DEPARTMENT OF STATE REVENUE

18-20160505R.ODR

Final Order Denying Refund: 18-20160505R
Financial Institutions Tax
For Tax Years 2010-13

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

HOLDING

Funding Company did not provide sufficient documentation to show that it was not a financial institution. Therefore, the Department correctly denied Company's refund request.

ISSUE

I. Financial Institutions Tax–Refund.

Authority: IC § 6-5.5-1-17; IC § 6-5.5-3-1; IC § 6-8.1-5-1; *Fresenius USA Marketing, Inc. v. Indiana Dep't of State Revenue*, 56 N.E.3d 734 (Ind. Tax Ct. 2016); 45 IAC 17-2-1; 45 IAC 17-2-4; Letter of Findings 18-20130319.

Taxpayer protests its refund denial.

STATEMENT OF FACTS

Taxpayer is a business that has subsidiaries in Indiana and is incorporated outside Indiana. Taxpayer was filing in Indiana as a financial institution. Taxpayer determined that it was incorrectly filing its tax returns and requested a refund of Financial Institutions Tax ("FIT") for tax periods ending May 29, 2011, through May 26, 2013. The Indiana Department of Revenue ("Department") determined that Taxpayer had been properly filing as a financial institution. The Department denied Taxpayer's refund request and determined that it also owed FIT for the tax year 2014. The Department therefore issued proposed assessments for FIT for 2014. Taxpayer protests the refund denial of FIT, stating that it does not have nexus with Indiana and has never conducted the business of a financial institution in Indiana. Therefore, Taxpayer protests, it is not subject to Indiana FIT. An administrative hearing was held and this Final Order Denying Refund results. A corresponding Letter of Findings 18-20160506 for the 2014 assessment is issued separately. Further facts will be supplied as necessary.

I. Financial Institutions Tax–Refund.

DISCUSSION

Taxpayer protests the Department's denial of its FIT refund claim. Taxpayer, a funding company, provides its related affiliates with receivables factoring services. Taxpayer filed as a financial institution for 2010-2014. Taxpayer has now filed amended returns seeking a refund of FIT for tax years 2010-2013. Taxpayer has elected to be treated as a C-corporation for income tax purposes and is included in its parent's consolidated federal return. The Department determined that Taxpayer's factoring agreements are the economic equivalent of short term loans by Taxpayer to its affiliates. The Indiana FIT statute states that a taxpayer will be taxed as a Financial Institution if over 80 percent of their income is either "loans arising in factoring or any other transaction with a comparable economic effect." IC § 6-5.5-1-17(d)(2)(A)(vii-viii). Taxpayer's sole business purpose is to buy its related entities' receivables at a discount and collect the receivables from customers. Thus, the issue under review is whether Taxpayer's factoring services are "loans arising in factoring," therefore, requiring Taxpayer to continue filing as a financial institution. 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).

During the refund process, the Department reviewed Taxpayer's factoring agreements with affiliates and determined that, based on the terms and language of the contracts, the parties were clearly involved in the factoring of extensions of credit. Taxpayer states that the *function* of a contract or agreement is controlling rather than the use of certain words or the contracts when determining any resulting legal and tax implications thereof.

The Department refers to IC § 6-5.5-3-1, which states:

> For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year only if the taxpayer:
> (1) maintains an office in Indiana;
> (2) has an employee, representative, or independent contractor conducting business in Indiana;
> (3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
> (4) regularly solicits business from potential customers in Indiana;
> (5) *regularly performs services outside Indiana that are consumed within Indiana*;
> (6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;
> (7) owns or leases tangible personal or real property located in Indiana; or
> (8) regularly solicits and receives deposits from customers in Indiana.
> (*Emphasis added.*)

The next relevant statute is IC § 6-5.5-1-17, which states:

