**DEPARTMENT OF STATE REVENUE**

02-20191221.LOF

**Letter of Findings: 02-20191221**
**Indiana Corporate Income Tax**
**For the Years 2014 and 2015**

**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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 Holding Company's argument that it shared a unitary business relationship with multi-state Gas Station Company; although both Holding Company and Gas Station Company participated in and were members of a joint operational arrangement, Holding Company failed to establish that the parties were functionally integrated, shared centralized management, and that they benefitted from the economies of scale characterizing a unitary relationship.

## ISSUE

### I. Indiana Corporate Income Tax - Unitary Relationships and the Apportionment of Partnership Income.

**Authority**: IC § 6-3-1-19; IC § 6-3-2-1(b); IC § 6-8.1-5-1(c); *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983); *F.W. Woolworth Co. v. Taxation and Revenue Dep't*., 458 U.S. 354 (1982); *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *Exxon Corp. v. Department of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Hunt Corp v. Indiana Dep't of State Revenue*, 709 N.E.2d 766 (Ind. Tax Ct. 1999); *Sherwin-Williams Co. v. Indiana Dep't. of State Revenue*, 673 N.E.2d 849 (Ind. Tax Ct. 1996); 45 IAC 3.1-1-153.

Taxpayer argues that it has a "unitary relationship" with a business partner and that the Department's audit conclusion to the contrary is erroneous.

## STATEMENT OF FACTS

Taxpayer is an out-of-state "holding company" which owns a minority interest in two multi-member LLCs. One of the LLCs owns and operates gas stations ("Gas Station LLC"). The other LLC is yet another "holding company" ("Holding Company LLC").

Taxpayer, Gas Station LLC, and Holding Company LLC - along with various other related entities - are all owned by a common parent venture capital company herein designated as "Venture Capital."

Taxpayer disposed of its Gas Station LLC interest in 2015. Taxpayer disposed of its Holding Company LLC interest in in *[sic]* 2014.

In reporting its Indiana corporate income tax, Taxpayer treated its interest in the two LLCs as unitary. Taxpayer included Gas Station LLC's distributive share of income/loss as apportionable income; Taxpayer did not include its eventual gain earned on the 2015 sale of Gas Station LLC as apportionable income because it treated this gain as non-business income.

Taxpayer included Holding Company LLC's distributive income/loss as apportionable income in its Indiana corporate income tax return; Taxpayer did not include the eventual gain earned on the 2014 sale of Holding Company LLC as apportionable income because it treated this gain as non-business income.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's 2014 and 2015 Indiana corporate income tax returns. The Department's audit concluded that Taxpayer, Gas Station LLC, and

Holding Company LLC did *not* share a unitary business relationship.

The Department's audit found that Taxpayer and Holding Company LLC "did not have any common management, common operational resources, or economies of scale in its investment of [Holding Company LLC] . . . ."

The Department's audit found that Taxpayer and Gas Station LLC did not share a unitary relationship because Taxpayer "[did] not control the day-to-day activities of [Gas Station LLC]" and that Taxpayer does not have the "means to participate in the operation of [Gas Station LLC] since [Taxpayer] has no employees or physical assets other than the interest in the partnership."

The Department's decision - finding that Taxpayer, Gas Station LLC, and Holding Company LLC did not share a unitary relationship - resulted in assessment of additional 2014 and 2015 Indiana corporate income tax. Taxpayer disagreed with the proposed assessment to the extent that the Department found that Taxpayer and *Gas Station LLC* did not have a unitary relationship. Taxpayer submitted a protest to that effect. An administrative hearing was conducted and this Letter of Findings results.

**I. Indiana Corporate Income Tax - Unitary Relationships and the Apportionment of Partnership Income.**

**DISCUSSION**

The issue addressed in this Letter of Findings is whether Taxpayer has met its statutory burden of establishing that it has a "unitary relationship" with Gas Station LLC and that the Department's decision to the contrary is erroneous.

