DEPARTMENT OF STATE REVENUE

18-20210085.LOF

Letter of Findings 18-20210085
Financial Institution Tax
For the Years 2014, 2015, and 2016

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

HOLDING

The Department correctly excluded Financial Institution from its affiliate groups' combined returns as it did not conduct financial business during the years at issue and, as a result, Financial Institution lacked Indiana nexus. The Department correctly found that the Financial Institution Tax does not provide a "business" / "nonbusiness" income distinction and Financial Institution's position to the contrary was wrong.

ISSUES

I. Financial Institution Tax - Indiana Nexus.

Authority: IC § 4-21.5-5-14; IC § 6-5.5-5-1; IC § 6-5.5-1-18; IC § 6-5.5-2-1; IC § 6-5.5-3-1; IC § 6-5.5-3-3; IC § 6-8.1-5-1; 45 IAC 17-2-5; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, (Ind. Tax Ct. 2012); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Black's Law Dictionary (11th ed. 2019); David L. Scott, *Wall Street Words* 176 (1997).

Taxpayer argues that the Department made a mistake by excluding Taxpayer from its affiliates' combined returns.

II. Financial Institution Tax - Business or Nonbusiness Income.

Authority: IC § 6-3-1-21; IC § 6-3-2-2; IC § 6-5.5-1-2; IC § 6-8.1-5-1; I.R.C. § 63; Black's Law Dictionary (11th ed. 2019); David L. Scott, *Wall Street Words* (1997).

Taxpayer maintains that the Department erred when it added back to its reported income money received from the sale of stock originally acquired from a credit card company in which it had a previous ownership interest.

STATEMENT OF FACTS

Taxpayer is a parent holding company owning businesses providing financial services in multiple states. Taxpayer's subsidiaries provide lending, cash management, credit card, investment management, and other typical banking services. Taxpayer has a number of affiliates including Subsidiary Bank which also provides a variety of banking services to individuals and businesses. In the issues raised by Taxpayer, Subsidiary Bank plays a separate and distinct role from that of the other numerous affiliates.

Taxpayer filed combined 2014, 2015, and 2016 Indiana Financial Institution Tax ("FIT") returns which included Taxpayer (as the parent holding company) along with a number of its subsidiaries. One of those subsidiaries is an Indiana single member limited liability company treated as a disregarded entity for income tax purposes. That subsidiary is hereinafter designated as "Broker/Dealer" because it buys and sells securities on behalf of itself or others.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's FIT returns and its business records. The audit resulted in an assessment of additional tax stemming from various adjustments to Taxpayer's and its affiliates' combined returns. Taxpayer disagreed with certain adjustments and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Financial Institution Tax - Indiana Nexus.

DISCUSSION

The issue is whether Taxpayer has met its burden of establishing that the Department should not have excluded Taxpayer from its affiliates' combined FIT returns. Taxpayer argues that Taxpayer has Indiana "nexus" by virtue of the disregarded entity Broker/Dealer's Indiana activities.

A. Taxpayer and Affiliates' Combined Returns and the Department's Audit Analysis.

Taxpayer originally filed combined Indiana FIT returns including Broker/Dealer and itself in those returns. The audit report explains Taxpayer's reasoning for doing so. "It is [T]axpayer position that [Taxpayer] should be included in the Indiana FIT-20 combined returns because [T]axpayer owns a disregarded entity with an employee living in Indiana conducting the business of a financial institution in Indiana."

The Department disagreed finding that Taxpayer should not have been included in 2015 and 2016 unitary returns because Broker/Dealer did not maintain an Indiana office conducting the business of a financial institution in this state. The audit report noted:

- Broker/Dealer did not maintain an Indiana office during 2015 and 2016;
- Broker/Dealer's (and by extension Taxpayer's) Indiana activities in Indiana were "de minimis";
- Including Taxpayer in the Indiana returns has the result of distorting Indiana adjusted gross income; the original returns do not reflect the affiliates' adjusted gross income.

