

Supplemental Letter of Findings: 18-20191030
Financial Institutions Tax
For the Year 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 Supplemental Letter of Findings.

HOLDING

Financial Institution met its burden of establishing that it was entitled to carry forward capital losses on its Indiana 2015 Financial Institutions Tax return provided that the losses were pro-rated among the affiliates as required under Indiana law.

ISSUE

I. Financial Institutions Tax - Capital Loss Carryforwards.

Authority: IC § 6-5.5-1-2; IC § 6-5.5-2-1; IC § 6-5.5-5-1; IC § 6-5.5-5-2; IC § 6-5.5-2-4; IC § 6-8.1-5-1; I.R.C. § 1221; *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); Letter of Findings 18-20191030 (July 23, 2021); General Tax Information Bulletin 200 (December 2019); Investopedia, Capital Loss, <https://www.investopedia.com/terms/c/capitalloss.asp>.

Taxpayer argues that the Department of Revenue erred when it disallowed capital loss carryforward amounts claimed on Taxpayer's 2015 Financial Institutions Tax unitary return.

STATEMENT OF FACTS

Taxpayer is a Financial Institution headquartered outside Indiana, but which conducts the business of a financial institution in Indiana. Taxpayer submitted its unitary 2015 Financial Institutions Tax ("FIT") return. As a "unitary" return, Taxpayer included itself and several affiliates. The Indiana Department of Revenue ("Department") conducted an audit review of the return. During the audit, the Department determined that Taxpayer deducted total federal capital losses of approximately \$4 million dollars accumulated during the previous five years. It deducted those capital losses as a modification or "other additions" in calculating its taxable income before apportionment.

The Department's audit concluded that Taxpayer failed to account for these "other additions" on its Indiana FIT-20 return, nor did it provide sufficient supporting documentation. As explained in the audit report, "The [T]axpayer did not report a capital loss attributable to Indiana which is prorated among the members the unitary return under Indiana Code" Thus, the modification was disallowed, resulting in an increase in Indiana FIT tax due. As a result, the Department issued Taxpayer a proposed assessment of additional FIT.

Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. Letter of Findings 18-20191030 ("LOF"), was issued on July 23, 2021, rejecting Taxpayer's protest. The LOF concluded as follows:

In the absence of adequate capital loss records, as required by IC § 6-5.5-2-1(d), all capital loss is considered to have been reported by affiliates which are improperly included in the FIT-20 return.

Taxpayer disagreed with the LOF's conclusions and submitted a rehearing request. The request was granted, the rehearing was conducted, and this Supplemental Letter of Findings results.

I. Financial Institutions Tax - Capital Loss Carryforwards.

DISCUSSION

The issue is whether Taxpayer has met its burden of establishing that it was entitled to claim the original capital loss carryforwards and that the assessment of additional FIT is unwarranted.

A. Taxpayer's Burden.

Because the audit's adjustment resulted in an assessment of additional FIT, it is the Taxpayer's responsibility to establish that this 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).

B. The Basics - Filing a Unitary Group's Combined Return.

Under Indiana law "a unitary group consisting of at least two (2) taxpayers shall file a combined return covering all the operations of the unitary business and including all of the members of the unitary business. However, only one (1) combined return needs to be filed. . . ." IC § 6-5.5-5-1. The combined return "must include the adjusted gross income of all members of the unitary group . . . the department may require a member of a unitary group to provide any information that is needed by the department to determine the unitary group's apportioned income. . . ." IC § 6-5.5-5-2. When filing a combined return for a unitary group, the group's apportioned income, according to IC § 6-5.5-2-4, consists of:

- (1) the aggregate adjusted gross income, from whatever source derived, of the members of the unitary group; multiplied by
- (2) the quotient of:
 - (A) all the receipts of the taxpayer members of the unitary group that are attributable to transacting business in Indiana; divided by
 - (B) the receipts of all the members of the unitary group from transacting business in all taxing jurisdictions.

C. Calculating Adjusted Gross Income for FIT Purposes.

The FIT is a "franchise tax" imposed on taxpayers based on their apportioned income "for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana." IC § 6-5.5-2-1(a).