Taxpayer maintains the decision was erroneous because Taxpayer and Gas Station LLC "are a unitary business for Indiana corporate income tax reporting purposes, and that flow-through income from [Gas Station LLC] to Taxpayer was properly reported as unitary on the Forms IT-20 for the years at issue." Therefore "income from [Gas Station LLC] is apportionable to Indiana for the periods at issue."

**A. Taxpayer Burden of Proof.**

As with any assessment, it is Taxpayer's responsibility to establish that this particular 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 Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

In making its case, each 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 the 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, informed and reasonable interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

**B. Audit Report Summary and Conclusions.**

The Audit Report found that Taxpayer's income from Gas Station LLC should not be apportioned because Taxpayer and Gas Station LLC did not share a unitary relationship. The Audit Report pointed to eight factors leading to its conclusion:

- Taxpayer holds a 36.79[percent] member interest in [Gas Station LLC];
- Taxpayer is not the managing member or Tax Matters Member;
- Taxpayer has no employees or officers;
- Taxpayer has no property;
- Taxpayer has no intercompany transactions with [Gas Station LLC];
- Taxpayer has no unity of use, operations or control;
- Taxpayer's Parent Company [Venture Capital] is in the business of venture capital and is using Taxpayer as a vehicle to hold interest in their investment;
- The Tax Matters Member is in the business of operating travel centers which is the same business as [Gas Station LLC].

The Department's audit utilized the "Three Unities" test (management, integration, economies) to determine whether Taxpayer and Gas Station LLC shared a unitary relationship. According to the Report, and in each test case, Taxpayer and Gas Station LLC did not.

> • "Centralized Management": Taxpayer has no employees (no salaries or benefits on the 1120) so [Taxpayer] has no means to oversee or contribute to the day-to-day operations of [Gas Station LLC];
>
> • "Functional Integration": There are no combined functions since the Taxpayer has no employees, assets or other activities other than holding the partnership interest;
>
> • "Economies of Scale": Taxpayer was formed for the express purpose of holding the interest in the partnership . . . the Taxpayer has no other purpose, no property, no employees and no activities [other] than holding the interest in the two LLCs, so there can be no economies of scale.

The audit found that it was "plainly obvious" from Taxpayer's 2014 and 2015 federal returns that it and Gas Station LLC did not share "common management, common operational resources, of economies of scale . . . ." From those returns, Taxpayer had "no gross receipts or sales and no expenses for . . . ." the following:

- Compensation of officer[s]
- Employee wages
- Repairs or maintenance
- Rental Expense
- Depreciation
- Advertising
- Pension of profit sharing
- Employee benefit programs

The audit concluded that Taxpayer erroneously treated its interest in Gas Station LLC as unitary and apportioning the income from Gas Station LLC. As summed up in the final report, "The only sales reported in the numerator of the sales factor are the Taxpayer's share of [Gas Station LLC's] Indiana sales." Taxpayer "does not control the activities of [Gas Station LLC]," and Taxpayer - which has no employees or property - "does not have the means to do so."

**C. Indiana Law of Partnership Income and Unitary Relationships.**

As a preliminary matter, the Department notes the following relevant law. For example, the term "Partnership" is defined at IC § 6-3-1-19:

> (a) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this chapter, a corporation or a trust or an estate. *The term also includes a limited liability company that is treated as a partnership for federal income tax purposes.*
>
> (b) The term "partner" means a member of a partnership.

(*Emphasis added*).

"Indiana imposes a tax on every corporation's adjusted gross income derived from sources within Indiana." IC § 6-3-2-1(b). In cases where a corporation derives business income from sources both within and without Indiana, the "adjusted gross income derived from sources within the state of Indiana" is determined by an apportionment formula. *Sherwin-Williams Co. v. Indiana Dep't. of State Revenue*, 673 N.E.2d 849, 851 (Ind. Tax Ct. 1996).