The audit report further explains that Broker/Dealer was not registered with the Indiana Secretary of State, an onsite visit to Broker/Dealer's stated business location found that "there is no business leasing an office . . . . under the name [Broker/Dealer], and the local building attendant stated that Broker/Dealer did not have an office in the building nor was it conducting business from that location." The audit concluded that Taxpayer is a "holding company" and should not have been included in 2015 and 2016 returns because Taxpayer - even by virtue of its ownership of and the activities of Broker/Dealer - "was not conducting the business of a financial institution as required under IC § 6-5.5-3-1."

For clarity's sake, a "holding company," such as Taxpayer, is "[a] type of parent company that exists primarily to exercise control over other firms . . . . Earnings of the holding company are derived from [the] earnings of the controlled firms[.]" David L. Scott, *Wall Street Words* 176 (1997).

B. Taxpayer's Objections to the Department's Analysis and Statements of Law.

Taxpayer argues that its ownership of Broker/Dealer confers Indiana nexus upon Taxpayer and that Taxpayer was properly included in the 2015 and 2016 returns.

Indiana imposes a financial institution tax pursuant to IC § 6-5.5-2-1(a) (applicable for the tax year 2015 and 2016) which states, as follows:

> There is imposed on each taxpayer a franchise tax measured by the taxpayer's apportioned income for the privilege of exercising its franchise or the corporate privilege of *transacting the business* of a financial institution in Indiana . . . . (*Emphasis added*).

When a taxpayer is taxable under the FIT (IC 6-5.5), the taxpayer is not subject to certain taxes, such as the adjusted gross income tax under IC 6-3. 45 IAC 17-2-5(a).

This franchise tax is imposed on financial businesses which "transact" business in Indiana. IC § 6-5.5-3-3 defines "*transacting business*" as follows:

> For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year *only* if the taxpayer:
> (1) *maintains an office in Indiana*;
> (2) has an employee, representative, or 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 section 8(5) of this chapter, and *result in receipts flowing to the taxpayer from within Indiana*;
(7) owns or leases tangible personal or real property located in Indiana; or
(8) regularly solicits and receives deposits from customers in Indiana. (*Emphasis added*).

Taxpayer points specifically to Broker/Dealer's employee as grounds for its position. IC § 6-5.5-3-1 provides:

An employee, representative, or independent contractor is considered to be conducting business in Indiana if:
(1) the employee, representative, or independent contractor is regularly engaged in the business of the taxpayer in Indiana;
(2) the office from which the employee's, representative's, or independent contractor's activities are directed or controlled is located in Indiana and a majority of the employee's, representative's, or independent contractor's service is not performed in any other taxing jurisdiction; or
(3) a contribution to the Indiana employment security fund is required under IC 22-4-2 with respect to compensation paid to the employee.

Taxpayer originally included itself in the combined 2015 and 2016 return as permitted for unitary businesses under IC § 6-5.5-1-18 which provides in small part:

The term "unitary group" includes those entities that are engaged in a unitary business transacted wholly or partially within Indiana. However, the term does not include an entity that *does not transact business in Indiana.* (*Emphasis added*).

Specifically, Taxpayer relies on IC § 6-5.5-3-1 which defines "conducting business in Indiana" to include: (1) maintaining an office in Indiana; (2) having an employee, representative, or independent contractor conducting business in Indiana. Taxpayer argues that Broker/Dealer is conducting the business of a financial institution in Indiana, and because Broker/Dealer is Taxpayer's disregarded entity, Taxpayer has nexus - an Indiana presence - with Indiana and should be included in the combined FIT returns.

C. Taxpayer's Burden of Proof - the Department's Decision was Wrong.

Taxpayer is required to make its case that the Department was wrong when it interpreted the facts and applied the law.

As explained under 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). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. 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 fn. 9 (Ind. Tax Ct. 2012).

