Indiana Department of Revenue

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Summary of Changes

Aside from technical, nonsubstantive changes, this bulletin adds language explaining what adjustments may be made when a combined return results in a failure to fairly reflect Indiana source income, information on the pass through entity tax, calculations for net operating losses including calculations when there is a discharge of indebtedness, and modifications of federal returns.

Introduction

The purpose of this bulletin is to present an overview of the Indiana financial institutions tax (FIT), found in Indiana Code (IC) 6-5.5. This overview is intended to highlight the major areas of the law and promote a general understanding of its basic principles.

Any taxpayer subject to FIT is exempt from Indiana's adjusted gross income tax. The law extends Indiana's tax jurisdiction to both resident and nonresident financial institutions and to all corporate entities that transact the "business of a financial institution" in Indiana regardless of where such entity is domiciled. Further, IC 6-5.5 adopts an economic presence concept for determining the jurisdictional basis for taxing nonresidents who conduct the business of a financial institution in Indiana.

Definitions

"Business of a financial institution" means the activities of a traditional financial institution. In addition, a corporation other than traditional financial institutions is considered to be in the "business of a financial institution" if the corporation derives 80% or more of its income (other than extraordinary income) from making, acquiring, servicing, or selling loans or extending credit.

If a transaction is treated as a lease for federal income tax purposes, the leasing transaction is not the economic equivalent of extending credit for purposes of the 80% test. However, for purposes of the 80% test, extending credit not only includes credit card operations, but also includes debit card, charge card, and similar businesses.

"Taxpayer" means regulated financial institutions, their holding companies, and the subsidiaries of either, as well as any other corporation (including entities taxed as a corporation under the Internal Revenue Code) organized under the laws of the U.S., Indiana, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution in Indiana.

A nonresident taxpayer is a corporation that is not commercially domiciled in Indiana but transacts the business of a financial institution in Indiana. IC 6-5.5-3 establishes the rules for determining when the activities of nonresident corporations constitute transacting business in Indiana. A taxpayer is transacting business in Indiana for the purposes of the FIT when it satisfies any one of the following nine tests:

(1) Maintains an office in Indiana;
(2) Has an employee, a representative, or an independent contractor conducting business in Indiana;
(3) Regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
(4) Regularly solicits business from potential customers in Indiana;
(5) Regularly performs services outside Indiana that are consumed within Indiana;
(6) Regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in IC 6-5.5-3-8(5), and result in receipts flowing to the taxpayer from within Indiana;
(7) Owns or leases intangible personal or real property located in Indiana; or
(8) Regularly solicits and receives deposits from customers in Indiana; or
(9) Ownership in a partnership transacting the business of a financial institution if the partner is also conducting the business of a financial institution.

The statute employs a single-factor receipts formula to determine the percentage of the taxpayer's income that is taxable. The single-factor receipts formula is derived by dividing the gross receipts attributable to transacting business in Indiana by the taxpayer's total receipts from transacting business in all taxing jurisdictions.

"Unitary business" means business activities or operations that are of mutual benefit, dependent upon or contributory to one another, individually or as a group, in transacting the business of a

financial institution. The term can be applied within a single entity or between multiple entities and without regard to whether each entity is a corporation, partnership, or trust.

"Unitary group" means those entities that are engaged in a unitary business wholly or partially within Indiana. Unity is presumed if there is unity of ownership, operation, or use as evidenced by centralized management, centralized purchasing, advertising, accounting, or other controlled interaction among entities that are members of the unitary group as defined in IC 6-5.5-1-18(a). In other words, members of a unitary group are limited to those members who meet the definition of "taxpayer" for purposes of IC 6-5.5, excluding those not engaging in business in Indiana.

Unity of ownership exists for a corporation if it is a member of a group of two or more business entities, 50% of whose voting stock is owned by a common owner or owners or by one or more of the member corporations of the group.

Tax Rate

The tax rate for the FIT was 8.5% for taxable years beginning before Jan. 1, 2014. However, the rate decreased in the following manner for the following time periods:

- For taxable years beginning after Dec. 31, 2013, and before Jan. 1, 2015, the rate is 8.0%.
- For taxable years beginning after Dec. 31, 2014, and before Jan. 1, 2016, the rate is 7.5%.
- For taxable years beginning after Dec. 31, 2015, and before Jan. 1, 2017, the rate is 7.0%.
- For taxable years beginning after Dec. 31, 2016, and before Jan. 1, 2019, the rate is 6.5%.
- For taxable years beginning after Dec. 31, 2018, and before Jan. 1, 2020, the rate is 6.25%.
- For taxable years beginning after Dec. 31, 2019, and before Jan. 1, 2021, the rate is 6.0%.
- For taxable years beginning after Dec. 31, 2020, and before Jan. 1, 2022, the rate is 5.5%.
- For taxable years beginning after Dec. 31, 2021, and before Jan. 1, 2023, the rate is 5.0%.
- For taxable years beginning after Dec. 31, 2022, the rate is 4.9%.

