusted gross income because [Receivables LLC] was doing business in Indiana and the receivables had acquired business situs in the State. The receivables resulted from the conduct of specific business operations in the State, namely the provision of electricity to Indiana customers within the State.

Taxpayer summarizes:

> [Utility Corp] was properly included in the Indiana consolidated return because its wholly owned subsidiary, [Receivables LLC], a limited liability corporation disregarded for federal and Indiana tax purposes, was doing business in Indiana and had adjusted gross income from Indiana sources, the Indiana customer accounts receivable.

C. Hearing Analysis.

The issue is whether Utility Corp should have been included in Taxpayer's consolidated income tax by virtue of Receivables LLC's collection of accounts receivables from Indiana utility customers.

There is no dispute that Taxpayer's Indiana production entity sells utility services to Indiana customers. Pursuant to a "Purchase and Sale Agreement," there is no dispute that Receivables LLC purchases account receivables from Taxpayer's production entities which generate and sell the utilities. There is no dispute that Receivables LLC earns customer late fees and - as Taxpayer explains - "income when the accounts receivables' net realizable value exceeds their discounted value."

There is no dispute that Indiana utility customers deal directly with Taxpayer when those customers pay those bills and not with Receivables LLC or its own designee. However, the arrangement is dictated by the Indiana Regulatory Commission, but the substance of the transaction is between the customers and Receivables LLC and its designee "Collection Agent."

There is no dispute that Receivables LLC is a flow-through entity and that income earned by Receivables LLC has the same identity as that of income earned by Utility Corp.

1. Business Situs.

Indiana law provides that receipts from the sale other than tangible personal property or from certain intangibles are sourced according to IC § 6-3-2-2(f) which states:

> (f) Sales, other than receipts from intangible property covered by subsection (e) and sales of tangible personal property, are in this state if:
>
> (1) the income-producing activity is performed in this state; or
> (2) the income-producing activity is performed both within and without this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance. (Emphasis added).

The Department's regulation, 45 IAC 3.1-1-55, interprets IC § 6-3-2-2(f). The regulation states:

> When Sales Other Than Sales of Tangible Personal Property Are in This State. Gross receipts from transactions other than sales of tangible personal property shall be included in the numerator of the sales factor if the income-producing activity which gave rise to the receipts is performed wholly within this state. Except as provided below if the activity is performed within and without this state such receipts are attributed to this state if the greater proportion of the income producing activity is performed here, based on costs of

performance. The term "income producing activity" means the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit. Such activity does not include activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, "income producing activity" includes but is not limited to the following:

(1) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.
(2) The sale, rental, leasing, or licensing the use of or other use of tangible personal property.
(3) The sale, licensing the use of or other use of intangible personal property.

Income producing activity is deemed performed at the situs of real, tangible and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the commercial domicile of the taxpayer (i.e., the principal place from which trade or business of the taxpayer is directed or managed), unless the property has acquired a "business situs" elsewhere. "Business situs" is the place at which intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property.

(Emphasis added).

In order for Indiana to tax the money received from any intangible - such as Receivables LLC's right to collect money from utility bills and late fees - the intangible must have acquired a "business situs" within the state. 45 IAC 3.1-1-55 states that "[t]he situs of intangible personal property is the commercial domicile of the taxpayer . . . unless the property has acquired a 'business situs' elsewhere. 'Business situs' is the place at which the intangible personal property is employed as capital; or the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property."

IC § 6-3-2-1 imposes a tax on the adjusted gross income derived from "sources within Indiana." IC § 6-3-2-2(a) states that adjusted gross income derived from sources within Indiana includes "income from doing business in this state." IC § 6-3-2-2(a). 45 IAC 3.1-1-38, in interpreting IC § 6-3-2-2(a), provides that for apportionment purposes a taxpayer is "doing business" in Indiana if it operates a business enterprise or activity in Indiana including "[r]endering services to customers in the state." 45 IAC 3.1-1-38(4).