The Department notes here that in seeking judicial review of a Department's decision, a taxpayer must establish that - among other provisions - that the Department's decision was "arbitrary and capricious." IC § 4-21.5-5-14. In doing so the Indiana Supreme Court has held that "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).

D. Analysis and Conclusion.

Both the Department and Taxpayer agree that Broker/Dealer had an employee working within Indiana and that Taxpayer issued employee regular paychecks. The discrepancy in whether or not Broker/Dealer has or does not have an Indiana "office" is explained by Broker/Dealer's employee. In an affidavit provided by the employee, he explained that he worked at locations which were not designated with the name of Broker/Dealer. Instead, he shared an office with other affiliates' employees working in offices owned by other Taxpayer affiliates.

Taxpayer essentially "bootstraps" its way into the 2015 and 2016 returns by virtue of the activities conducted by its disregarded Indiana Broker/Dealer. As Taxpayer explains:

> Because [Broker/Dealer] had an employee located in Indiana it is clear that [Taxpayer] was conducting business in Indiana . . . .

The unvarnished facts tend not to support Taxpayer's position. Broker/Dealer is not registered to conduct business in Indiana. In 2014 Broker/Dealer managed a single mutual fund and reported 2014 receipts of approximately $20,000. Broker/Dealer had no receipts in either 2015 or 2016 which are precisely the years addressed in the audit report. All things considered, Broker/Dealer's activities in this state are best classified as "de minimis" or as "insignificant." Black's Law Dictionary, 544 (11th ed. 2019). Broker/Dealer did not conduct 2015 and 2016 activities which "result[ed] in receipts flowing to the taxpayer from within Indiana." IC § 6-5.5-3-3(6).

What is not "de minimis" is Taxpayer's position which corrals Taxpayer into the combined FIT returns. IC § 6-5.5-5-1 requires both a taxpayer and the Department to determine whether or not a word-for-word application of the law results in that taxpayer's income being fairly represented. *See* IC § 6-5.5-5-1(b). Taxpayer sustained considerable losses during the three-year period amounting to approximately 850 million dollars. The significance of that is explained in the audit report:

> By including [Taxpayer] in the Indiana return, the [T]axpayer has greatly reduced taxable Indiana adjusted gross income while not contributing to the unitary group's apportionment percentage.

Broker/Dealer does not have an "office" location in Indiana but relies on the hospitality of related business entities. It is difficult to conclude that Broker/Dealer was "conducting business" when it reported having no revenue during 2015 and 2016 and when no "receipts flow[ed] to the taxpayer from within Indiana." IC § 6-5.5-3-3(6).

By any reasonable measure, including Taxpayer in the 2015 and 2016 combined returns by virtue of Broker/Dealer's "insignificant" activities results in the disproportionate allocation of the combined group's income and losses (-$850,000,000/$0) that does not fairly represent the combined group's income attributable to Indiana.

In conclusion, Broker/Dealer did not maintain an office in Indiana and did not generate income from Indiana in the years at issue. Broker/Dealer's Indiana activities for 2015 and 2016 were de minimus. Including Taxpayer's losses incurred during the audit period would not fairly represent the combined group's income attributable to Indiana for FIT purposes. Taxpayer has not met its statutory burden under IC § 6-8.1-5-1(c) of establishing that the audit's analysis and the subsequent assessment were wrong.

FINDING

Taxpayer's protest is respectfully denied.

II. Financial Institution Tax - Business or Nonbusiness Income.

DISCUSSION

Taxpayer argues that the Department made an error "adding back" income *Subsidiary Bank* received from the sale of stock originally purchased from Credit Card Company. Subsidiary Bank acquired the stock in 2008 and sold it during 2014, 2015, and 2016 for approximately $800 million dollars.

In its original 2014, 2015, and 2016 returns, Taxpayer reported the sales proceeds as Subsidiary Bank's "non-business" income. Generally, "business income" is defined as "any income realized as a result of commercial activity," Black's Law Dictionary 913 (11th ed. 2019), while Indiana statute defines "non-business income" as "all income other than business income." IC § 6-3-1-21. In calculating Indiana adjusted gross income, nonbusiness income is *allocated* to the state in which the income is earned, and business income is *apportioned* among the states in which the Taxpayer conducts business. IC § 6-3-2-2.