Exemptions and Exclusions

Five specific types of corporations are exempted from the financial institutions tax:

- Insurance companies or organizations offering nonprofit agricultural organization insurance coverage subject to the tax under IC 27-1-18-2, IC 6-3, or IC 6-8-15;
- A captive insurer subject to taxation under IC 27-1-2-2.3;
- International banking facilities (as defined in Regulation D of the Board of Governors of the Federal Reserve System);
- Any corporation that is exempt from income tax under Section 1363 of the Internal Revenue Code; and
- Nonprofit corporations.

An exclusion is also provided for those financial institutions whose Indiana activities are limited to certain activities. These activities include owning an interest in the following types of property, including those activities within Indiana that are reasonably required to evaluate and complete the acquisition or disposition of the property, the servicing of the property or the income from

the property, the collection of income from the property, and the acquisition or liquidation of collateral relating to the property:

- An interest in a real estate mortgage investment conduit (REMIC), a real estate investment trust (REIT), or a regulated investment company (as those terms are defined in the Internal Revenue Code);
- An interest in a loan-backed security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments in relation to payments or reasonable projections of payments on the notes or certificates;
- An interest in a loan or other asset in which the interest is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5, and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person who is independent and not acting on behalf of the owner;
- An interest in the right to service or collect income from a loan or other asset from which interest on the loan or other asset is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5, and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person who is independent and not acting on behalf of the owner; and
- An amount held in an escrow or a trust account with respect to property described in this subdivision.

Combined Returns

A taxpayer is allowed to file a separate return only in those instances where the taxpayer is not a member of a unitary group. If the taxpayer is a member of a unitary group, combined reporting is mandatory. However, if the taxpayer determines that its Indiana income is not accurately reflected by the filing of a combined return, the taxpayer may petition the department by indicating on its annual return that the return is a separate return made by a member of a unitary group. Such petition is subject to approval by the department. Petitions to file a separate return must be submitted to the Tax Policy Division. Petitions may be filed using intime.dor.in.gov/eServices/, by e-mail at taxpolicy@dor.in.gov or the following address:

Tax Policy Division
Indiana Department of Revenue
100 N. Senate Ave., Room N248, MS# 102
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All taxpayers that are part of a unitary group must be included in one combined return. The statute requires that the combined return include the adjusted gross income of all members of the group that are transacting business of a financial institution wholly or partially within Indiana. The statute provides an exclusion for the income of corporations or other entities organized in foreign countries, except a federal or state branch of a foreign bank or its subsidiary that transacts business in Indiana. In other words, combined reporting is on a "water's edge" basis.

In calculating adjusted gross income, the taxpayer shall also eliminate all income and deductions from transactions between entities that are included in the combined return. In addition, in computing receipts for the apportionment factor, the taxpayer shall eliminate receipts between unitary group members included in the combined return.

As noted above, corporations that are not transacting business in Indiana are not included in a combined FIT return even if they share a unitary relationship with a taxpayer subject to FIT. Thus, it is possible that intercompany transactions between included and excluded corporations that have a unitary relationship can create a failure to fairly reflect the Indiana source income of a taxpayer subject to FIT. If the department determines that the application of the FIT statutes fail to fairly reflect a taxpayer's Indiana source income, the department may require the taxpayer to utilize separate accounting of Indiana income, file a separate FIT return, or the department may reallocate tax items between a taxpayer and another member of the taxpayer's unitary group or an entity that would be a member of a taxpayer's unitary group if it were transacting business in Indiana. "Tax items" means gross income, deductions, gains, losses, and credits used in computing the tax under this article, except the term shall exclude dividends or other distributions regardless of whether the amounts are deductible or taxable in computing taxable income under the Internal Revenue Code.

NOTE: The department will not make FIT adjustments that would reduce the dividends-paid deduction taken by a captive real estate investment trust.

Effective for taxable years beginning in 2022, an S corporation or partnership can elect to be subject to Indiana pass through entity tax. If an S corporation makes an election, it must remit pass through entity tax based on its shareholders' incomes. In addition, an S corporation that does not elect to be subject to pass through entity tax may remit pass through entity tax paid by another entity (e.g., a partnership owned by an S corporation). For further information on the pass through entity tax, refer to Income Tax Information Bulletin #72B at in.gov/dor/resources/tax-library/information-bulletins/.

