DEPARTMENT OF STATE REVENUE

02-20190490.LOF

Letter of Findings: 02-20190490
Corporate Income Tax
For the Year 2017

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Investment Holding Company was not entitled to an additional interest expense deduction based on an amount of repatriated income - originally deducted on its federal return - which Indiana required be added back for Indiana purposes. There was no Indiana provision permitting Investment Holding Company to claim an additional interest expense deduction based on the amount of repatriated tax "added back" for Indiana purposes.

ISSUE

I. Corporate Income Tax - Interest Expense Adjustment.

Authority: IC § 6-3-1-3.5(b)(13); IC § 6-3-1-11; IC § 6-8.1-5-1(c); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc*., 963 N.E.2d 463 (Ind. 2012); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Miller Brewing Co. v. Indiana Dep't of State Revenue*, 903 N.E.2d 64, 69 (Ind. 2009); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue,* 867 N.E.2d 289 (Ind. Tax Ct. 2007); I.R.C. § 163(j) (2017); I.R.C. § 965; Internal Revenue Service, Forms, Instructions & Publications: *IRS Reporting Related to IRC Section 965 on 2017 Returns*; Income Tax Information Bulletin 116 (July 2018 revised)(retroactive).

Taxpayer argues the Department erred in assessing additional corporate income tax based on an adjustment to Taxpayer's interest expense deduction.

STATEMENT OF FACTS

Taxpayer is an out-of-state investment holding company. Together with its subsidiaries, Taxpayer files for and pays Indiana corporate income tax. Taxpayer filed a 2017 corporate income tax return (IT-20).

In November 2018, Taxpayer filed its 2017 corporate income tax return. On line 6 of that return (under "Modifications for Adjusted Gross Income"), Taxpayer reported an approximately $200 million dollar interest expense deduction. On line 6, Taxpayer labeled the $200 million interest expense deduction as a negative number (for example, "-200,000,000") using "code 115." Taxpayer noted that the code indicates the deduction was for "intangible expenses."

The Indiana Department of Revenue ("Department") adjusted Taxpayer's return recharacterizing the $200 million dollar deduction as an *addition* modification. The result was reversing the $200 million *deduction* to a $200 million dollar *addition* to Taxpayer's Indiana taxable income.

The Department's adjustment to the return resulted in an assessment of additional income tax. Taxpayer disagreed with the Department's adjustment to its 2017 original return and the consequent tax assessment. Taxpayer submitted a protest to that effect, and an administrative hearing was conducted during which Taxpayer's representatives explained the basis for its protest. This Letter of Findings results.

I. Corporate Income Tax - Interest Expense Adjustment.

DISCUSSION

Taxpayer protests the Department's proposed assessment, stemming from an "add-back" modification on its 2017 Indiana corporate income tax return. Taxpayer asserted that it was entitled to an interest expense deduction - "a

subtraction modification on line 6" - under Indiana law because, in 2018, Indiana adopted the federal relevant statutory provisions, I.R.C. §§ 965 and 163(j), which retroactively apply in filing its 2017 Indiana income tax return.

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); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc*., 963 N.E.2d 463, 466 (Ind. 2012). "[E]ach assessment and each tax year stands alone." *Miller Brewing Co. v. Indiana Dep't of State Revenue*, 903 N.E.2d 64, 69 (Ind. 2009). Thus, the taxpayer is required to provide documentation explaining and supporting her challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

The issue is whether Taxpayer has established that it is entitled to its originally claimed interest expense deduction and that the Department's assessment was wrong.

Taxpayer cites to Indiana law, IC § 6-3-1-11 (effective January 1, 2018 (retroactive)), for calendar year ending December 31, 2017. The relevant statute provides:

> (a) The term "Internal Revenue Code" means the Internal Revenue Code of 1986 of the United States as amended and in effect on February 11, 2018.
>
> (b) Whenever the Internal Revenue Code is mentioned in this article, the particular provisions that are referred to, together with all the other provisions of the Internal Revenue Code in effect on February 11, 2018, that pertain to the provisions specifically mentioned, shall be regarded as incorporated in this article by reference and have the same force and effect as though fully set forth in this article. To the extent the provisions apply to this article, regulations adopted under Section 7805(a) of the Internal Revenue Code and in effect on February 11, 2018, shall be regarded as rules adopted by the department under this article, unless the department adopts specific rules that supersede the regulation.
>
> (c) An amendment to the Internal Revenue Code made by an act passed by Congress before February 11, 2018, other than the federal 21st Century Cures Act (P.L. 114-255) and the federal Disaster Tax Relief and Airport and Airway Extension Act of 2017 (P.L. 115-63), that is effective for any taxable year that began before February 11, 2018, and that affects:
> (1) individual adjusted gross income (as defined in Section 62 of the Internal Revenue Code);
> (2) corporate taxable income (as defined in Section 63 of the Internal Revenue Code);
> (3) trust and estate taxable income (as defined in Section 641(b) of the Internal Revenue Code);
> (4) life insurance company taxable income (as defined in Section 801(b) of the Internal Revenue Code);
> (5) mutual insurance company taxable income (as defined in Section 821(b) of the Internal Revenue Code); or
> (6) taxable income (as defined in Section 832 of the Internal Revenue Code);
> is also effective for that same taxable year for purposes of determining adjusted gross income under section 3.5 of this chapter.
>
> (d) This subsection applies to a taxable year ending before January 1, 2013. The following provisions of the Internal Revenue Code that were amended by the Tax Relief Act, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312) are treated as though they were not amended by the Tax Relief Act, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312):
> (1) Section 1367(a)(2) of the Internal Revenue Code pertaining to an adjustment of basis of the stock of shareholders.
> (2) Section 871(k)(1)(C) and 871(k)(2)(C) of the Internal Revenue Code pertaining the treatment of certain dividends of regulated investment companies.
> (3) Section 897(h)(4)(A)(ii) of the Internal Revenue Code pertaining to regulated investment companies qualified entity treatment.
> (4) Section 512(b)(13)(E)(iv) of the Internal Revenue Code pertaining to the modification of tax treatment of certain payments to controlling exempt organizations.
> (5) Section 613A(c)(6)(H)(ii) of the Internal Revenue Code pertaining to the limitations on percentage depletion in the case of oil and gas wells.
> (6) Section 451(i)(3) of the Internal Revenue Code pertaining to special rule for sales or dispositions to implement Federal Energy Regulatory Commission or state electric restructuring policy for qualified electric utilities.

(7) Section 954(c)(6) of the Internal Revenue Code pertaining to the look-through treatment of payments between related controlled foreign corporation under foreign personal holding company rules.

The department shall develop forms and adopt any necessary rules under IC 4-22-2 to implement this subsection. (*Effective January 1, 2018 to December 31, 2018*).

Taxpayer then cites to I.R.C. § 965 requiring it to include "repatriated income" in its reported federal taxable income. The Internal Revenue Service describes the repatriation provision:

> Pursuant to section 965, US shareholders are required to pay a transition tax on the untaxed foreign earnings of certain specified foreign corporations as if those earnings had been repatriated to the United States. Therefore, certain taxpayers may have to pay tax under Section 965 when filing their 2017 tax returns. Internal Revenue Service, Forms, Instructions & Publications: *IRS Reporting Related to IRC Section 965 on 2017 Returns*, available at https://www.irs.gov/forms-pubs/reporting-related-to-irc-section-965-on-2017-returns, (last visited July 5, 2019).

However, Taxpayer next states that under IC § 6-3-1-11 Indiana conformed to I.R.C. § 163(j) in effect for the year 2017.

Upon review, Taxpayer is partially correct to the extent that Indiana conformed to I.R.C. § 163(j), but the conformity was not retroactive. With respect to I.R.C. § 965 income, IC § 6-3-1-3.5(b)(13) provides in part:

> **For taxable years beginning after December 25, 2016:**
> (A) **for a corporation** other than a real estate investment trust, **add**:
> (i) an amount equal to the amount reported by the taxpayer on IRC 965 Transition Tax Statement, line 1;
> (ii) if the taxpayer deducted an amount under Section 965(c) of the Internal Revenue Code in determining the taxpayer's taxable income for purposes of the federal income tax, the amount deducted under Section 965(c) of the Internal Revenue Code[.] (**Emphasis added**)(P.L. 214-2018, § 2; codified at IC § 6-3-1-3.5(b)(13)).

In other words, if a corporate taxpayer deducted for federal purposes any portion of the repatriated income, IC § 6-3-1-3.5(b)(13) required that the amount of the deduction be "added back" for Indiana purposes. *See* Income Tax Information Bulletin 116 (July 2018 revised)(retroactive), 20180829 Ind. Reg. 045180354NRA. ("For C corporations . . . the corporation will be required to add back the amount reported by the corporation on the IRC Transition Tax Statement, Line 1."). As an example, if a taxpayer had $100 in repatriated income but reported $80 on its federal return, IC § 6-3-1-3.5(b)(13) required the taxpayer to addback the $20 for Indiana purposes.

