DEPARTMENT OF STATE REVENUE

Revenue Ruling # 2023-01FIT
July 21, 2023

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ISSUES

I. Financial Institutions Tax-Amount of Receipts Reportable

Authority: IC 6-5.5-1-10; IC 6-5.5-4-2; IRC section 61; IRC section 6501; *U.S. v. Home Concrete & Supply, LLC*, 566 U.S. 478 (2012); *Colony, Inc. v. C.I.R.*, 357 U.S. 28 (1958).

A bank ("Taxpayer") requests guidance on what amounts should be reported as receipts for purposes of financial institutions tax apportionment.

II. Financial Institutions Tax-Attribution of Receipts

Authority: IC 6-5.5-4-4; IC 6-5.5-4-9.

Taxpayer requests guidance on where receipts from certain sales of mortgages.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation and is headquartered in Indiana. Subsidiary operates under an Indiana charter and has depository branches in Indiana. Both Taxpayer and Subsidiary are taxpayers for purposes of Indiana financial institutions tax under IC 6-5.5.

Subsidiary has two lines of business relevant to this letter, a banking and retail lending line and a mortgage warehousing line.

The first line of business is its standard banking and retail lending line. For the banking and retail lending line, the employees at Subsidiary's lending offices deal directly with borrowers seeking loans, generally secured by real property. Once a loan is approved, Subsidiary will provide the funds directly to the borrower. Subsidiary will record principal and interest over the period of the loan and earns income from interest and fees.

In many cases, Subsidiary will sell the loans it originates to third-party investors. These loans are generally packaged into investment vehicles and priced to downstream investors in a manner similar to other securities. Subsidiary earns an amount equal to the proceeds from the sales to the third party.

The second line of business that it refers to a "mortgage warehousing service line." This line consists of loans that Subsidiary does not originate. Instead, the loan is originated by a third party and title continues to be held by the third-party originator. Subsidiary has the right to a pro rata share of all payments in the underlying loan. In other words, if Subsidiary purchases a 35% participation interest in the loan, Subsidiary is entitled to 35% of all payments. Subsidiary generally earns a participation fee, which is either a fixed fee, a fee based on a percentage of the outstanding principal amount of the loan, or a combination of the two.

The third-party originator is required to either sell the loan or issue mortgage-backed securities on behalf of Subsidiary based on the percentage of its participation interest in the loan. Subsidiary is entitled to a portion of the receipts from the sale of the loan or mortgage-backed securities. The proceeds are applied to Subsidiary's pro rata interest in the outstanding principal balance of the loan. If the proceeds are in excess of Subsidiary's and third-party originator's interests in the principal balance loan, the excess (net of any fees owed from the third-party originator to Subsidiary) is remitted to the third-party originator. If the proceeds are less than the principal balance, then the third-party originator would be Subsidiary the pro rata share difference. After the sale of the loan, Subsidiary has no interest in the loan.

For purposes of this ruling:

1. This ruling does not apply to any receipts from mortgage-backed securities.
2. This ruling is based on federal law as in effect on the date this ruling is issued. Any material change in federal law controlling the definition of gross income for these types of transactions, either by statute or by controlling case law (i.e., a United States Supreme Court case in this instance) will make this ruling inapplicable.
3. This ruling assumes that the receipts fairly reflect Taxpayer's and Subsidiary's Indiana source receipts for purposes of IC 6-5.5-5-1. In other words, this ruling assumes that the transactions are such that they would not create an inordinate amount of receipts compared to actual economic activity and that the mortgages are more analogous to the treatment of inventory compared to potential churning-type activities.
4. Taxpayer and Subsidiary take a consistent approach to the treatment of transactions for state and federal purposes.

DISCUSSION

I. Financial Institutions Tax-Amount of Receipts Reportable

The first issue is the amount of receipts reportable for purposes of financial institutions tax. For instance, assume Subsidiary acquires a mortgage for $200,000 and then sells the mortgage for $250,000, is the amount reported $250,000 (gross receipts) or $50,000 (gain)?

Under IC 6-5.5-4-2(1),

> "Receipts" means gross income (as defined in IC 6-5.5-1-10), plus the gross income excluded under Section 103 of the Internal Revenue Code, less gross income derived from sources outside the United States. However, upon the disposition of assets such as securities and money market transactions, when derived from transactions and activities in the regular course of the taxpayer's trade or business, receipts are limited to the gain (as defined in Section 1001 of the Internal Revenue Code) that is recognized upon the disposition.

IC 6-5.5-1-10 provides:

> "Gross income" means gross income (as defined in Section 61 of the Internal Revenue Code) for federal income tax purposes.

In this case, Subsidiary has noted that it enters the gross proceeds of the loan transactions (i.e., the amount it receives from the loans) on Line 1 of its Form 1120. Further, the mortgages are not money market transactions or securities as defined by IC 6-5.5-4-2(2)-(3).

The definition of gross income under IRC section 61 is ambiguous as to the sale of loans. However, the history of case law under IRC section 6501 (requiring an understatement of gross income by 25% or more to extend the assessment statute of limitations to six years) indicates that the IRC does not consider basis (i.e., the $200,000 acquisition) for purposes of determining whether the six-year statute of limitations applies. *U.S. v. Home Concrete & Supply, LLC*, 566 U.S. 478 (2012); *Colony, Inc. v. C.I.R.*, 357 U.S. 28 (1958). Based on this, the department's interpretation is that federal law treats "gross income" as the amount received as opposed to the gain or loss on the sale or disposition of the property.

Based on the federal treatment, the department will treat the gross proceeds of the sale or other disposition of the property as the "gross income" for purposes of applying IC 6-5.5-4.

II. Adjusted Gross Income–Attribution of Receipts

Subsidiary also requests a determination on the sourcing of loan transactions for purposes of determining whether receipts are attributable to Indiana or other states for financial institutions tax purposes.

IC 6-5.5-4-4 states that:

> Interest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property must be attributed to Indiana if the security or sale property is located in Indiana.

In the case of mortgages, this treats receipts as attributable to Indiana if the real property associated with the receipts is in Indiana. In addition, IC 6-5.5-4-9 provides that receipts from the sale of the asset is attributable to

Indiana in the same manner that the income from the asset is attributed. Thus, if a mortgage or other secured loan–either a direct mortgage or a participation interest–is sold, the sale of the mortgage or secured loan is treated as being from Indiana if the underlying property securing the loan is in Indiana.

RULING

With regard to the transactions above, the receipts from the sale of mortgages and similar loans are treated as reportable based on a gross receipts basis. In addition, to the extent the mortgages are secured by Indiana property, the receipts are treated as being from Indiana for financial institutions tax apportionment.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

Ruling Replaces: New

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