DEPARTMENT OF STATE REVENUE

Letter of Findings Number: 02-20140629
Corporate Income Tax
For Tax Years 2010-12

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. 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 removal of five entities from a consolidated return was incorrect. The resulting imposition of adjusted gross income was incorrect.

ISSUE

I. Adjusted Gross Income Tax–Consolidated Return.

Authority: IC § 6-3-2-2; IC § 6-3-4-14; IC § 6-8.1-5-1; 15 U.S.C. § 381; Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dept. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981); 45 IAC 3.1-1-38; 45 IAC 3.1-1-110.

Taxpayer protests adjustments to its consolidated returns for adjusted gross income tax.

STATEMENT OF FACTS

Taxpayer consists of related entities in an affiliated group which filed consolidated Indiana income tax returns. The entities are businesses which are incorporated out-of-state, some of which are domiciled in Indiana, some of which are domiciled outside of Indiana, with operations in Indiana and other states. As originally filed, the consolidated returns included all entities which were included in the federal consolidated 1120 return. As the result of an audit for income tax covering the tax years 2010, 2011, and 2012, the Indiana Department of Revenue ("Department") determined that Taxpayer had included five entities which had no nexus with Indiana and were therefore ineligible for inclusion on the consolidated return. The Department recalculated Taxpayer's return without including the data for those entities. As a result of that recalculation, the Department issued a proposed assessment for additional adjusted gross income tax ("AGIT") and interest for 2010. Taxpayer protested the determination that the five entities were not eligible for inclusion in the consolidated return, as well as the proposed assessment for 2010. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax–Consolidated Return.

DISCUSSION

Taxpayer protests the imposition of additional Indiana AGIT for the tax year 2010. The Department determined that Taxpayer owed additional AGIT due to its observation that five of the entities listed on Taxpayer's consolidated returns for 2010, 2011, and 2012 had no Indiana nexus. Taxpayer protests that the five entities did have nexus with Indiana for all three years at issue and that they were properly included on the consolidated returns. As a secondary argument, Taxpayer protests that even if (without conceding) the five entities were properly removed from the consolidated return, that the Department made a calculational error which resulted in significantly more AGIT due than was actually due. Also, Taxpayer notes that the Department sent it two different notices of proposed assessment with identical liability numbers but with different amounts of proposed assessments due.

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 Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. 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 adjusted gross income tax is imposed under IC § 6-3-2-2, which during the tax years at issue provided in part:

> (a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:
> (1) income from real or tangible personal property located in this state;
> (2) income from doing business in this state;
> (3) income from a trade or profession conducted in this state;
> (4) compensation for labor or services rendered within this state; and
> (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.
> . . . .

Further, 45 IAC 3.1-1-38 provides:

> For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:
> (1) Maintenance of an office or other place of business in the state
> (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
> (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
> (4) Rendering services to customers in the state
> (5) Ownership, rental or operation of a business or of property (real or personal) in the state
> (6) Acceptance of orders in the state
> (7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income.
> As stated in Regulation 6-3-2-2(b)(010) [45 IAC 3.1-1-37], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of IC 6-3-2-2(b)-(n).

(Emphasis added).

Next, IC § 6-3-4-14 provides:

> (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.

(Emphasis added).

Also, 45 IAC 3.1-1-110 states:

> An affiliated group as defined in IC 6-3-4-14(b) may file consolidated returns for Adjusted Gross Income Tax and Supplemental Net Income Tax purposes if the members of the affiliated group consent to follow the provision of IC 6-3-4-14 and the regulations established thereunder, including Federal regulations promulgated pursuant to Internal Revenue Code section 1502 which are incorporated by reference in IC 6-3-4-14. The inclusion of a member of an affiliated group in the consolidated return is deemed to be its consent to the consolidated filing. Once an election is made to file consolidated, a taxpayer must obtain written permission from the Department to change from this method of reporting.
>
> Taxpayers filing consolidated returns should notify the Department of their election to so file by attaching to their first consolidated return a statement indicating which corporations are joining in the return. In addition, a worksheet must accompany all consolidated returns showing the consolidated income of the affiliates.

The Department determined that four of the five entities were domiciled outside Indiana and that the fifth entity had Indiana domicile but no Indiana property or payroll for 2010 and no sales at all for all three audit years. Similarly, the Department determined that four of the five entities had no Indiana property in 2010 and that the fifth entity had de minimis Indiana property in 2010. Also, four of the five entities had no Indiana sales in all three years while the fifth entity had de minimis Indiana sales in all three years. During the audit, the Department asked why the five entities in question were included in the Indiana consolidated return and were told that those five entities would sometimes send employees into Indiana for meetings. After reviewing all of these factors, the Department determined that the five entities did not have Indiana nexus and so were not eligible to be included on Taxpayer's 2010, 2011, and 2012 consolidated returns.

Taxpayer disagrees with the Department's determination. Taxpayer points out that the Department's prior audit accepted that three of the five entities at issue in the instant protest were properly included in Taxpayer's returns as filed for the tax years 2005, 2006, and 2007. Further, when Taxpayer protested the prior audit's inclusion of the other two entities at issue in the instant protest the Department issued a Memorandum of Decision confirming its decision to include those two entities. Taxpayer states that the circumstances of all five entities are unchanged in all material aspects from those years to the years at issue in the instant protest.