Computation

Taxpayers compute the FIT by using net federal taxable income from the federal Form 1120 with the adjustments required by IC 6-5.5-1-2, depending on the type of financial institution. There are special rules pertaining to losses for purposes of determining Indiana net operating losses.

Net Operating Loss (NOL)

Indiana's net operating loss begins with the federal NOL. If the taxpayer does not have a federal NOL, the taxpayer will not have an Indiana NOL, even if modifications otherwise would create or increase an NOL. If an addback is required under IC 6-5.5-1-2, the addbacks will reduce the NOL, while deductions will increase the NOL. Once the modifications are applied to the federal NOL, that amount is multiplied by the apportionment factor to determine the Indiana NOL. In general, if there is negative taxable income when the FIT income is determined, there is an Indiana NOL. However, some reductions in federal taxable income are not permitted for net operating loss purposes under IRC section 172; Indiana has incorporated those federal modifications.

The NOL may be carried forward 15 years. Losses are not carried back. The loss must be allocated to the members of a unitary group in proportion with their respective Indiana receipts for the taxable year in which the loss is incurred. In applying the loss, the positive income must be

allocated to the members of a unitary group in proportion with their respective Indiana receipts for the taxable year in which the income is earned.

Example: Assume a unitary group has a $100,000 Indiana net operating loss in 2019. Member A has $600,000 (60%) of Indiana receipts in 2019 and Member B has $400,000 (40%) of Indiana receipts for a total of $1 million in Indiana receipts. Member A has $60,000 (600,000/1,000,000 X 100,000) of the net operating loss and Member B has $40,000 (400,000/1,000,000 X 100,000) available for future use.

In 2020, a new corporation, Member C, joins the group and has $100,000 of Indiana adjusted gross income after apportionment. Member A has $400,000 of Indiana receipts for 2020, Member B has $500,000 of Indiana receipts, and Member C has $100,000 of Indiana receipts for a total of $1 million in Indiana receipts. Member A is allocated $40,000 (400,000/1,000,000 X 100,000) of income against which to apply its net operating loss. The group can use $40,000 of Member A's allocated net operating loss in 2020 and has $20,000 for future use against Member A's income. The group must use the $40,000 net operating loss from Member B against Member B's $50,000 (500,000/1,000,000 X 100,000) allocated income, leaving $10,000 of adjusted gross income subject to tax. Member C has no net operating losses against which to offset its $10,000 (100,000/1,000,000 X 100,000) of adjusted gross income.

If the taxpayer has discharge of indebtedness excluded from federal gross income under IRC sections 108(a)(1)(A) (Chapter 11 bankruptcy), 108(a)(1)(B) (the taxpayer is insolvent), or 108(a)(1)(C) (qualified farm indebtedness), the Indiana net operating loss available for use or carryover available shall be reduced by the remainder of:

The amount of discharge of indebtedness excluded from federal gross income		_____
The apportionment percentage applicable to the taxpayer under IC 6-5.5 or IC 6-3 for the year of discharge	x	_____
Subtotal 1		_____
The amount of discharge of indebtedness excluded from federal gross income that reduced the tax attributes under IRC sections 108(b)(2)(D) (capital loss carryovers), 108(b)(2)(E) (basis reduction), or 108(b)(2)(F) (passive activity loss and credit carryovers), or was applied for federal tax purposes under IRC section 108(b)(5) (election to apply reduction first against depreciable property)		_____
The apportionment percentage applicable to		

the taxpayer under IC 6-5.5 or IC 6-3 for the year of discharge	x	_____
Subtotal 2		_____
Subtotal 1 – Subtotal 2 = Remainder		_____

The amount of the reduction computed for the discharge of indebtedness shall be applied:

1. First, as if the discharge of indebtedness was a modification of an item set forth in IC 6-5.5-1-2 that increased the taxpayer's adjusted gross income for the taxable year to zero (0), but only if the amount determined after modifications under IC 6-5.5-1-2 was less than zero (0); and
2. After the application required above, as if the discharge of indebtedness was part of the taxpayer's apportioned income and prorated for the taxable year of discharge between taxpayer members of a unitary group based on their respective receipts, similar to the application of positive income to net operating losses.. However, if this application results in a net operating loss of a member being reduced to zero (0), the excess shall not be considered income of the taxpayer nor shall it reduce the net operating loss of any other taxpayer member of a unitary group.