> (a) "Taxpayer" means a corporation that is transacting the business of a financial institution in Indiana, including any of the following:
> (1) A holding company.
> (2) A regulated financial corporation.
> (3) A subsidiary of a holding company or regulated financial corporation.
> (4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution.
> . . .
> (d) For purposes of this section and when used in this article, "business of a financial institution" means the following:
> (1) For a holding company, a regulated financial corporation, or a subsidiary of either, the activities that each is authorized to perform under federal or state law, including the activities authorized by regulation or order of the Federal Reserve Board for such a subsidiary under Section 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)), as in effect on December 31, 1990.
> (2) For any other corporation described in subsection (a)(4), all of the corporation's business activities if eighty percent (80%) or more of the corporation's gross income, excluding extraordinary income, is derived from one (1) or more of the following activities:
> (A) Making, acquiring, selling, or servicing loans or extensions of credit. For the purpose of this subdivision, loans and extensions of credit include:
> (i) secured or unsecured consumer loans;
> (ii) installment obligations;
> (iii) mortgage or other secured loans on real estate or tangible personal property;
> (iv) credit card loans;
> (v) secured and unsecured commercial loans of any type;
> (vi) letters of credit and acceptance of drafts;
> (vii) loans arising in factoring; and
> (viii) any other transactions with a comparable economic effect.
> (B) Leasing or acting as an agent, broker, or advisor in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes.
> (C) Operating a credit card, debit card, charge card, or similar business.
> As used in this subdivision, "gross income" includes income from interest, fees, penalties, a market discount or other type of discount, rental income, the gain on a sale of intangible or other property evidencing a loan or extension of credit, and dividends or other income received as a means of furthering the activities set out in this subdivision.

Next, the Department refers to 45 IAC 17-2-1, which states:

> (a) The Financial Institutions Tax (FIT) is intended to tax both traditional financial institutions (such as banks and savings and loans, etc.), that are transacting business within Indiana, as well as other types of businesses that are deemed to be transacting the business of a financial institution in Indiana.

(b) The FIT is a franchise tax imposed upon a corporation that:
(1) *is transacting the business of a financial institution in Indiana*;
(2) is a partner in a partnership that is transacting the business of a financial institution in Indiana; or
(3) is the grantor and beneficiary of a trust that is transacting the business of a financial institution in Indiana.
(*Emphasis added.*)

Finally, the Department refers to 45 IAC 17-2-4, which states:

(a) The tax is also imposed upon any corporation if the corporation is organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government and the corporation is carrying on the business of a financial institution within Indiana.
(b) The corporation is deemed to be conducting the business of a financial institution and therefore subject to the FIT if eighty percent (80 [percent]) or more of the corporation's gross income during the taxable year is derived from the following activities:
(1) *Extending credit. (Refer to subsection (e) below.)*
(2) Leasing that is the economic equivalent of extending credit.
(3) Credit card operations.
(c) As used in this section, "gross income" includes the income derived from activities which are performed by corporations primarily (as defined by the eighty percent (80 [percent]) test) engaged in the business of extending credit. Gross income includes income from the following:
(1) Interest.
(2) Fees.
(3) Penalties.
(4) A market discount or other type of discount.
(5) Rental income.
(6) The gain on a sale of intangible or other property evidencing a loan or extension of credit.
(7) Dividends or other income received as a means of furthering any of the three (3) activities listed in subsection (b).
(d) Extraordinary income is excluded from gross income for purposes of satisfying the eighty percent (80 [percent]) test. Extraordinary income includes income which is unusual, infrequent, nonrecurring, and unrelated to the extension of credit.
(e) *For purposes of satisfying the eighty percent (80 [percent]) test, corporations which are in the business of a financial institution must be conducting the activities of extending credit, leasing that is the economic equivalent of the extension of credit, or credit card operations, as follows:*
(1) Making, acquiring, selling, or servicing loans or extensions of credit. For the purpose of this subdivision, loans and extensions of credit include secured or unsecured consumer loans; installment obligations; mortgage or other secured loans on real estate or tangible personal property; credit card loans; secured and unsecured commercial loans of any type; letters of credit and acceptance of drafts; loans arising in factoring; and any other transactions with a comparable economic effect. The following are examples of extending credit:
(A) A corporation is a manufacturer of widgets. In 19x9, the corporation received one million dollars ($1,000,000) in gross income from the sale of widgets. In selling such widgets, the corporation makes available an installment obligation plan whereby its customers buy widgets over an extended period of time. In 19x9, the corporation received one hundred thousand dollars ($100,000) in interest and fees from such installment obligations. Because only ten percent (10 [percent]) of the corporation's total receipts from all sources is derived from extending credit, the corporation is not considered a taxpayer for purposes of the FIT.
(B) Corporation A is primarily engaged in the business of a collection agency. Various other corporations enter into contracts with Corporation A for purposes of having delinquent loan monies collected. Corporation A does not originate or acquire the loans. Corporation A receives income from the various corporations based upon the percentage of payments collected. Corporation A is not a taxpayer for purposes of the FIT. Although one hundred percent (100 [percent]) of Corporation A's income is from servicing loans, Corporation A is not extending credit.
(2) Leasing or acting as an agent, broker, or advisor, in connection with leasing real and personal property that is the economic equivalent of the extension of credit if the transaction is not treated as a lease for federal income tax purposes. If the lease is the economic equivalent of the extension of credit, and the lease is not treated as a lease for federal income tax purposes, the income derived from the lease is included in gross income for purposes of satisfying the eighty percent (80 [percent]) test whether the corporation is leasing its own real or personal property or is the lessor of real or personal property owned by another.
(3) Operating a credit card, debit card, charge card, or similar business. If eighty percent (80 [percent]) of a

