Indiana DOR Finds Economic Nexus, Disregards *UPS*

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In this article, the authors write about a ruling from the Indiana Department of Revenue finding that a company with no physical presence in the state had nexus for Indiana corporate tax purposes because it earned royalty income from licensing trademarks and trade names with two Indiana affiliates. The department disregarded the state tax court's 2013 decision in *UPS*, in which the court required physical presence for imposing the corporate income tax.

The Indiana Department of Revenue recently concluded that a company that earned royalty income from licensing trademarks and trade names to two of its Indiana affiliates, and had no physical presence in the state, nonetheless had nexus with the state for corporate income tax purposes.[1] Although the DOR acknowledged the Indiana Tax Court's statement that the Indiana corporate income tax does not use an economic presence standard of nexus, the DOR did not address the company's argument that the tax court required physical presence for purposes of imposing the state's corporate income tax in *UPS Inc. v. Indiana Department of Revenue*, 995 N.E.2d 20 (Ind. Tax Ct. 2013).

[1]Letter of Findings No. 02-20140072.

UPS

In *UPS*, the tax court addressed whether a foreign reinsurance company must be physically present in Indiana to be subject to Indiana's premiums tax. If the foreign reinsurer were subject to the premiums tax, it could not be in a combined corporate income tax return. The court found that the foreign reinsurer with no physical presence was not subject to the premiums tax, saying, "There is no tension between Indiana's premiums tax and its corporate income tax because each uses a physical presence standard."[2] In ruling that physical presence was required for corporations to be subject to the Indiana corporate income tax and the Indiana premiums tax, the tax court distinguished an earlier decision in which it had confirmed an economic nexus standard for the Indiana financial institutions tax.[3]

Letter of Findings No. 02-20140072

The company earned royalties from two affiliates that both conducted business in Indiana, arising from an agreement to use the company's trademarks and trade names in manufacturing some products. The company managed its trademarks and trade names from its corporate offices located outside Indiana. In 2009 the company entered into a voluntary disclosure agreement with the DOR under which it was required to file income tax returns for 2005 through 2008 and to continue to file returns prospectively through 2011.

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The DOR later audited the company's corporate income tax returns for 2008 through 2010, resulting in the assessment of additional income tax stemming from the sourcing of receipts in calculating the sales factor. As an alternative to the audit conclusion, the company proposed filing combined returns with other unitary entities in its parent's affiliated group. The DOR determined that a combined unitary return would more fairly reflect the company's Indiana income and issued a supplemental audit report to

[2]*UPS*, 995 N.E.2d at 23.

[3]*Id.* (distinguishing *MBNA Am. Bank NA & Affiliates v. Indiana Department of Revenue*, 895 N.E.2d 140 (Ind. Tax Ct. 2008)).

the company. The company protested, asserting that it did not have nexus with Indiana because the state did not use an economic nexus standard and did not have physical presence in Indiana, and requested a refund for all open years.

The DOR denied the company's protest. It found that the company's trademarks had acquired an Indiana business situs and that the royalty payments received by the company were subject to Indiana's corporate income tax. The DOR concluded:

> Taxpayer's "income producing activity" is performed in Indiana because "the act or acts directly engaged in by the taxpayer for the ultimate purpose of obtaining gains or profit" occur in Indiana. . . . Taxpayer earns money because it develops intellectual property, licenses that intellectual property to its Indiana affiliates, and obtains money from activity which occurs within this state. Under any reasonable interpretation of IC section 6-3-2-2(a), Taxpayer has nexus within Indiana because it has "income from doing business in this state."

The DOR also affirmed the 10 percent underpayment penalty.

Insights

It is noteworthy that the DOR concluded that sufficient nexus existed without finding that the company had a physical presence in Indiana and without addressing *UPS*. As such, Letter of Findings No. 02-20140072 conflicts with the ruling in *UPS* that companies must have a physical presence in Indiana to be subject to corporate income tax. It is yet to be seen whether the ruling in the letter of findings is an isolated incident resulting from a unique factual background, or whether the DOR will continue to disregard the tax court and *UPS* and assert that other corporations have income tax nexus without a physical presence in Indiana. Stay tuned. ☆