Receivables LLC's commercial domicile is not in this state. However, by virtue of the Purchase and Sale Agreement between Taxpayer's production affiliates and Receivables LLC, the intangible - consisting of Indiana accounts receivable - has acquired a "business situs" within Indiana. Receivables LLC formally acquired right and title to the receivables from which it earned substantial late fees and income when the net realizable value of the receivables exceeded the original discounted price (factoring income). Of course, Receivables LLC also assumed substantial financial risk stemming from its ability - or inability - to collect on the receivables from the Indiana utility customers.

The "substantial use or value" which attaches to the intangible receivables derives from the Receivables LLC's right and ability to monetize those receivables within this state. Receivables LLC is the entity which obtains value from the receivables because it is the direct financial beneficiary of the Purchase and Sale Agreement between itself and Taxpayer's production affiliates.

As the receivables' owner, Receivables LLC exploits its intangible receivables within Indiana each time a receivable generates payments and late fees from Indiana customers. The monetized receivables are simply the economic benefits which derive from the ability of Receivables LLC to exploit the intangible receivables within this state.

The Department concludes that Receivables LLC's "income producing activity" is performed in Indiana because "the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit" occur in Indiana. 45 IAC 3.1-1-55. Receivables LLC does not earn money from obtaining and managing the receivables outside the state; Taxpayer earns money because it purchases Indiana collectibles, exploits the ability to monetize those collectibles within the states, and obtains late fees and factoring income from activity which occurs within this state. Under any reasonable interpretation of IC § 6-3-2-2(a), Receivable LLC has nexus with Indiana because it has "income from doing business in this state."

Under 45 IAC 3.1-1-55, the intangible receivables acquired an Indiana business situs; under IC § 6-3-2-2(a), and

the money earned by Utility Corp/Receivables LLC from collecting payments, late fees, and factoring income are subject to Indiana's adjusted gross income tax.

This conclusion is entirely consistent with prior administrative rulings issued by the Department. In Letter of Findings 02-20030312 (April 21, 2005), 28 Ind. Reg. 3092, the Department found that an out-of-state taxpayer's trade names, trademarks, and other intellectual property had acquired a business situs in the state under 45 IAC 3.1-1-55. As stated in the LOF:

> For purposes of Indiana's adjusted gross income tax, it is apparent that taxpayer's intellectual property has acquired a "business situs" within the state. Taxpayer derives income from Indiana franchisees which pay taxpayer for the right to make use of taxpayer's trademarks and trade names in order to sell fast food to Indiana customers at Indiana business locations.
>
> . . . .
>
> The intellectual property - consisting of words, symbols, color-combinations, decorative elements, and the like - is, standing alone, of no value unless taxpayer takes steps to associate that property with the conduct of a specific business operation. Taxpayer is not paid royalties because it successfully administers the intellectual property at an out-of-state location; taxpayer receives income because it licenses Indiana franchisees to associate that intellectual property with the Indiana franchisees' fast food business.

In Letter of Findings 02-20130047 (November 27, 2013), 20140129 Ind. Reg. 045140003NRA, the Department found that a multi-state taxpayer's service marks, logos, slogans, and brand identities had acquired a business situs in the state and that money earned from licensing that intellectual property was subject to Indiana's adjusted gross income tax under IC § 6-3-2-1(b). As stated in the LOF:

> Taxpayer receives income because it licenses the Intellectual Property to Franchisees and routinely conducts business activities to ensure the fulfillment of the franchise agreements in Indiana.

2. Distortion of Indiana Income.

Having found that Utility Corp earned income from Indiana source intangibles, the issue becomes whether Utility Corp should be excluded from Taxpayer's consolidated return on the ground that including Utility Corp "would not fairly reflect Indiana income." As explained in the audit report, "Since the taxpayer has no Indiana payroll, the large expenses deducted on the Federal return which created large losses are not performed in Indiana."