Next, Taxpayer points out that multiple key officers from each of the five entities were residents of Indiana and had Indiana office locations for 2010, 2011, and 2012. The key officers listed across all five entities include positions such as: Chairman, President, Executive Vice President, Senior Vice President, Vice President and Controller, Vice President and Treasurer, Assistant Treasurer, and Assistant Secretary. Taxpayer argues that, while the parent entity paid these officers, all five entities reimbursed the parent for those salary expenses. This, Taxpayer argues, shows that all five entities had the equivalent of payroll in Indiana for all three years. Also, Taxpayer explained that many other employees of all five entities travelled from out-of-state locations to Indiana pursuant to an ongoing schedule of non-solicitation meetings at Taxpayer's "nerve center" Headquarters in Indiana.

The issue of establishing nexus in Indiana under P.L. 86-272 (15 U.S.C.A. § 381) has been addressed by the Indiana Supreme Court in Indiana Dep't. of Revenue v. Kimberly-Clark Corp., 416 N.E.2d 1264 (Ind. 1981), when the court explained:

> Public Law 86-272 (15 U.S.C.A. § 381), in pertinent part is as follows:
>
> (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
>
> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)
> Id. at 1265. (Internal quotation omitted).

The Court then explained:

> We also believe that Congress perceived "solicitation" as embodying "sundry activities so long as those activities [are] closely related to the eventual sale of a product." Finally, when a corporate representative performs an "act of courtesy" in order to accommodate a customer, he has not ventured beyond the realm of "solicitation."
> Id. at 1268. (Internal citation omitted).

The United States Supreme Court explained its standard for determining "solicitation of sales" in Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co., 505 U.S. 214 (1992). In Wrigley, the Court explained:

> We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are entirely ancillary to requests for purchases -- those that serve no independent business function apart from their connection to the soliciting of orders -- and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. National Tires, Inc. v. Lindley, 68 Ohio App. 2d 71, 78-79 426 N.E.2d 793, 798 (1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business"). Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to requesting purchases, and cannot be converted into "solicitation" by merely being assigned to salesmen. See, e. g., Herff Jones Co. v. State Tax Comm'n, 247 Ore. 404, 412, 430 P.2d 998, 1001-1002 (1967) (no § 381 immunity for sales representatives' collection activities).
> Id. at 228-30.

The Court further explained:

> By contrast, Wrigley's in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which Wrigley's regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [Wrigley's] credit department communicating." App. 71, 72. It hardly appears likely that this mediating function between the customer and the central office would have been performed by some other employee -- some company ombudsman, so to speak -- if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases.
>
> Finally, Wrigley argues that the various nonimmune activities, considered singly or together, are de minimis. In particular, Wrigley emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007 [percent] of Wrigley's annual Wisconsin sales, and in absolute terms amounted to only several hundred dollars a year. We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in § 381, the prohibition on net-income taxation contained in that provision was inapplicable.
> Id. at 234-5.

Therefore, the Department is compelled to look at a taxpayer's Indiana activities as a whole to determine if the activities as a whole exceed the protection of Public Law 86-272. In this case, Taxpayer has established that all five entities had high-level officers working non-solicitation jobs in Indiana for all three years at issue. The issue of how those officers were compensated is not germane under Kimberly-Clark and Wrigley. Rather, the relevant factor was those employees' activities on behalf of the entities. In this case, those activities exceeded mere solicitation of orders on behalf of all five entities. This alone gave the five entities nexus with Indiana for the years at issue. Also, the Department acknowledged that throughout the audit period several of the five entities had other activities in Indiana such as owning property and having direct intrastate wholesale sales between the related entities on the consolidated return. These factors, taken together, clearly give the five entities in question more than de minimis contact with Indiana and so all five entities exceed the protection of Public Law 86-272, as provided by the courts in Kimberly-Clark and Wrigley. Since the entities had nexus with Indiana, the Department's reasoning in determining to remove the five entities from the consolidated returns was not correct.

In conclusion, the Department agrees with Taxpayer's protest. While it was reasonable for the Department to take the initially provided information that the five entities only had occasional employee travel to Indiana as evidence that the five entities had (at most) de minimis contact with Indiana, Taxpayer has now provided additional documentation and analysis to establish that each of the five entities had significantly more contacts with Indiana. Taken together, the activities of the five entities in question went beyond de minimis non-solicitation activities and so gave all five entities nexus with Indiana, as provided by Kimberly-Clark and Wrigley. Since those five entities had nexus with Indiana during the tax years at issue, they were properly included on Taxpayer's consolidated returns for those years. Since Taxpayer has been sustained on its protest that the five entities were properly included in the consolidated return, Taxpayer's secondary argument regarding the Department's calculations after removing the five entities is moot. Also, since Taxpayer has been sustained on its protest regarding the inclusion of the five entities on the consolidated return, Taxpayer's protest/observation that the Department issued two proposed assessment amounts for the same liability number is similarly moot. Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

Posted: 03/30/2016 by Legislative Services Agency
An html version of this document.