DEPARTMENT OF STATE REVENUE

02-20180708.LOF

Letter of Findings: 02-20180708
Corporate Income Tax
For the 2008-2015 Tax Years

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Company was able to show that its calculation of its I.R.C. § 382 net operating loss limitation was correct. According to IC § 6-3-2-2.6, the Department should not have applied a separate asset allocation percentage to Company's I.R.C. § 382 fair market value.

ISSUE

I. Adjusted Gross Income Tax-Net Operating Losses.

Authority: I.R.C. § 172; I.R.C. § 381; I.R.C. § 382; IC § 6-3-2-2.6; IC § 6-8.1-5-1; *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 3.1-1-9.

Taxpayer protests the assessment of adjusted gross income taxes resulting from the disallowance of its net operating loss deductions.

STATEMENT OF FACTS

Taxpayer operates in the United States and some foreign countries. Taxpayer also has operations in Indiana. Taxpayer claimed net operating loss deductions ("NOLs") on its adjusted gross income tax returns for the 2008-2015 tax years. The Indiana Department of Revenue ("Department") disallowed a portion of the net operating losses. The Department's disallowance of the net operating losses resulted in the assessment of additional adjusted gross income tax. Taxpayer protested assessments for 2013-2015 and conceded assessments for 2008-2010. An administrative hearing was conducted, and this Letter of Findings results. Additional facts will be provided as necessary.

I. Adjusted Gross Income Tax-Net Operating Losses.

DISCUSSION

Taxpayer protests the imposition of adjusted gross income tax resulting from the disallowance of its net operating loss deduction carryovers. The Department based its determination on the application of I.R.C. code sections regarding NOLs and Indiana code sections regarding NOL apportionment. Taxpayer protests, contending that it properly applied those code sections when it calculated its NOLs.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

A corporation, which is required to file the Indiana corporate income tax return, is entitled to a net operating loss deduction. IC § 6-3-2-2.6(a). A corporation's Indiana net operating loss deduction is determined under IC § 6-3-2-2.6(c), which provides a computation that starts with the "taxpayer's federal net operating loss for a taxable year as calculated under Section 172 of the Internal Revenue Code, derived from sources within Indiana and adjusted for the modifications required by IC 6-3-1-3.5." I.R.C. § 172 requires the application of net operating loss limitations for corporations that have acquired certain "built-in loss" corporations. *See* I.R.C. § 172(k)(1) (providing "[f]or treatment of net operating loss carryovers in certain corporate acquisitions, see section 381"). *See also* I.R.C. § 172(k)(2) (providing "[f]or special limitations on net operating loss carryovers in case of a corporate change of ownership, see section 382"). Thus, pursuant to I.R.C. §§ 381 and 382, when an "ownership change" or "corporate acquisition" has occurred, the post-change and acquiring corporations generally are allowed to carry over and use the pre-change and pre-acquisition NOLs. These statutes also impose conditions which limit the amount of the pre-change NOLs and the time period for the pre-acquisition NOLs to be carried over.

Accordingly, if a business is deemed to have acquired a predecessor's net operating loss for federal tax purposes, then the net operating loss is treated as passing to the successor business for Indiana purposes as well. *See* 45 IAC 3.1-1-9 (explaining that "[w]hen a corporate merger takes place . . . , the Department follows the guidelines of the Internal Revenue Code as to the treatment of net operating losses sustained by any of the corporations involved").

In this instance, Taxpayer purchased a company that included an Indiana Company ("Company") in 2013. Taxpayer absorbed Company and its NOLs. The Department conducted an audit of Taxpayer for tax years 2008-2015. The Department during the audit stated:

