

Letter of Findings: 02-20221344
Indiana Corporate Income Tax
For the Years 2017 - 2019

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Business protested a portion of the Department's audit relating to cancellation of indebtedness income; business was able to establish that it was entitled to make the modification.

ISSUE

I. Corporate Income Tax - Cancellation of Indebtedness Income.

Authority: [IC 6-3-1-3.5](#); [IC 6-3-2-1](#); [IC 6-3-2-2](#); [IC 6-8.1-5-1](#); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Express Scripts Inc. v. Indiana Dep't of State Revenue*, 170 N.E.3d 273 (Ind. Tax Ct. 2021); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); IRC § 61; IRC § 108.

Taxpayer protests a portion of the Department's audit relating to cancellation of indebtedness income.

STATEMENT OF FACTS

Taxpayer is headquartered outside of Indiana but operates businesses within Indiana. The Department conducted a corporate income tax audit for the years 2017 through 2019. The audit resulted in adjustments and thus a Notice of Proposed Assessment was issued for additional Indiana income tax. Taxpayer filed a protest regarding a specific issue within the audit—namely, cancellation of indebtedness income. An administrative hearing was held. Additional facts will be provided as necessary below.

I. Corporate Income Tax - Cancellation of Indebtedness Income.

DISCUSSION

The Department's audit report states that Taxpayer operated four businesses with Indiana locations during the audit period. Taxpayer is headquartered in another state, operates businesses in Indiana and other states. The audit report states that "[p]rior to its emergence from bankruptcy, [Company Z] was a subsidiary" of Taxpayer and that "[a]ccording to the taxpayer's calculations, this entity [i.e., Company Z] incurred net operating losses ("NOLs" or "losses") in Indiana from 2009 to the short period return ending 10/5/17." As will be seen below, this business indebtedness discharge and reacquisition, is the issue protested by Taxpayer.

Before addressing the protested issue, the Department notes at the outset that it is Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in [IC 6-8.1-5-1\(c\)](#), "[t]he notice of proposed assessment is prima facie evidence that the [D]epartment'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 Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). The Indiana Tax Court has noted that 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). A taxpayer, when submitting evidence as part of the taxpayer's protest, needs to specify and explain the portions of the evidence that taxpayer believes to be relevant. As the Indiana Tax Court has previously noted (in the context of a summary judgment motion): "the Court will not

consider" exhibits "on the off chance that it might find, on its own and undirected, some fact that supports" a claim, and "the Court is not required to search for specific facts on which" a party relies. *Express Scripts Inc. v. Indiana Dep't of State Revenue*, 170 N.E.3d 273, 279 (Ind. Tax Ct. 2021). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "when [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).

The Audit Report

Returning to the protested issue, the audit report states, "IRC 61(a)(12) provides that income from the discharge of indebtedness is includable in gross income. However, such income may be excludable from gross income under Section 108 in certain circumstances." The audit report states that the "American Recovery and Reinvestment Act of 2009 amended IRC 108 by adding a provision cancelling debt income" which "allowed taxpayers to elect to defer, for federal purposes, the recognition of income realized from the discharge of indebtedness until 2014, providing that the taxpayer would recognize the deferred income over a five-year period or until 2018." However, the audit report notes, "Indiana decoupled from this federal provision" and "[c]onsequently, taxpayers who deferred income from the discharge of indebtedness for federal purposes must recognize that income for Indiana purposes in the same year in which it was earned." The audit report states:

As a result, taxpayers are required to add back to AGI an amount equal to the amount claimed on the federal return as a deferral of income arising from business indebtedness discharged in connection with the reacquisition of an applicable debt instrument after December 31, 2008, and before January 1, 2011, in accordance with IRC Section 108(i).

The audit report analyzes various Indiana statutes (e.g., [IC 6-3-2-1\(b\)](#); [IC 6-3-2-2](#)), noting regarding [IC 6-3-1-3.5\(b\)](#) that:

In essence, this subtraction (or negative add-back) is providing an offset of the amount included in federal gross income because of the deferral of income arising from business indebtedness discharged in connection with the reacquisition of debt after December 31, 2008, and before January 1, 2011, that was previously added back and included in Indiana adjusted gross income.

Company Z "did report an add-back of business indebtedness discharge and reacquisition on the Indiana income tax return" and "[t]hen, [Company Z] reported a negative addback in the years that this deferred income was recognized for federal purposes (2014 and 2015)." The audit report also states that "the taxpayer reported a negative addback for federal purposes in calendar year 2017."

The Department took issue "with the application of the negative deferred income modifications for two [] reasons." First, the audit report stated that a "negative Indiana modification (or subtraction) with respect to the Deferral of Business Indebtedness Discharge can ONLY be made if the deferred income was originally added back as a modification to the Indiana adjusted gross income on Indiana return in an earlier tax period." As the audit report puts it (quotation marks in the original):

While the amount of the federal business indebtedness discharge and reacquisition was listed as a positive amount as a state modification on the 2008-2010 Indiana income tax return for [Company Z], the taxpayer then also reported that this income was "nonbusiness income sourced to another state. This income was deemed by the taxpayer to not be "adjusted gross income from Indiana sources."

In a call with Taxpayer's Vice President of Tax Planning the auditor was told that the "nonbusiness income for calendar years 2008, 2009, and 2010 related to the deferral of business indebtedness."

Regarding the first reason, the audit report concludes:

The taxpayer cannot meet the prerequisite for having first included the deferral of debt income as Indiana adjusted gross income in order to report the subtraction modification with deferral of business indebtedness that it had excluded from Indiana adjusted gross income by reporting it as nonbusiness income that was sourced and, therefore, allocated to another state.

