

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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## SALT

### SUBJECT

**INDIANA ELIMINATES ITS SALES FACTOR THROWBACK RULE, MODIFIES ITS RELATED PARTY EXPENSE ADDBACK PROVISION, EXPANDS BUSINESS INCOME DEFINITION, DEFINES COMPUTER SOFTWARE AS TANGIBLE PERSONAL PROPERTY, AND ESTABLISHES A TAX AMNESTY**

### SUMMARY

In early May, Indiana Governor Michael Pence (R) signed into law Senate Bill 441 ("S.B. 441") and House Bill 1001 ("H.B. 1001"), which together eliminate sales factor throwback, expand the related party expense add back to require adjustment for all interest expense, broadens the definition of business income to include all income apportionable under the U.S. Constitution, treat the sale of computer software as a sale of tangible personal property for receipts factor purposes, and require the establishment of tax amnesty for income, sales/use and certain other taxes due for a taxable period ending before January 1, 2013. The foregoing substantive changes to the law take effect January 1, 2016, and apply to taxable years beginning after December 31, 2015. The provisions related to tax amnesty take effect July 1, 2015, and require the establishment of a maximum eight-week tax amnesty period that ends before January 1, 2017.

### DETAILS

#### *Definition of Business Income*

Indiana income tax law currently defines business income as "all 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."

Applicable to taxable years beginning after December 31, 2015, S.B. 441 replaces this definition of business income with the following more expansive definition: "all income that is apportionable to the state under the Constitution of the United States."



### CONTACT:

#### WEST:

ROCKY CUMMINGS, Tax Partner  
415-490-3130 / rcummings@bdo.com

PAUL MCGOVERN, Tax Senior Director  
714-913-2592 / pmcgovern@bdo.com

#### NORTHEAST:

JANET BERNIER, Tax Partner  
212-515-5405 / jbernier@bdo.com

MATTHEW DYMENT, Tax Senior Director  
617-239-4130 / mdyment@bdo.com

#### SOUTHEAST:

ASHLEY MORRIS, Tax Senior Director  
919-278-1963 / amorris@bdo.com

SCOTT SMITH, Tax Senior Director  
615-493-5629 / ssmith@bdo.com

#### ATLANTIC:

JEREMY MIGLIARA, Tax Senior Director  
703-770-0596 / jmigliara@bdo.com

JONATHAN LISS, Tax Senior Director  
215-636-5502 / jliss@bdo.com

#### CENTRAL:

ANGELA ACOSTA, Tax Senior Director  
248-688-3313 / aacosta@bdo.com

NICK BOEGEL, Tax Senior Director  
414-615-6773 / nboegel@bdo.com

JOE CARR, Principal  
312-616-3946 / jcarr@bdo.com

MARIANO SORI, Tax Partner  
312-616-4654 / msori@bdo.com

RICHARD SPENGLER, Tax Senior Director  
616-776-3687 / rspengler@bdo.com

#### SOUTHWEST:

GENE HEATLY, Tax Senior Director  
214-665-0716 / gheatly@bdo.com

TOM SMITH, Tax Partner  
918-281-4080 / tasmith@bdo.com

### **Addback**

Subject to certain exceptions, Indiana income tax law currently requires a corporate taxpayer to increase (i.e., “addback”) the federal income tax base, which is used as the starting point for calculating taxable income for intangible expenses and related *intangible* interest expenses paid to a member of the same affiliated group or a foreign corporation. For taxable years beginning after December 31, 2015, S.B. 441 expands the amount required to be added back to include *all* interest expenses paid to a member of the same affiliated group or a foreign corporation. However, in addition to currently existing exceptions to addback, S.B. 441 also excepts such interest expense from addback if the income recipient: (1) is subject to the financial institutions tax; (2) files a financial institutions tax return; and (3) apportions the interest income.

### **Sales Factor**

For sales factor purposes, Indiana income tax law currently sources receipts from sales of tangible personal property to Indiana if the tangible personal property is shipped from a location in Indiana and the taxpayer is not subject to tax in the state of the purchaser (i.e., “throwback”). For taxable years beginning after December 31, 2015, S.B. 441 eliminates throwback, as well as statutorily treats receipts from the sale of computer software as receipts from sales of tangible personal property.

### **Amnesty**

Effective July 1, 2015, S.B. 1001 requires the Indiana Department of Revenue to establish a maximum eight-week tax amnesty ending before January 1, 2017 for the following taxes, among others, “due and payable” for a taxable period ending prior to January 1, 2013: adjusted gross income tax, sales and use taxes, financial institutions tax, utility receipts and services use taxes, and various excise and fuel taxes (collectively, “listed taxes”). Upon payment of all listed taxes due and payable by a taxpayer under amnesty, the Department must abate interest, penalties, and collection fees and costs. For these purposes a listed tax “due and payable” includes one that the Department has assessed, one for which the Department has issued a demand for payment or a demand notice for payment, one that the taxpayer has reported on a return, and one for which the taxpayer has filed an acceptable written statement of liability.

Taxpayers eligible for amnesty include those that have not participated in a previous amnesty. An eligible taxpayer that does not participate in the amnesty to be established under S.B. 1001 may be subject to a penalty for failure to participate.

## **BDO INSIGHTS**

- ▶ The change in the business income definition to “all income apportionable to the state under the Constitution of the United States” could have the effect of including more income in a taxpayer’s apportionable base because, as a result of S.B. 441, Indiana will no longer look to whether the acquisition, management, *and* disposition of the property constitutes integral parts of the taxpayer’s regular trade or business operations. Instead, Indiana will look to whether the income is unitary with the taxpayer’s business carried on in the state – a more inclusive definition.
- ▶ The elimination of Indiana’s throwback rule will benefit those taxpayers that ship tangible property from a location in the state, but are not subject to tax in one or more states where they have customers, by reducing the amount of sales required to be sourced to Indiana and the corresponding sales only apportionment factor applied to apportionable income.
- ▶ The specification that a sale of computer software constitutes a sale of tangible personal property will likely have little impact as the Department appears to currently take the position that a sale of computer software, regardless of delivery method, constitutes a sale of tangible personal property for income tax purposes. However, specifying this treatment in the statute removes any doubt as to the treatment of such receipts for purposes of sourcing receipts from sales of computer software.
- ▶ The expansion of Indiana’s related party expense addback to include *all* interest income paid to an affiliated group member or a foreign corporation may have the effect of increasing the amount of overall income apportionable to Indiana for taxpayers that have intercompany loan arrangements (or loan arrangements with a foreign corporation) unrelated to an intangible licensing agreement.

- ▶ The amnesty program required to be established under H.B. 1001 will provide eligible Indiana taxpayers with the opportunity to report and/or pay taxes, including those that are presently assessed or otherwise due, without the cost of interest and penalties. The risk of the Department imposing an additional penalty on an eligible taxpayer for not participating in the amnesty adds to the incentive to participate.

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