In support of the decision excluding Utility Corp, the audit report cites to IC § 6-3-2-2(l), (m), and (p).

IC § 6-3-2-2(l) states:

> 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 l, 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.

IC § 6-3-2-2(m) authorizes the Department to resort to alternative methods of reporting income:

> 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.

The audit report also references IC § 6-3-2-2(p) which provides:

> 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).

Taxpayer cites to Wabash, Inc. v. Department of State Revenue, 729 N.E.2d 620 (Ind. Tax Ct. 2000). In Wabash, the court held that before resorting to an alternate apportionment method, "[T]he Department bears of burden of proving that Wabash's Indiana income does not fairly reflect Indiana source income." Id. at 624. Taxpayer also points to the decision for the premise that, as Taxpayer explains, "The Court noted that the Department had consistently 'reiterated its preference for the standard method . . . . [a]s the most accepted and recognized method of computing a company's taxes.'" Citing Wabash, N.E.2d at 625.

Taxpayer also cites to the Department's regulation, 45 IAC 3.1-1-62, which 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 3.1-1-37-45 IAC 3.1-1-61] 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. (Taxpayer's emphasis).

At the outset, the Department notes that the audit's reliance - in part - on IC § 6-3-2-2(p) is misplaced because the audit did not resort to requiring Taxpayer to file a combined return. Excluding Utility Corp from a consolidated return might well be an appropriate response to "distortion," but excluding an entity such as Utility Corp must necessarily come within one of the permissible remedies defined under IC § 6-3-2-2(l), (m).

Those remedies are circumscribed under Indiana law. As noted in Wabash, the Department bears the burden of demonstrating that Taxpayer's originally filed consolidated return does not "fairly reflect [its] Indiana source income" and that the returns produce "incongruous results." Wabash, 729 N.E.2d at 624; IC § 6-3-2-2(l); 45 IAC 3.1-1-62. In addition, the Department must find that the choice of excluding Utility Corp was "reasonable," that the originally-filed return "results in an arbitrary division of income" and the those returns "do[] not fairly attribute income to this state or other states." IC § 6-3-2-2(l); 45 IAC 3.1-1-62 (Emphasis added).

In this instance, the audit report states that Utility Corp has "minimal or no property, no payroll or Indiana receipts" and that "the large expenses deducted on the federal return which created large losses are not performed in Indiana." The audit report may be entirely correct in its summarization, but the report falls short of meeting the statutory standard and the Department's own regulation. The report does not meet the burden of demonstrating that the originally filed consolidated returns produce an "incongruous" result and arbitrarily divide income between Indiana and the other states in which Taxpayer conducts business. Instead, the report provides a conclusion but does delineate the specific, detailed rationalization underlying the decision. The audit report has not sufficiently defined the "limited and unusual circumstances" which would justify excluding Utility Corp from Taxpayer's consolidated returns.

FINDING

Taxpayer's protest is sustained.

II. Corporate Income Tax - Ohio Commercial Activity Tax Add-back.

DISCUSSION

The issue is whether Ohio's Commercial Activity Tax ("Ohio CAT") is "based on or measured by income" and should have been added back by Taxpayer in computing its adjusted gross income.

As in Part I above, IC § 6-8.1-5-1(c), Taxpayer has "[t]he burden of proving that the proposed assessment is wrong . . . ."

A. Audit Result.

The audit report found as follows:

> During the audit period, the [T]axpayer failed to add back the Ohio CAT tax when computing adjusted gross income. The CAT is measured by gross receipts which is gross income. This distinguishes it from a tax that is based on equity which is employed by some taxes.

The audit relied on IC § 6-3-1-3.5(b)(3) as authority for its decision requiring the addback of the Ohio CAT. The statutory provision provides:

> Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States.