45 IAC 3.1-1-153 provides:

> (a) A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income.
> (b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the *unitary business* attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within

or with the corporate partner's income year, with the following modifications:

(1) The value of property which is rented or leased by the corporate partner to the partnership or vice versa shall, with respect to the corporate partner, be excluded from the property factor of the partnership or eliminated to the extent of the corporate partner's interest in the partnership, whichever the case may be, in order to avoid duplication.

(2) Intercompany sales between the corporate partner and the partnership shall be eliminated from the corporate partner's sales factor as follows:

(A) Sales by the corporate partner to the partnership to the extent of the corporate partner's interest in the partnership.

(B) Sales by the partnership to the corporate partner not to exceed the corporate partner's interest in all partnership sales.

(c) If the corporate partner's activities and the partnership's activities *do not constitute a unitary business* under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follows:

(1) If the partnership derives business income from sources within and without Indiana, the business income derived from sources within Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the partnership.

(2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.

(d) A partner's distributive share of income will be adjusted by the partner's proportionate share of the partnership's income that is exempt from taxation under the Constitution and statutes of the United States and by the partner's proportionate share of the partnership's deductions allowed or allowable under Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.

(e) After determining the amount of business income attributable to Indiana under subsection (c), the corporate partner's distributive share of such income shall be added to the corporate partner's other business income apportioned to Indiana and its nonbusiness income, if any, allocable to Indiana, in determining the corporate partner's total taxable income. (*Emphasis added*).

The Indiana Tax Court, in *Hunt Corp v. Indiana Dep't of State Revenue*, 709 N.E.2d 766 (Ind. Tax Ct. 1999), provided guidance for computing a corporate taxpayer's tax liabilities when a taxpayer and its subsidiaries/affiliates file consolidated returns as a group and where some income was received from its subsidiaries/affiliates in the form of distributive partnership shares. Even though the *Hunt* case dealt with a consolidated, not combined, filing, the court in *Hunt* provided general rules for computing corporate taxpayer's tax liabilities. The court in *Hunt* explained that IC § 6-3-2-2 "is a general provision that deals with how of all of a corporate taxpayer's adjusted gross income is attributed by way of allocation and apportionment rules . . . ." "[T]he fact that section 6-3-2-2 deals with the attribution of all of a corporate taxpayer's adjusted gross income means that income derived from a corporate partnership . . . is subject to section 6-3-2-2." *Id*. at 776. The court further explained that:

> Under section 6-3-2-2, in order to determine where the income from the corporate partnership is to be attributed, it must first be determined whether that income constitutes business or nonbusiness income for the affiliated group. That determination is made by ascertaining whether the affiliated group and the partnerships are engaged in a unitary business or not. If the income from the partnerships constitutes business income (i.e., if the affiliated group and the partnerships are engaged in a unitary business), under section 6-3-2-2, all of that income would be subject to apportionment based on an application of the affiliated group's property, payroll, and sales factors. If the income from the partnerships constitutes nonbusiness income for the affiliated group (i.e., if the affiliated group and the partnerships are not engaged in a unitary business), that income will be allocated to a particular jurisdiction. Section 6-3-2-2 does not specifically address the question of whether a partnership's property, payroll, and sales factors may be considered in apportioning a corporation's business income derived from a corporate partnership. The regulation [45 IAC 3.1-1-153] addresses this technical problem and provides a comprehensive description of the treatment of income derived from corporate partnerships. Mirroring the analysis required by section 6-3-2-2, the regulation makes the crucial distinction between the situation where the corporate partner's activities and the partnership's activities constitute a unitary business and when they do not. *Id*.

The United States Supreme Court has defined the unitary business principle which allows a State to apply formula apportionment to all unitary business income which a taxpayer's affiliates or subsidiaries received. *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 180 (1983). See *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992); *F.W. Woolworth Co. v. Taxation and Revenue Dep't*., 458 U.S. 354 (1982);

*ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307 (1982); *Exxon Corp. v. Department of Revenue*, 447 U.S. 207 (1980); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980). The three unities are: "functional integration;" "centralization of management;" and "economies of scale." *Id*. at 103-04. However, the Court has held that the showing of day-to-day operational control in the partnership indicates the existence of a unitary business relationship.