With that Indiana addback, in mind, Taxpayer essentially claims that it is now entitled to an additional interest expense deduction of approximately $200 million. In particular, Taxpayer explained:

> Indiana specifically decoupled from the limitations on deductible business interest expenses under [I.R.C.] § 163(j)(1) for tax years starting after December 31, 2017. However, Indiana is silent as to its treatment of the limitations for tax year 2017. Indiana adopted the Internal Revenue Code [] as amended and in effect on February 11, 2018. This definition includes limitations under [I.R.C.] § 163(j); unless Indiana decouples from there provisions. Since Indiana decoupled from [I.R.C.] § 163(j), starting in 2018, Indiana incorporates the provisions of [I.R.C.] § 163(j) for tax year 2017.
>
> Federal taxable income as reported on line 1 of the Taxpayer's Form IT-20 includes a deduction for interest expense that is limited by [I.R.C.] § 163(j). The [I.R.C.] § 163(j) limitation, or "excess interest expense[,"] is equal to a corporation's net interest expense over 50[percent] of the adjusted taxable income of the corporation . . . . [T]he inclusion of deemed repatriated dividends results in an adjustment to the amount of excess interest expense calculated pursuant to [I.R.C.] § 163(j).
>
> For Indiana income tax purposes, the amount of interest expense disallowed pursuant to [I.R.C.] § 163(j) decreases as a result of the increase to adjusted taxable income attributable to the inclusion of deemed repatriated dividends thereby resulting in the ability to deduct additional interest expense. Accordingly, the Taxpayer adjusted the [I.R.C.] § 163(j) limitation for those members of the Indiana consolidated group whose federal adjusted taxable income was increased based on the inclusion of deemed repatriation dividends . . . .

The interest expense deduction that Taxpayer relies on is found in the federal repatriation provision, I.R.C. §

163(j) (2017), which provides.

(B) Excess interest expense.--
(i) In general.--For purposes of this subsection, the term "excess interest expense" means the excess (if any) of--
(I) the corporation's net interest expense, over
(II) the sum of 50 percent of the adjusted taxable income of the corporation plus any excess limitation carryforward under clause (ii).
(ii) Excess limitation carryforward.--If a corporation has an excess limitation for any taxable year, the amount of such excess limitation shall be an excess limitation carryforward to the 1st succeeding taxable year and to the 2nd and 3rd succeeding taxable years to the extent not previously taken into account under this clause. The amount of such a carryforward taken into account for any such succeeding taxable year shall not exceed the excess interest expense for such succeeding taxable year (determined without regard to the carryforward from the taxable year of such excess limitation).

I.R.C. 163(j) allows a taxpayer to claim an interest expense deduction based on the amount of repatriated income reported on the taxpayer's federal return. In the example cited above, the taxpayer could claim an interest expense deduction based on the $80 million amount reported on its federal return.

However, there is nothing in either the federal or state provisions which allows an additional interest expense deduction based on the amount Indiana requires be added back. Again, citing to the example provided above, the taxpayer was entitled to claim an interest expense consistent with the $80 amount reported federal return but not with the $20 amount of repatriated income added back for Indiana purposes. Why not? Because Indiana has no provision allowing Taxpayer to claim the additional expense.

Upon further review of the Department's line six adjustment, although Taxpayer may not claim the additional $200 million dollar expense, the Department erred in converting the deduction to an addition. The $200 million dollar deduction may not be a deduction, but it also does not represent additional Indiana income. The Department incorrectly adjusted the -$200 million deduction to +$200 million in additional income; the -$200 million should have been adjusted to "zero."

Not directly related to the interest expense deduction issue, Taxpayer also raises an issue related to the calculation of its net operating losses. As Taxpayer explains, "[I]f the Department concludes that [Taxpayer] is not entitled to the interest expense deduction of [approximately $200 million] [Taxpayer] is entitled to and reserves the right to apply the . . . NOL and credit attributes." Taxpayer apparently argues that it is entitled to apply NOL and credit attributes if its interest expense protest is denied. However, Taxpayer did not provide any further explanation or statutory authority to support its position. Therefore, this Letter of Findings takes no position on Taxpayer's claims to the NOLs and "credit attributes" because those claims are not at issue in the return as filed. Although, Taxpayer provided certain information regarding the NOLs and credit attributes which warrants the Department's further review, in order for the Department to properly consider those NOLs and credits, Taxpayer must file an amended return.

In short, Taxpayer is not entitled to claim the additional $200 million dollars in interest expense deductions. However, the Department erred in converting the disallowed amount to an addition to Taxpayer's taxable income. The Department takes no position on any NOLs and "credit attributes" which Taxpayer may or may not claim in the future. However, of course, the Department will review any additional NOLs and "credit attributes" Taxpayer may decide to submit.

FINDING

As to Taxpayer's argument that it is entitled to an additional interest expense deduction, Taxpayer's protest is respectfully denied. However, Taxpayer is sustained to the extent that the Department erred in adjusting the claimed expense to reflect additional income.

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