For FIT purposes, "adjusted gross income" means taxable income as defined in Section 63 of the Internal Revenue Code," with certain adjustments. IC § 6-5.5-1-2. One such adjustment is the addition of "[a]n amount equal to the deduction under Section 172 or 1212 of the Internal Revenue Code for net operating losses or net capital losses." IC § 6-5.5-1-2(a)(1)(E).

D. Calculating the Amount of FIT Due.

Under IC § 6-5.5-2-1(a), the amount of the tax is determined by multiplying the applicable rate by the remainder of:

- (1) the taxpayer's apportioned income; minus
- (2) the taxpayer's deductible Indiana net operating losses as determined under this section; minus
- (3) the taxpayer's net capital losses minus the taxpayer's net capital gains computed under the Internal Revenue Code for each taxable year or part of a taxable year beginning after December 31, 1989, multiplied by the apportionment percentage applicable to the taxpayer under this chapter for the taxable year of the loss.

A *net capital loss* for a taxable year is a net capital loss carryover for each of the five (5) years that follow the taxable year in which the loss occurred.

IC § 6-5.5-2-1(e) sets out the provisions which apply to a combined return - such as that filed by Taxpayer - computing the tax on the basis of the income of the unitary group when the return is filed for more than one taxpayer member of the unitary group for any taxable year:

- (1) Any net capital loss or net operating loss attributable to Indiana in the combined return shall be prorated

between each taxpayer member of the unitary group by the quotient of:

- (A) the receipts of that taxpayer member attributable to Indiana under section 4 of this chapter; divided by
 - (B) the receipts of all taxpayer members of the unitary group attributable to Indiana.
- (2) The net capital loss or net operating loss for that year, if any, to be carried forward to any subsequent year shall be limited to the capital gains or apportioned income for the subsequent year of that taxpayer, determined by the same receipts formula set out in subdivision (1).

E. Net Capital Losses.

For reference's sake and not as authoritative a "net capital loss" is defined as "a loss incurred when a capital asset is sold for less than the price it was purchased for." Investopedia, Capital Loss, <https://www.investopedia.com/terms/c/capitalloss.asp> (Last visited December 5, 2021), while a "capital asset" is defined as "an asset with a useful life longer than a year that is not intended for sale in the regular course of the business's operation." *Id.* (See also I.R.C. § 1221).

For purposes of this Supplemental Letter of Findings, the key words or phrases are "**net capital loss**," "**prorated**," and "**unitary group**."

The Department's Information Bulletin explains as follows:

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. General Tax Information Bulletin 200 (December 2019), 20200401 Ind. Reg. 045200142NRA (*Emphasis added*).

F. The Department's FIT Audit Conclusions.

The original audit report disagreed with the FIT modification attributable to approximately \$3.8 million in "federal capital losses for years 2010 - 2014." As explained in that report:

- The [T]axpayer did not report an Indiana FIT-20 modification to add the amount allowed for capital loss for federal tax calculation required under Indiana Code § 6-5.5-1-2.
- The [T]axpayer did not report a capital loss attributable to Indiana which is prorated among the members of the unitary return under Indiana Code § 6-5.5-2-1(e).
- Federal form 1120 Schedule D Capital Gains and Losses was not provided for any year.
- The proration of capital or loss among Indiana unitary group members was not provided for any year.

Taxpayer responded to these concerns and provided additional documentation which the Department's audit found deficient. As stated in the audit report, "The two additional records provided by the [T]axpayer are not sufficient to determine either the addback capital loss carryovers to the extent used in offsetting capital gains on Schedule D or the Indiana net capital loss adjustment."

In a follow-up letter sent to Taxpayer, the Department explained:

Indiana Code 6-5.5-2-1(e) allows a capital loss deduction attributed to Indiana which is *prorated among members of the unitary group* and carried forward and applied to attributed capital gain which has been prorated among the members of the unitary group. Indiana modification of "Other Additions" does not conform to the Indiana Code and does not follow the return instructions. The adjustment of [\$4 million dollars] reduces to zero the "Other Additions" modification. (*Emphasis added*).

