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DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 96-0632 ITC
ADJUSTED GROSS INCOME TAX
FOR TAX PERIOD: 1992 THROUGH 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax: Income of Corporate Partners: Unitary Operations

Authority: IC 6-3-2-2; 45 IAC 3.1-1-50; 45 IAC 3.1-1-153. Container Corp. v. Franchise Tax Board, 463 U.S. 159 (1983). ASARCO v. Idaho State Tax Commission, 458 U.S. 307 (1982). Allied Signal v. Director, Division of Taxation, 504 U.S. 768 (1992).

The taxpayer protests the Department's determination that taxpayer is not operating in a unitary relationship with its Indiana partnerships.

II. Adjusted Gross Income Tax: Interest Expense Deduction

Authority: IC 6-3-2-2; 45 IAC 3.1-1-56.

The taxpayer protests the Department's failure to allow deductions for interest expenses directly associated with the income from the Indiana partnerships.

III. Tax Administration: Penalty

Authority: IC 6-8.1-6-1; IC 6-8.1-10-2.1; 45 IAC 15-11-2

The taxpayer protests the imposition of a negligence penalty.

STATEMENT OF FACTS

Taxpayer is a corporation that invests in real estate partnerships. In Indiana, these investments consist of investment into two partnerships as a limited partner. These investments represent taxpayer's total Indiana income. Additional facts will be supplied as necessary for discussion.

I. Adjusted Gross Income Tax: Income of Corporate Partners: Unitary Operations

DISCUSSION

Taxpayer claims that although taxpayer is a limited partner, taxpayer is in reality operating in a unitary relationship with the partnerships in Indiana. By establishing that Taxpayer is in a unitary relationship with the Indiana partnerships, as well as California partnerships, Taxpayer is hoping to offset some Indiana income and reduce the tax liability. Indiana law specifically addresses how to treat a corporate partner with respect to partnership income. 45 IAC 3.1-1-153. This regulation is also determinative of how to determine whether or not a unitary relationship exists.

45 IAC 3.1-1-153(b) reads in part that if a "corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements…" This section indicates that to establish the existence of a unitary operation, the taxpayer must demonstrate that the relationship between itself and the partnership meet the established characteristics of a unitary relationship. The unitary principle is addressed repeatedly by the Supreme Court and while no single definition exists, one characteristic appears to be essential – day to day operational control. See Container Corp. v. Franchise Tax Board, 463 U.S. 159 (1983). ASARCO v. Idaho State Tax Commission, 458 U.S. 307 (1982). Allied Signal v. Director, Division of Taxation, 504 U.S. 768 (1992).

To establish that a unitary relationship does in fact exist, taxpayer would have to demonstrate at the very least that taxpayer has operational control of the partnership or that management of the partnership is centralized with management of the corporation. Given taxpayer's status as a limited partner, taxpayer would have to been given an unusual amount of control from the general partner.

Taxpayer submits sections of each partnership agreement in an attempt to demonstrate that day to day operational control of the partnerships lies with taxpayer. However, these partnership agreements do not evidence any unusual amount of control being given to the taxpayer. The rights spelled out for taxpayer are simply those of any limited partner. Taxpayer is given certain rights to protect its investment, but nothing approaching control. Taxpayer's rights are akin to the derivative rights of minority shareholders, and provides a check to potential abuses by the general

partner. These rights do not give taxpayer any significant control over the partnerships, nor do they evidence the existence of a unitary relationship.

FINDING

The taxpayer's protest on this issue is denied.

II. Adjusted Gross Income Tax: Interest Expense Deduction

DISCUSSION

In the alternative, Taxpayer argues that interest expense it incurred on money taxpayer borrowed and then invested in the partnerships is deductible against income received from the partnerships. Under Indiana law, Taxpayer is indeed entitled to deduct interest expenses directly associated with income earned. Taxpayer borrowed money and invested this money in the Indiana partnerships. Taxpayer has paid interest on this loan in all three tax periods under discussion. These interest expenses are directly related to the income taxpayer has received, and as such are deductible.

FINDING

The taxpayer's protest on this issue is sustained.

III. Tax Administration: Penalty

DISCUSSION

The Department can impose a ten percent (10%) negligence penalty under IC 6-8.1-10-2.1. This code section states, in pertinent part, that if " the deficiency determined by the Department was due to reasonable cause and not willful neglect, the Department shall waive the penalty."

Further, 45 IAC 15-11-2 states that "negligence on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary, reasonable taxpayer."

The taxpayer must demonstrate that its actions involved the use of reasonable care, caution, or diligence, in attempting to comply with the law in order to avoid a penalty. The taxpayer's arguments and evidence demonstrate that the taxpayer exercised reasonable care, caution or diligence in reporting income and remitting taxes.

FINDING

The taxpayer's protest of the penalty is sustained.