The Department's audit disagreed with Taxpayer's decision "allocating" the Subsidiary Bank's stock sale proceeds. According to the audit report:

> Under IC § 6-5.5-1-2, Indiana Financial Institution Tax is calculated by including all taxable income as defined in Section 63 of the Internal Revenue Code adjusted for certain modifications . . . . There is no provision in Article 5.5 for nonbusiness income or the segregation of business and nonbusiness income for purposes of

> assigning the income to different taxing jurisdictions. All income is treated as apportionable income to be apportioned among the states in which the taxpayer has economic nexus.

In effect, the audit found that, for FIT purposes, the $800 million should have gone into the apportionment pot and "distributed" among the states in which Taxpayer was conducting the business of a financial institution.

Taxpayer points out that it is headquartered outside Indiana and was never involved in the operation of Credit Card Company. Subsidiary Bank had simply acquired an interest in the Credit Card Company during the company's initial public offering ("IPO"). For clarity's sake, an IPO is a "[c]ompany's first sale of stock to the public." David L. Scott, *Wall Street Words* 189 (1997). Taxpayer states that under either the "functional" or "transactional" tests, money received from the stock sale was "not related to [Subsidiary Bank's] regular trade or business nor did the sale . . . result in the direct financial betterment of [Subsidiary Bank's] business line."

Specifically, Taxpayer points to Indiana law, IC § 6-3-2-2(i) which, according to Taxpayer, stands for the proposition "that capital gains from the sale of intangible property would only be considered allocable to Indiana if the taxpayer's commercial domicile was in Indiana." Taxpayer concludes as follows:

- Subsidiary Bank's commercial domicile is outside Indiana;
- Money from the sale of the Credit Card Company stock was a sale of intangible property;
- A capital gain from the sale of stock is not included in apportionable income and not allocated to Indiana;
- Under Indiana law, gains from the sale of the Credit Card Company stock should be allocated to the state of its commercial domicile.

It bears repeating here that Taxpayer is obligated to establish that the Department's decision, adding back the stock sale proceeds, was wrong. IC § 6-8.1-5-1(c).

At the outset, the Department here notes that Taxpayer is trying to compare apples and oranges. It is transplanting the business/nonbusiness provisions found in Indiana's Article 3 adjusted gross income tax provision into Indiana's Article 5 FIT provisions. The audit report was correct in its analysis that FIT is determined under IC § 6-5.5-1-2(a) which provides:

> Except as provided in subsections (b) through (d), "adjusted gross income" means taxable income as defined in Section 63 of the Internal Revenue Code. (*Effective January 1, 2013, to December 31, 2015*).

I.R.C. § 63 provides in small part as follows:

> Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus the deductions allowed by this chapter (other than the standard deduction).

Together the two provisions operate to determine the income subject to Indiana's FIT. In other words, for FIT purposes, in calculating a taxpayer's Indiana adjusted gross income, Indiana first refers to I.R.C. § 63 as the beginning point, with modifications thereafter such as "itemized deductions." Modifications to a taxpayer's federal adjusted gross income are outlined in IC § 6-5.5-1-2(a). IC § 6-5.5-1-2(a)(1) provides that certain income is added back to a taxpayer's adjusted gross income and IC § 6-5.5-1-2(a)(2) provides that certain income is subtracted from the taxpayer's adjusted gross income. These FIT statutes have no provision allowing the business/nonbusiness distinction Taxpayer seeks.

Taxpayer may be a step removed from the initial acquisition of the Credit Card Company stock and another step removed from the sale of that stock. But there is nothing Taxpayer has cited which allows the business/non-business distinction in the realm of the FIT calculation.

FINDING

Taxpayer's protest is respectfully denied.

November 18, 2021

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