The audit noted Taxpayer's objection to this decision. Taxpayer maintained that the Ohio CAT "is not based on or measured by income." The audit report quotes Taxpayer's explanation:

> "Gross receipts" means the total amount realized by a taxpayer, without deduction for costs of goods sold or other expenses. The Ohio CAT calculation does not start with, nor is it based on, the entity's income as reported on the federal income return. There are no material adjustments to, or deductions from, the Ohio CAT base. The taxpayer further provided that the Ohio legislature specifically pointed out in the statute that the Ohio CAT is not subject to the restrictions of [Public Law] 86-272, the legislature clearly intended the Ohio CAT not be considered as an income tax. Therefore, it is clear from the substance of the calculation and the face of the Ohio Revised Code that the Ohio CAT tax is not an income tax.

The audit disagreed with Taxpayer's explanation stating that Taxpayer was erroneously "treating income synonymously with net income . . . ." The audit pointed out that Indiana previously had its own gross income tax which was treated as an income tax for purposes of IC § 6-3-1-3.5(b)(3). According to the audit report, both the Ohio CAT and Indiana's former gross income tax "are based on gross receipts." The audit concluded that the "CAT is measured by gross receipts which is gross income" and should be added back for purposes of determining Taxpayer's adjusted gross income.

B. Taxpayer's Response.

Taxpayer disagrees concluding that the Ohio CAT should not be added back for purposes of calculating its Indiana adjusted gross income. Taxpayer explains that the Ohio CAT is a "privilege tax measured by business gross receipts." Taxpayer further explains that "[u]nlike an income tax, which is imposed on a business' profits, a gross receipts tax is imposed on a business' total sales of goods and services, with no deduction for the cost of doing business." (Taxpayer's emphasis).

C. Hearing Analysis.

In Consolidated Coal Company v. Indiana Department of Revenue, 538 N.E.2d 309 (Ind. 1991), the Indiana Supreme Court addressed the issue of whether the West Virginia Business & Occupation Tax was a tax "based on or measured by income" such that it was subject to the add-back provision in IC § 6-3-1-3.5(b)(3). Id. at 311. The court cited to Miles v. Department of Treasury, 199 N.E. 372 (Ind. 1935), in which the supreme court found that Indiana's own Gross Income Tax was a tax measured by income in the face of Consolidated's argument that the "tax was a property tax." Id. at 310. In Miles, the court found as follows:

> We conclude that the tax in question is an excise levied upon those domiciled within the state, or who derived income from sources within the state, upon the basis of the privilege of transacting business within the state and that the burden may reasonably be measured by the amount of income. Miles, 199 N.E. at 379. (Emphasis added).

The Indiana Tax Court addressed the add-back issue again in Aztar Indiana Gaming Corp. v. Indiana Dept. of State Revenue, 806 N.E.2d 381 (Ind. Tax Ct. 2004). In that case, Aztar argued that Indiana's Riverboat Wagering

Tax ("RWT") was not a tax measured by income for purposes of the IC § 6-3-1-3.5(b)(3) add-back provision. Id. at 382. Aztar argued that the RWT was not an income tax "but rather a tax upon the 'exercise of the state-granted privilege of conducting authorized gaming.'" Id. at 383. Aztar maintained the RWT was a "traditional excise tax" which was "not even remotely similar to [an] . . . . 'income tax.'" Id.

The court disagreed finding that the RWT was a tax based on income and subject to the add-back provision. Id. at 385. The court stated:

> [I]t is clear that the RWT is an excise tax: it is not payable unless the privilege of conducting riverboat gambling is exercised and the exercising of those privileges is the occasion for the imposition of the tax. Nevertheless, it is an excise tax that is measured by income. Id. at 386.

The court concluded that "all cash and property received by Aztar from its gaming operations (minus certain adjustments) certainly constitutes income to Aztar." Id. (Emphasis added).