corporation's total gross income is derived from:
(A) extending credit;
(B) leasing; or
(C) credit card operations;
the corporation is subject to the FIT.
(*Emphasis added.*)

The Department based the denial on the language in IC § 6-5.5-1-17(d)(2)(A)(vii-viii), "loans arising in factoring; and any other transaction with a comparable economic effect" if found applied to these transactions. In Taxpayer's factoring agreements with its related affiliates, "receivables" are defined as "indebtedness and other obligations owed (at the time it arises, and before giving effect to any transfer or conveyance contemplated hereunder) to Originator [affiliate], whether constituting an account, chattel paper, instrument or general intangible, arising in connection with the provision of goods by originator and includes, without limitation, the obligation to pay any finance charges with respect thereto." The Department determined that this clause shows that the receivables are in fact loans, and that Taxpayer is factoring loans, and therefore a financial institution as described under IC § 6-5.5-1-17(d)(2)(A)(vii).

The Department also references another clause in the agreement that states "If [] notwithstanding the intention of the parties expressed in clause 2.1C, the conveyance by the Originator to the [Taxpayer] hereunder shall be characterized as a secured loan and not a sale, this Agreement shall constitute a security agreement under the UCC and other applicable law." Thus, the Department determined that the agreement means if the transaction is treated as a loan by a jurisdiction, the factoring agreement will constitute a security agreement under UCC. The Department's implication is that some jurisdictions could deem these transactions to be secured loans, therefore buttressing the Department's finding that the transactions are "loans arising in factoring."

Even if, for the sake of argument, the Department's position stated above is not sufficiently convincing, other documentation in the protest file shows that Taxpayer is actually acquiring lines/extensions of credit. This documentation consists of invoices and agreements between the affiliates and the affiliates' customers. The documentation includes signed agreements that either extend or give customers a line of credit. A letter even states that the affiliate would like to "extend more generous credit terms." The letter is clearly an extension of credit signed by the affiliate and the customer. These are the "factoring" accounts that Taxpayer is purchasing, thus, Taxpayer is purchasing extensions of credit. Therefore under IC § 6-5.5-1-17 Taxpayer is conducting the business of a financial institution. In addition, Taxpayer failed to meet its burden of showing the initial transactions are not lines of credit, nor has Taxpayer shown that the character of the transactions changed from a lines of credit to an account receivables once sold by the affiliates.

Taxpayer also argues that it relied on Letter of Findings 18-20130319 (February 2014), 20140430 Ind. Reg. 045140129NRA ("LOF"). Thus, Taxpayer argued that according to *Fresenius USA Marketing, Inc. v. Indiana Dep't of State Revenue*, 56 N.E.3d 734 (Ind. Tax Ct. 2016), Taxpayer properly relied on the previous LOF and therefore is entitled to the same treatment as the previous LOF's taxpayer.

Taxpayer is mistaken. Taxpayer's facts are distinguishable from those of the referenced LOF's taxpayer in that the LOF states that "There is no evidence in the protest file which indicates that Taxpayer was extending any kind of credit or loans or that it was purchasing accounts which were extensions of credit or loans." Letter of Findings 18-20130319. In this case, Taxpayer has agreements between affiliates and affiliates' customers that clearly state the agreements are extensions of credit. As stated in the referenced LOF, no evidence existed to determine that the taxpayer was subject to FIT. Contrary to that fact, in this instance there are documents in the protest file that confirms Taxpayer is operating as a financial institution and is subject to FIT.

Based on the above reasoning, Taxpayer is a financial institution, and Taxpayer's refund request is denied.

FINDING

Taxpayer's protest is denied.

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