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Multistate Tax
EXTERNAL ALERT

Indiana Amends Tax Code, Updates IRC Conformity and Authorizes an Amnesty

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Overview

Indiana Governor Pence recently signed into law Senate Bill 441 and House Bills 1472, 1271 and 1001, which collectively include the following modifications to the Indiana tax code:

- Elimination of the sales factor "throwback" rule
- Revision of the intercompany expense "addback" statute
- Redefinition of "business income"
- Updated conformity to the Internal Revenue Code
- Adoption of several changes to Indiana sales and use tax law
- Authorization of a new amnesty program

In this Tax Alert we summarize these law changes, which have various effective dates as specified in the discussion that follows.

S.B. 441[1]

Effective January 1, 2016, S.B. 441 eliminates Indiana's sales factor "throwback" rule for purposes of computing state adjusted gross income – this rule currently requires sales of tangible personal property to be sourced to Indiana if: 1) the property is shipped from an office, store, warehouse, factory or other place of storage in Indiana; *and* 2) the taxpayer is not taxable in the state of the purchaser. The new law also specifies that sales of computer software are treated as sales of tangible personal property for sales factor sourcing purposes.

Also effective January 1, 2016, the new law revises Indiana's intercompany intangible and interest expense "addback" statute by allowing an intercompany expense deduction if the related-party recipient receives an item of income that corresponds to the directly-related interest expenses, *and* the recipient:

- Is subject to Indiana's financial institutions tax (FIT),
- Files an FIT return, and
- Apportions the items of income that correspond to the intangible expenses and the directly related interest expenses in accordance with Indiana FIT statutes.

The intercompany expense "addback" statute was also modified to expand the addback requirement to include "all intangible expenses" and "all directly related interest expenses." Previously, the statute required an addback for "intangible expenses" and "directly related intangible interest expenses."

Effective January 1, 2016, the new law also revises the definition of "business income" to mean "all income that is apportionable to the state under the Constitution of the United States." Existing law defines business income as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations."

In addition to the law changes summarized above, H.B. 441 extends from January 1, 2017 to January 1, 2021, the sunset date for the Venture Capital Investment Tax Credit and the Hoosier Business Investment Tax Credit.

The new law also expands the agricultural and manufacturing sales and use exemptions. Effective January 1, 2016, these exemptions are expanded to include purchases of material handling equipment used to transport materials from an onsite location to the site of the production, extraction or harvesting activity. The manufacturing

[1] Ind. P.L. 250; Senate Enrolled Act No.441 (May 6, 2015). A copy of the adopted law is accessible **here**.

exemption is also expanded to include the cutting of steel bars into billets and the felling of trees for further use in production or sale in the ordinary course of business as the processing of property.

H.B. 1472[2]

Effective retroactively to January 1, 2015, H.B. 1472 updates corporate and personal income tax statutory references to the Internal Revenue Code (IRC) to refer to the IRC in effect on January 1, 2015 (previously, January 1, 2013).

For taxable years ending before January 1, 2013, the law continues to decouple from certain provisions under the federal Tax Relief, Unemployment Insurance Reauthorization and Jobs Creation Act of 2010, including IRC Sec. 954(c)(6), which pertains to the look-through treatment of payments between related controlled foreign corporations under the foreign personal holding company rules. Also, state law continues to impose a number of decoupling adjustments, including addition adjustments related to IRC Sec. 168(k) (bonus depreciation), IRC Sec. 179 (expensing), IRC Sec. 108(i) (the deferral of recognition of income from discharge of certain business indebtedness), IRC Sec. 199 (deduction for domestic production activities) and IRC Sec. 172 (the expanded carryback period for net operating losses of certain small businesses).

H.B. 1472 also increases from 60 days to 90 days the period to appeal to the Tax Court a Letter of Finding or a claim denial from the Department of Revenue (DOR). Additionally, language was added on what constitutes a modification to a federal income tax return, which triggers a reporting requirement to the state.