Taxpayer itself admits that the Ohio CAT is a "privilege tax measured by business gross receipts" but makes a distinction between gross and adjusted income that is nowhere to be found in the add-back provision. Despite what Taxpayer cites to as Ohio's interpretation of its CAT, it is Indiana's interpretation of Indiana law that is relevant here. IC § 6-3-1-3.5(b)(3) calls for the add-back of "taxes based on or measured by income . . . ." It is basic law that "income" is simply "money or other form of payment that one receives [usually] periodically from employment, business, investments, royalties, gifts, and the like." Black's Law Dictionary 766 (7th ed. 1999). Taxpayer's argument flies in the face of both the Consolidated Coal and Miles decisions. Taxpayer's Ohio CAT is subject to the add-back provisions of IC § 6-3-1-3.5(b)(3).

Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c) of establishing that the proposed assessment stemming from the add-back provision is wrong.

FINDING

Taxpayer's protest is respectfully denied.

III. Tax Administration - Underpayment Penalty.

DISCUSSION

Taxpayer argues that the Department should abate an underpayment penalty because it purportedly exercised "reasonable care" in reporting its Indiana corporate income tax and that it exercised "ordinary business care and prudence" in doing so.

IC § 6-3-4-4.1(c) imposes on each taxpayer the responsibility to calculate and pay a "declaration of estimated tax for the taxable years" if the amount of that estimated is more than $1,000. Id.

> Every corporation subject to the adjusted gross income tax liability imposed by this article shall be required to report and pay an estimated tax equal to the lesser of:
> (1) twenty-five percent (25[percent]) of such corporation's estimated adjusted gross income tax liability for the taxable year; or
> (2) the annualized income installment calculated in the manner provided by Section 6655(e) of the Internal Revenue Code as applied to the corporation's liability for adjusted gross income tax.

IC § 6-3-4-4.1(d) imposes a penalty if a taxpayer fails to pay the correct amount of estimated tax.

> The penalty prescribed by IC 6-8.1-10-2.1(b) shall be assessed by the department on corporations failing to make payments as required in subsection (c) or (f). However, no penalty shall be assessed as to any estimated payments of adjusted gross income tax which equal or exceed:
> (1) the annualized income installment calculated under subsection (c); or
> (2) twenty-five percent (25[percent]) of the final tax liability for the taxpayer's previous taxable year. Id.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the under-estimate results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty."

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.

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 . . . ."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment - including the underpayment penalty - is presumptively valid.

Taxpayer believes it is entitled to abatement of the penalty. Taxpayer states that "it exercised ordinary business care and prudence in computing the estimated income tax payments for the 2013 year" and "[p]rior to the 2008-2010 tax audit, the Department had never challenged the inclusion of the excluded . . . affiliated entities in the consolidated group return." "Any deficiency ultimately determined to be owed by [Taxpayer] is not due to [Taxpayer's] negligence or intentional disregard of the tax laws or regulations." Instead, Taxpayer argues that it has made every effort to comply with proper tax reporting and payment requirements and believes that it has in good faith on a reasonable basis interpreted and applied Indiana's tax laws in the preparation of its returns.

Upon review, the Department is in agreement with Taxpayer's assertion that it did not act negligently or fail to exercise the judgment "as would be expected of an ordinary reasonable taxpayer." 45 IAC 15-11-2(b). Whatever disagreement the Department may have with the Taxpayer's method of preparing its original returns and calculating its tax liability, there is sufficient evidence to agree with Taxpayer that it "exercised ordinary business care and prudence . . . ." in preparing those original returns. 45 IAC 15-11-2(c).

Based on a consideration of the relevant "facts and circumstances," Taxpayer has met its burden of establishing that the penalty should be abated.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's protest is denied in part and sustained in part; the Department erred in holding that Taxpayer could not include Utility Corp in Taxpayer's Indiana consolidated income tax return. However, Taxpayer was required to add back Ohio Commercial Activity Tax in calculating its adjusted gross income tax liability. Taxpayer's protest of the underpayment penalty was sustained.

Posted: 07/29/2015 by Legislative Services Agency
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