In *Allied-Signal,* 504 U.S. at 783 the United States Supreme Court discussed the unitary business taxation principle:

> In the course of our decision in *Container Corp.,* we reaffirmed that the constitutional test focuses on functional integration, centralization of management, and economies of scale. We also reiterated that a unitary business may exist without a flow of goods between the parent and subsidiary, if instead there is a flow of value between the entities. The principal virtue of the unitary business principle of taxation is that it does a better job of accounting for "the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise" than, for example, geographical or transactional accounting.

*Allied-Signal,* 504 U.S. at 783 (Internal citations omitted).

**D. Taxpayer's Argument that it Shares a Unitary Relationship with Gas Station LLC.**

In support of its argument that it shares a unitary relationship with Gas Station LLC, Taxpayer cites to its LLC agreement between itself and Gas Station LLC.

> The business and affairs of [Gas Station LLC] shall be managed by the Members acting through their representatives on the Board of Managers . . . . no Member shall act unilaterally on behalf of [Gas Station LLC] or any of its Subsidiaries without the approval of other members and no member shall have power to unilaterally to bind [Gas Station LLC] or any of its members.

According to Taxpayer, control over Gas Station LLC is vested in a "Board of Managers." Taxpayer points out that the Board of Managers has "jurisdiction to approve the following:"

> • The President and Chief Executive Officers selection of Executive Officers of [Gas Station LLC] evaluating their performance and planning for succession;
>
> • [Gas Station LLC's] strategies, Annual Operating Budgets, Business Plans and Annual Capital Budgets;
>
> • Significant external business opportunities for [Gas Station LLC], including acquisitions, mergers and divestitures;
>
> • Policies of [Gas Station LLC] that maintain high standards in areas of business ethics, environmental responsibility, employee safety and health, community, government, employee and customer relations;
>
> • External and internal audits and management responses thereto; and
>
> • Compensation and benefits policies for employees of [Gas Station LLC].

Taxpayer emphasizes what it believes is the significance of the relationship imposed under the LLC Agreement.

> Pursuant to the LLC Agreement, [Gas Station LLC] was a "member managed limited liability company" where the Members ran the day-to-day activities of the limited liability company . . . . Taxpayer as a Member of [Gas Station LLC] was involved in the day-to-day activities of [Gas Station LLC] and contributed to [Gas Station LLC's] business through common management, which establishes a unitary business relationship . . . . Taxpayer was not a mere passive Investor in [Gas Station LLC]. Rather, the LLC Agreement distinguishes Taxpayer from taxpayers who were limited partners of a partnership that were excluded from the right to exercise management and control of the partners.

Specifically, Taxpayer points to the Board of Managers which included two Taxpayer representatives and which, according to Taxpayer, has these duties:

> [A]re responsible for, among other tasks, are responsible for determining and finalizing [Gas Station LLC's]

business strategies, annual operating budgets, business plans and capital budgets.

Taxpayer maintains that the presence of its two representatives on the Board of Managers satisfies the requirement (noted above) of "common management" indicative of a unitary business relationship.

Taxpayer also argues that the unitary business principle is part and parcel of its relationship with Gas Station LLC and has been since the relationship first began.

> The foundation of Taxpayer and [Gas Station LLC's] relationship . . . signifies the existence of a unitary relationship. Taxpayer was specifically formed to invest in and be in the business of [Gas Station LLC's] one stop travel centers. The sole purpose of Taxpayer's formation was to be a part of and integrate with [Gas Station LLC] both within and without Indiana. The integral nature of [Gas Station LLC] to Taxpayer's business and Taxpayer's overall involvement in the decision-making process for [Gas Station LLC's] operations highlights the truly unitary nature of Taxpayer and [Gas Station LLC's] business operations.

