

Letter of Findings: 02-20182449
Corporate Income Tax
For the Year 2016

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

The Department disagreed with out-of-state Investment Company that it met its burden of establishing that it was entitled to claim a research expense credit on the Investment Company's 2016 corporate income tax return; there was no evidence that Investment Company's claim to the credit represented qualifying research activities or that the Investment Company retained contemporaneous records documenting those activities.

ISSUE

I. Indiana Corporate Income Tax - Research Expense Credit.

Authority: IC § 6-3-1-3.5(b); IC § 6-3.1-4-1; IC § 6-3.1-4-2(a); IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); I.R.C. § 41(d)(1); I.R.C. § 41(d)(1)(A); I.R.C. § 41(d)(1)(B)(i); I.R.C. § 41(d)(1)(B)(ii); I.R.C. § 41(d)(1)(C); *United States v. McFerrin*, 570 F.3d 672 (5th Cir. 2009); *Stinson Estate v. United States*, 214 F.3d 846 (7th Cir. 2000); *Conklin v. Town of Cambridge City*, 58 Ind. 130 (1877); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); Treas. Reg. § 1.41-4(d).

Taxpayer argues the Department erred in disallowing a research expense credit claimed on Taxpayer's 2016 corporate income tax return.

STATEMENT OF FACTS

Taxpayer is an out-of-state, employee-owned, private equity investment company. Taxpayer filed a 2016 "Indiana S Corporation Income Tax Return" (IT-20S). On that return, Taxpayer claimed approximately \$1,000 in research expense credits based on - according to Taxpayer - spending approximately \$360,000 on qualifying research activities. Those research and development expenses were incurred at its leased space at an Indiana "innovation center."

The Indiana Department of Revenue ("Department") reviewed the return and disallowed the credit. That disallowance resulted in a proposed assessment of additional corporate income tax. Taxpayer disagreed with the Department's proposed assessment and submitted a protest to that effect. In its protest submission, Taxpayer asked that the Department render a "final determination without a hearing." After reviewing Taxpayer's original return and its protest submission, this Letter of Findings results.

I. Indiana Corporate Income Tax - Research Expense Credit.

DISCUSSION

The issue is whether Taxpayer has met its statutory burden of establishing that the Department's disallowance of the research and expense credit ("REC") was wrong.

Tax assessments are *prima facie* evidence that the Department's assessment of tax is presumed correct; the taxpayer bears the burden of proving that the 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).

IC § 6-3.1-4-1 provides that, "Research expense tax credit' means a credit provided under this chapter against any tax otherwise due and payable under [IC 6-3](#)." Similar to deductions, exemptions, and exclusions, tax credits -

such as RECs - "are matters of legislative grace." *Stinson Estate v. United States*, 214 F.3d 846, 848 (7th Cir. 2000).

Any taxpayer who claims the tax credit is required to retain records necessary to substantiate that credit. Indiana and federal law require that a taxpayer maintain and produce contemporaneous records sufficient to verify those credits. See Treas. Reg. § 1.41-4(d). (See also IC § 6-8.1-5-4(a) which requires that taxpayers keep records). Where such a credit is claimed "the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 100-01 (Ind. Ct. App. 1974) (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

Citing *Stinson Estate*, the circuit court in *United States v. McFerrin* summarized that "[t]ax credits are a matter of legislative grace, are only allowed as clearly provided for by statute, and are narrowly construed." *United States v. McFerrin*, 570 F.3d 672, 675 (5th Cir. 2009).

For corporate income tax purposes, Indiana follows the federal tax scheme with certain modifications. IC § 6-3-1-3.5(b). Indiana provides tax credits outlined in [IC 6-3.1](#) which a taxpayer may claim to reduce its taxable income. One of the tax credits is the "Indiana qualified research expense" tax credit under IC § 6-3.1-4-2(a), which states that, "A taxpayer who incurs Indiana qualified research expense in a particular taxable year is entitled to a research expense tax credit for the taxable year." IC § 6-3.1-4-1 defines the credit. In part, this statute - in effect for the taxable years in question - provides:

"Indiana qualified research expense" means qualified research expense that is incurred for research conducted in Indiana. "Qualified research expense" means qualified research (as defined in Section 41(b) of the Internal Revenue Code).

Further, "qualified research" is defined in the Internal Revenue Code ("IRC") under section 41(d). I.R.C. subsection 41(d) states in part as follows:

- (d) Qualified research defined.-For purposes of this section-
 - (1) In general.-The term "qualified research" means research-
 - (A) with respect to which expenditures may be treated as expenses under section 174,
 - (B) which is undertaken for the purpose of discovering information-
 - (i) which is technological in nature, and
 - (ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and
 - (C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph.

This provision sets out a four-pronged test for qualified research. First, the research must have qualified as a business deduction under § 174. See *Id.* § 41(d)(1)(A). Second, the research must be undertaken to "discover information which is technological in nature." *Id.* § 41(d)(1)(B)(i). Third, the taxpayer must intend to use the information to develop a new or improved business component. *Id.* § 41(d)(1)(B)(ii). Finally, the taxpayer must pursue a "process of experimentation" during substantially all of the research. *Id.* § 41(d)(1)(C).

Other than setting out a bare claim to the \$1,000 credit, Taxpayer has provided no information establishing that activities engaged in at its innovation center met the I.R.C. § 41(d)(1) four-part test. There is nothing to establish that the expenses qualified as a "business deduction," that the activities were engaged in to discover technological information, that the information discovered would result in an "improved business component," or that the activities involved a "process of experimentation."

In addition, Taxpayer's claim misses the mark because Taxpayer has not provided the requisite, contemporaneous documentation clearly establishing that activities conducted at the innovation center fell within the definition of "Indiana qualified research."

Given that any claim to an exemption from tax is "narrowly construed," the Department is unable to agree that Taxpayer has met its statutory burden of establishing that the proposed assessment was wrong." IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

May 20, 2019

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