G. The Department's 2021 Letter of Findings.

Taxpayer's original protest was addressed in Letter of Findings 18-20191030 (July 23, 2021), 20210929 Ind. Reg. 045210406NRA, again raising the same concerns raised during the audit. The LOF states:

Taxpayer filed a combined return for tax year 2015. Taxpayer's 2015 FIT-20 reported its *total federal capital*

losses for tax years 2010 - 2014 as a modification to the calculation of total income prior to Indiana apportionment.

The amount represents *total federal capital losses* for tax years 2010 to 2014 for one single member.

Taxpayer did not report an Indiana FIT-20 modification to add the amount of the deduction allowed for capital loss for federal tax calculation as required by IC § 6-5.5-1-2. Nor did Taxpayer report a *capital loss attributable to Indiana prorated among the unitary members*.

....

The auditor requested additional documentation during the audit. That information was found to be "[insufficient] to determine either the addback of the net capital loss carryovers to the extent used in offsetting capital gains on federal Schedule D or the Indiana net capital loss adjustment.

The LOF noted that Taxpayer had "provided a schedule which it believed the auditor wanted and which Taxpayer believed would resolve the issue and reverse the audit adjustment." However, after reviewing Taxpayer's "schedule," both the Department's Legal Division and Audit Division found that the schedule was "insufficient support of the capital loss deduction."

The LOF concluded "as required by IC § 6-5.5-2-1(d) all capital loss is considered to have been reported by affiliates [and] which are improperly included in the FIT-20 return."

H. Application of Law and Conclusions.

In its rehearing request, Taxpayer states that the "Federal Capital Losses shown on the Indiana returns do not represent losses for a single member. The amounts are summations of the separate entities that make up the combined group." In that request, Taxpayer agrees "that the capital loss attributable to Indiana was *not prorated* among the unitary members on the return as followed . . ." (*Emphasis added*).

In its attempt to address the issue, Taxpayer states that it "is providing the calculation for every year that shows the prorating of capital losses by entity and the subsequent capital loss carryforward utilization . . ." To that end, Taxpayer has provided:

- Exhibit E: [Taxpayer] Capital Loss Calculation
- Exhibit F: [Taxpayer] 1120 Schedule D Details for Tax Years 2010-2015
- Exhibit G: [Taxpayer] 1120 ProFormas for Tax Years 2010-2015
- Exhibit H: [Taxpayer] FIT-20 Page 1 for Tax Years 2010-2015
- Exhibit I: [Taxpayer] Other Additions Details for Tax Years 2010-2015
- Exhibit J: [Taxpayer] Net Operating Loss Calculation
- Exhibit L: [Taxpayer] Adjusted FIT 20.

The omitted exhibits (A, B, K etc.) are copies of routine documents to and from Taxpayer.

After review of the documentation and analysis submitted in the rehearing process, it becomes clear that to one degree or another, one degree or another, everyone involved in this protest has made at least one mistake. Taxpayer erred when it made a wholesale, undifferentiated claim to capital losses on its original 2015 FIT return; the Department erred when it made a wholesale denial of those losses; the original LOF mischaracterized and/or misunderstood the issues in play. However, the resolution is relatively straightforward. Taxpayer is a financial institution entitled to file a combined FIT return and to claim a pro-rated (*not* wholesale) amount of federal capital losses. However, Taxpayer must pro-rate those losses amongst its affiliates in a matter in accordance with Indiana law as set forth in IC § 6-5.5-2-1(d). Without going into detail, that means that the losses are allocated amongst Taxpayer and its affiliates "in proportion with their respective Indiana receipts for the taxable year in which the gain is earned." General Tax Information Bulletin 200. Taxpayer has now provided information which, on its face, appears to do just that with the only remaining task for the Department's audit division to review that documentation and to verify and "crunch the numbers."

FINDING

Taxpayer is sustained to the extent set out in this SLOF; that means the Department's audit review team will calculate the amount of tax owed by Taxpayer after having taken into consideration the federal capital losses as

apportioned among the members of the unitary group.

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