Taxpayer concludes its analysis as follows:

> Taxpayer and [Gas Station LLC] are a unitary business for Indiana corporate income tax reporting purposes, and the flow-through income from [Gas Station LLC] to Taxpayer was properly reported as unitary on the Forms IT-20 for the periods at issue. As such, income from [Gas Station LLC] is apportionable pursuant to 45 IAC 3.1-1-153(c). Accordingly, since Taxpayer and [Gas Station LLC] constitute a unitary business, the business income from [Gas Station LLC] was properly apportioned to Indiana on Taxpayer's Forms IT-20 as filed for the periods at issue.

**E. Analysis of the Facts and Law and the Conclusion.**

At the outset of this analysis and conclusion, it merits repeating several points of law. Taxpayer is under an obligation to establish that the assessment is wrong and that courts (and Taxpayer) are required to defer to the Department's analysis of the facts and law even in the face of what is Taxpayer's equally "reasonable" interpretation of those same facts and law. IC § 6-8.1-5-1(c); *Caterpillar, Inc.*, 15 N.E.3d at 583.

The issue is whether Taxpayer has established it shares a unitary business relationship with Gas Station LLC and that the Department's contrary decision - and the consequent assessment of additional corporate income tax - was wrong.

Both Indiana's Tax Court and the Supreme Court have laid out a blueprint for making such a determination. That blueprint calls for the parties to meet the "three unities" standard: functional integration; centralized management; and economics of scale. In other words, does the Taxpayer exercise "day-to-day operational control in the partnership" and is there a "flow of value between the entities"? *Hunt Corp.*, 709 N.E.2d at 769; *Allied Signal,* 504 U.S. at 788.

The Department acknowledges Taxpayer's reliance on the governing document entered into between itself and Gas Station LLC. That document clearly calls for Taxpayer's two members of the Board of Managers to participate in decisions relating to the day-to-day operation of Gas Station LLC's travel centers. However, when pressed to provide concrete examples of when and how that authority was exercised, Taxpayer declined to provide the specifics requested. Did the Board of Managers - including Taxpayer's two members - decide when and how to expand or contract its gas station operations? Did they make decisions on hiring or firing Gas Station LLC's managers or employees? Did they make decisions on the pricing of fuel sold at the Gas Station LLC's locations? Did they make decisions on the impact or cost of increased or changed state, federal, or state environmental regulations? Although the governing agreement clearly states that the Board of Managers *could* make such operational decisions, the evidence that they actually did so is absent. There is little or nothing to indicate that Taxpayer met its requirement of "showing of day-to-day operational control in the partnership . . . indicat[ing] the existence of a unitary business relationship." *Allied Signal,* 504 U.S. at 788.

As the Supreme Court has explained, the virtue of the "unitary business concept "is that it does a better job of accounting for the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." *Id.* at 783 (internal punctuation omitted). There is no such subtlety here. Other than the apparently unrealized formalities contained in the governing agreement between Taxpayer and Gas Station LLC, the evidence indicates that Taxpayer is an employee-less, officer-less, property-less holding company that owns a minority interest in Gas Station LLC and earns money by virtue of that interest.

Although not entirely dispositive of the issue, Taxpayer itself seems to realize that it did not intend nor does it now share a unitary relationship with Gas Station LLC. At the time Gas Station LLC was acquired in 2008, Venture Capital, Taxpayer's parent, announced in a press release that Gas Station LLC's "current management . . . will continue to manage the business on a day-to-day basis." In addition during the course of the audit, Taxpayer was asked to allow an extension of time - a seemingly routine matter - in which to conclude the audit of Taxpayer, Gas Station LLC, and Holding Company LLC. Taxpayer's representative replied in writing.

> One thing I wanted to make sure you were aware of, we can only sign the waiver for [Taxpayer]. [Taxpayer] does not have the authority to sign the waivers for [Gas Station LLC] or [Holding Company LLC], the two underlying partnerships. Since we do not have authority to sign the waivers, we also do not have the authority to extend the statute for the partnerships.

Taxpayer's own view of its relationship with Gas Station LLC does little to reinforce the premise that it exercises "operational control" over that business.

**FINDING**

Taxpayer's protest is respectfully denied.

June 3, 2020

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An html version of this document.