> A section 382 [of the IRC] "ownership change" generally occurs if the percentage of the stock of the "loss corporation" owned by one or more "5-percent shareholders" has increased by more than 50 percentage points over the lowest percentage of stock of the loss corporation owned by such shareholders at any time during the relevant "testing period." I.R.C, [*sic*] § 382(g)(1).
>
> [Taxpayer] did not own any of the stock of [Company] prior to the acquisition so an ownership change did occur.
>
> Accordingly, if a business is deemed to have acquired a predecessor's net operating loss for federal tax purposes, then the net operating loss is treated as passing to the successor business for Indiana purposes as well. See 45 IAC 3.1-1-9 (explaining that "[w]hen a corporate merger takes place . . . , the Department follows the guidelines of the Internal Revenue Code as to the treatment of net operating losses sustained by any of the corporations involved").
>
> Since I.R.C. § 172 incorporates the I.R.C. § 382 limitations into the computation of the federal net operating loss deduction and the federal net operating loss deduction as calculated under I.R.C. § 172 is the starting point for the Indiana net operating loss deduction, the I.R.C. § 382 limitations are incorporated into the Indiana net operating loss deduction. After the I.R.C. § 382 limitations are incorporated into the calculation to arrive at Taxpayer's federal net operating loss as required by I.R.C. § 172 had the loss been carried forward. The loss is modified and apportioned as provided in section 2 of this chapter to determine the loss derived from sources within Indiana. See IC § 6-3-2-2.6(c)-(d)(2).
>
> . . .
>
> Taxpayer is permitted to utilize and carryforward the net operating loss of [Company]. However, the carryforward amount is subject to certain 382 limitations. The Base is determined by:
>
> Fair Market Value of Old Loss Corporation Stock x Federal Long-Term Exempt Rate (published monthly) = Section 382 Base Limitation
>
> The Fair Market Value would be the purchase price. But in this case Indiana only has one member of the purchased consolidated group. Therefore, in order to allocate the purchase price, it was agreed the [Company's] (Fixed Assets + Current Assets -Current Liabilities) would be divided by and total groups' (Fixed Assets + Current Assets -Current Liabilities) to yield the percentage of [Company's] assets of 15.05[percent] . . .
>
> Then the FMV [fair market value] of [Company's] stock is multiplied by the federal long term exempt rate which is a published percentage. This would yield the federal limitation. That amount is then multiplied by [Company's] Indiana apportionment as shown on its 2013 Indiana return.

This calculation ultimately reduced Taxpayer's NOLs causing the tax liabilities at issue. Taxpayer contends that its I.R.C. § 382 limitation should be determined in the same manner as called for under the IRC and then apportioned to Indiana using the agreed apportionment percentage. Specifically, Taxpayer protests the 15.05 percent Asset Ratio, used by the Department, to determine the Fair Market Value ("FMV") of the acquisition for the purposes of Indiana income tax. Taxpayer contends that the Department provides no statutory authority to support this methodology, and the IC § 6-3-2-2(b) apportionment percentage should be the only apportionment to utilize Taxpayer's I.R.C. § 382 limitation.

As stated above § 382(b) states that loss limitation is equal to the value of the acquired company times the federal long-term exempt rate. The value of the acquired company is the value of the stock of such corporation immediately before the ownership of change. I.R.C. § 382(e)(1). In addition IC § 6-3-2-2.6(d)(2) states that a Taxpayer's NOL "shall be derived from sources within Indiana shall be determined in the same manner that the amount of the taxpayer's adjusted income derived from sources within Indiana is determined under section 2 of this chapter for the same taxable year during which each loss was incurred." Thus, a taxpayer's federal NOL is apportioned to Indiana by the same apportionment percentage to determine Indiana income.

In this instance, Taxpayer followed § 382 in calculating its NOL limitation and applied its Indiana apportionment percentage for the same years as the loss. The Department did not disagree with either the § 382 NOL limitation or the apportionment percentage, however the Department applied an asset ratio of 15.05 percent to Taxpayer's § 382 limitation. The Department, during the audit, did so to limit Taxpayer's NOL limitation to Indiana based losses. The audit report therefore determined an Indiana FMV and applied the apportionment percentage to that number. The audit report does not cite to any authority and in review of IC § 6-3-2-2.6 there is no discussion of apportioning a taxpayer's FMV in any way. The Department's adjustment to Taxpayer's FMV calculation is incorrect. Therefore, Taxpayer has met its burden under IC § 6-8.1-5-1(c) and is therefore sustained.

FINDING

Taxpayer's protest of the imposition of tax resulting from the disallowance of the NOLs resulting in a 2013-2015 tax year liability is sustained.

May 26, 2018

Posted: 07/25/2018 by Legislative Services Agency
An html version of this document.