For purposes of the rules pertaining to discharges of indebtedness, the provisions of IRC sections 108(d)(6) (relating to provisions of section 108(a), (b), (c), and (g) being applied at the partner level) and Section 108(d)(7) (regarding special rules for S corporations) shall apply.

Net Capital Loss

A taxpayer's Indiana net capital loss for the taxable year equals the taxpayer's net capital losses for the taxable year minus the net capital gains for the year multiplied by the apportionment percentage applicable to the taxpayer under IC 6-5.5-2 for the taxable year of the loss. A net capital loss for a taxable year may be carried forward to each of the 5 succeeding taxable years. Similar to net operating losses, a net capital loss must be allocated to the members of a unitary group in proportion with their respective Indiana receipts for the taxable year in which the loss is incurred. In applying the loss, the capital gains must be allocated to the members of a unitary group in proportion with their respective Indiana receipts for the taxable year in which the gain is earned.

Nonresident Taxpayer Credit

A nonresident taxpayer is entitled to a credit against the tax due under this article for the amount of net income tax due to the nonresident taxpayer's domiciliary state for a taxable year if:

- The receipt of interest or other income from a loan or loan transaction is attributable both to the taxpayer's domiciliary state under that state's laws and also to Indiana under IC 6-5.5-4; and
- The principal amount of the loan is at least $2 million.
- The amount of the credit for each taxable year is the lesser of:

- The portion of the net income tax actually paid by the nonresident taxpayer to its domiciliary state that is attributable to the loan or loan transaction; or
- The portion of the FIT due to Indiana under this article that is attributable to a loan or loan transaction. The amount of tax attributable to a loan or loan transaction is the portion of the total tax due to each state in an amount equal to the same proportion as the receipts from the loan or loan transaction bear to the taxpayer's total receipts.

Additional Information

In the case of a credit union, "adjusted gross income" for a taxable year means the total transfers to undivided earnings minus dividends for that taxable year after statutory reserves are set aside under IC 28-7-1-24, multiplied by their apportionment factor.

In the case of an investment company, "adjusted gross income" means the company's federal taxable income plus the amount excluded from federal gross income under Section 103 of the Internal Revenue Code for interest received on an obligation of a state other than Indiana, or a political subdivision of such a state, that was acquired by the taxpayer after Dec. 31, 2011, multiplied by the quotient created by:

- The aggregate of the gross payments collected by the company during the taxable year from old and new business upon investment contracts issued by the company and held by a resident of Indiana; divided by
- The total amount of gross payments collected during the taxable year by the company from the business upon investment contracts issued by the company and held by persons residing within Indiana and elsewhere.

Federal Alteration or Modification of a Federal Return

The taxpayer is required to notify the department within 180 days after the alteration or modification of federal taxable income. A modification or an alteration occurs on the date upon which a:

- Taxpayer files an amended federal income tax return
- Final determination is made concerning an assessment
- Final determination is made concerning a claim for refund
- Taxpayer waives the restrictions on assessment and collection of all, or any part, of an underpayment of federal income tax
- Taxpayer enters into a closing agreement with the IRS concerning the taxpayer's tax liability under Section 7121 of the IRC that is a final determination; or
- Modification or an alteration in an amount of tax is otherwise made that is a final determination

for a taxable year, regardless of whether a modification or an alteration results in an underpayment or overpayment of tax.

A final determination means an action or a decision by a taxpayer, the IRS, the U.S. Tax Court, or any other U.S. federal court concerning any disputed tax issue that is final and conclusive and cannot be reopened or appealed by a taxpayer or the IRS as a matter of law.

The taxpayer is required to file an amended Indiana FIT return and a copy of the amended federal income tax return or Revenue Agent Report with the department no later than the date that is 180 days after the modification or alteration is made, or within the normal time limitation for claiming a refund for a tax period. A failure to report the modification by amended return leaves the statute of limitation open for the department to adjust. For further information on statute of limitations, refer to General Tax Information Bulletin #100, available at in.gov/dor/resources/tax-library/information-bulletins/.

Payment of the Tax

The FIT is payable directly to the department. Quarterly estimated payments are required if the taxpayer's annual liability exceeds $2,500. If the taxpayer's quarterly estimated payments exceed $5,000, the estimated payment must be made by electronic funds transfer. A taxpayer can use the department's customer portal, INTIME, to make estimated payments for financial institutions tax.

If you have any questions concerning this bulletin, contact the Tax Policy Division at taxpolicy@dor.in.gov.

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Indiana Department of Revenue