Additional Sales Tax Changes

Effective July 1, 2015, H.B. 1472[3] includes the following:

- The new law expands the exemption for durable medical equipment to include repair or replacement parts used to repair durable medical equipment, mobility enhancing equipment and prosthetic devices. Hearing aid parts, attachments, batteries or accessories bought for the patient's own use are exempt even when not prescribed, as are devices and equipment used to administer insulin. Also exempt when bought without a prescription and for the patient's own medical use are insulin, oxygen, blood and blood plasma.
- A new section is added to include a definition for "Licensed Practitioner" related to the exemption for prescription drugs. "Licensed practitioner" is defined to include doctors, dentists, veterinarians or other practitioners licensed to prescribe drugs as part of the practitioner's professional practice.
- The exemption for recycling machinery, tools and equipment has been replaced with an exemption for tangible personal property if the person acquiring the property: 1) acquires it for the person's direct use in processing recycling materials; and 2) is occupationally engaged in the business of recycling. Recycling carts, meaning manually propelled containers with a 100 gallon or less capacity, are specifically exempt.
- The DOR may revoke a retail merchant's certificate if the retailer fails to file a return or remit tax. The DOR can revoke a certificate before a criminal adjudication or without a criminal charge being filed.
- The new law expands the list of authorized person eligible to issue exemption certificates to include power subsidiaries. Only listed authorized persons that have received an exemption certificate are able to provide exemption certificates in lieu of paying sales tax on purchases.
- A power subsidiary or a person selling electrical energy, natural or artificial gas, water, steam or steam heating service that accepts a sales and use tax exemption certificate is not required to collect sales or use tax on the sale of the services or commodities until notified by the DOR that the exemption certificate has expired or has been revoked.
- The 36-month limitation on filing refund claims based on the electrical energy, artificial or natural gas, water, steam and steam heat exemptions is repealed.

Effective January 1, 2016, H.B. 1472[4] also includes the following:

- Property that is stored in Indiana for 180 days or less for the purpose of being used solely outside Indiana is not subject to Indiana sales and use tax.
- The R&D equipment exemption includes the design, refinement and testing of prototypes of new or improved commercial products before sales have begun for the purpose of determining facts, theories or

[2] Ind. P.L. 242; House Enrolled Act No. 1472 (May 6, 2015). A copy of the adopted law is available **here**.
[3] *Id.*
[4] *Id.*

principles, or for the purpose of increasing scientific knowledge that may lead to new or enhanced products. The new law also defines a list of expenditures that do not constitute R&D activity.

H.B. 1271[5]

Sales of government-mandated labels to be used on items sold at retail are exempt from Indiana gross retail tax, effective May 4, 2015.

H.B. 1001[6] - Tax Amnesty Program

H.B. 1001 (the State Biennial Budget Bill) requires the DOR to establish a tax amnesty program for taxpayers having an unpaid tax liability for a "listed" tax (*i.e.*, most taxes administered by the DOR, including the state adjusted gross income tax, financial institutions tax and gross retail and use tax) due and payable for a tax period ending before January 1, 2013. The amnesty program will be limited to a period to be determined by the DOR, "not to exceed eight regular business weeks" ending before the earlier of the date set by the DOR or January 1, 2017. As applied to eligible, participating taxpayers, the program will provide for the waiver of related penalties and interest. A taxpayer who participated in certain previous Indiana amnesty programs would not be eligible for this amnesty program.

Considerations

Taxpayers with unpaid Indiana liabilities may wish to consider participating in the new tax amnesty program to potentially limit their Indiana liability.

Also, the Indiana Legislative record confirms that the income tax law changes discussed in this Tax Alert were enacted in early May 2015. Accordingly, any impact of these law changes should be treated as a second quarter event for financial statement purposes for calendar year taxpayers.

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[5] Ind. P.L. 138; House Enrolled Act No. 1271 (May 4, 2015). A copy of the adopted law is available **here**.
[6] Ind. P.L. 213; House Enrolled Act No. 1001 (May 7, 2015). A copy of the adopted law is available **here**.