The audit report's second line of disagreement with Taxpayer is that the "amount the taxpayer reported as a modification or negative addback was also more than the amount that it reported as an add-back lines of the 2009

and 2010 returns." The audit report finds:

With respect to this audit, the tax periods in [Company Z] reported a negative business indebtedness modification (2014 and 2015), are beyond the statute of limitations for issuing an assessment or a refund. Nonetheless, these prior periods may be examined to determine the correct amount of net operating loss which would be carried into the current audit period and available for future periods. The AGI reported for a closed year (or an out-of-statute period) can be adjusted regardless of the statute of limitations.

Taxpayer's Position

Taxpayer, in a series of bullet points, summarized the facts "not in dispute." Taxpayer states that in "2009 and 2010, [Company Z] a first-tier subsidiary of [Taxpayer], generated cancellation of indebtedness income (COD income)" and that the "income was generated through a series of open-market purchases, debt-for-debt exchanges, and negotiated principal reductions with lenders." Taxpayer states that for "federal income tax purposes, [Company Z] availed itself of IRC § 108(i) which allowed taxpayers to defer the recognition of COD income generated in 2009 and 2010 to the five-year period from 2014-2018," and that "Indiana did not conform to IRC § 108(i)." Taxpayer's bullet points state:

Both the 2009 and 2010 Indiana Corporate Adjusted Gross Income Tax Returns for [Company Z] reflected (1) a modification adding the deferred COD to Indiana adjusted gross income and (2) a negative adjustment to reflect the fact that the income constitutes nonbusiness income allocable to [Company Z's] state of domicile.

And:

In 2013, the Indiana Department of Revenue [. . .] audited [Company Z's] 2009 and 2010 tax returns. No challenge was proposed by the Department to the nonbusiness income positions that were taken on the returns.

Taxpayer states that in "2014, [Company Z] recognized one fifth of the deferred COD income and in 2015 filed an election to accelerate all remaining COD income for federal income purposes" and that Company Z's "2014 and 2015 Indiana Corporate Adjusted Gross Income Tax Returns showed negative modifications[.]"

Analysis

Taxpayer originally characterized the income at issue as nonbusiness income. Assuming, *arguendo*, that Taxpayer's original characterization was correct, that does not prohibit the modification made by Taxpayer in 2014 (namely, the 2014 subtraction of the 2009 add-back). Additionally, the second issue raised by the Department is the statute of limitations issue regarding adjusting the net operating loss. However, that issue is moot because of the resolution of the first issue and Taxpayer's concession of the audit modification of tax year 2017.

The following example, using simple numbers for illustration purposes only, in essence shows Taxpayer's position. In the example a parenthesis represents subtraction:

Illustrative Example

2009		2014
Federal AGI:	\$100	\$101
IRC § 108(i):	\$5	(\$1) Note: five year recognition
Indiana taxable income before nonbusiness income:		
	\$105	\$100
Nonbusiness income:	(\$5)	(\$1) Actual inclusion of income
		\$1 Nonbusiness deduction for 2014
Business income:	\$100	\$100

The netting of the income by the Taxpayer did create what *appears* at first to be inconsistent treatment. However, that is not the case upon further examination. Because the Department's adjustments are to net operating losses carried forward from past tax years, this protest rests on the application of [IC 6-3-1-3.5\(b\)\(12\)](#) as it existed in 2014 and 2015. That statute stated in relevant part:

Add an amount equal to any income not included in gross income as a result of the deferral of income arising

from business indebtedness discharged in connection with the reacquisition after December 31, 2008, and before January 1, 2011, of an applicable debt instrument, as provided in Section 108(i) of the Internal Revenue Code. Subtract from the adjusted gross income of any taxpayer that added an amount to adjusted gross income in a previous year the amount necessary to offset the amount included in federal gross income as a result of the deferral of income arising from business indebtedness discharged in connection with the reacquisition after December 31, 2008, and before January 1, 2011, of an applicable debt instrument, as provided in Section 108(i) of the Internal Revenue Code.

This subsection is effectively a decoupling from IRC § 108(i). It requires a taxpayer to modify its federal adjusted gross income by: (1) adding back deferred business indebtedness ("DBI") income that was deferred to a different year; and (2) removing DBI income which was included in the current year. By doing this, Indiana includes the income in the year it arose, instead of allowing for its deferral.

The Department's audit found that Taxpayer did not add back income in 2009 and 2010 because this income was treated as nonbusiness income. Because of this, the Department reasoned, the removal of DBI income in 2014 and 2015 was improper, as [IC 6-3-1-3.5\(b\)\(12\)](#) states that DBI income should be removed in "the amount necessary to offset the amount included in federal gross income." That is to say, since the DBI income was treated as nonbusiness income in 2009 and 2010, there would be nothing to offset in the later years, so the amount removed in subsection (b)(12) should be zero.

This, however, misstates Indiana's treatment of nonbusiness income. The DBI income classified as nonbusiness income was, in fact, added back to federal taxable income in determining Indiana adjusted gross income, but then removed as nonbusiness income. This income was not taxed in Indiana, as it was allocated elsewhere based on [IC 6-3-2-2](#). But the language of subsection (b)(12) does not require DBI income which is added or removed from the current year to be apportioned to Indiana for its modification.

Taxpayer correctly added back the DBI income in 2009 and 2010 and allocated that income outside of Indiana because Taxpayer treated it as non-business income. Because of this, Taxpayer also correctly removed the DBI income included in its federal gross income in 2014 and 2015, and this reduction was then also allocated elsewhere.

This Letter of Findings does not examine whether the DBI income at issue was business or nonbusiness income since the parties treated the DBI income at issue as non-business income. Given this fact, the Department's adjustments to NOLs based on the DBI income treatment in 2014 and 2015 are incorrect.

FINDING

Taxpayer's protest is sustained.

November 28, 2023

Finding Replaces: New

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