Indiana – Physical presence required for corporate income tax and insurance premiums tax

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In brief

The Indiana Tax Court held that out-of-state reinsurers must be physically present in Indiana to satisfy the statutory requirement of 'doing business' for insurance premiums tax purposes and that the corporate income tax has the same physical presence requirement. The court also dismissed the taxpayer's Commerce Clause discrimination argument because insurance transactions are not provided Commerce Clause protection under federal law.

For taxpayers lacking a physical presence in Indiana, the rationale in this opinion may help to defend against a *Geoffrey*-type nexus standard for Indiana corporate tax purposes. [United Parcel Service, Inc. v. Indiana Department of State Revenue, Ind. Tax Court, No. 49T10-0704-TA-24 (9/16/13)]

In detail

Facts and procedural history

United Parcel Service, Inc. (UPS) traditionally filed a combined Indiana corporate income tax return with its affiliates. Two of its affiliates are reinsurance companies: UPINSCO and UPS Re (Reinsurance Affiliates). During the 2000 and 2001 tax years, the Reinsurance Affiliates reinsured, or indemnified, independent primary insurers for worker's compensation insurance and liability insurance covering package damages for UPS operations nationwide, including Indiana.

On its 2000 and 2001 Indiana corporate income tax returns, UPS sought to exclude the income of the Reinsurance Affiliates, claiming that they were subject to the Indiana premiums tax and therefore exempt from the corporate income tax and not eligible to be included in a combined return. UPS asserted that the Reinsurance Affiliates were 'doing business' in Indiana (and therefore subject to the premiums tax) for reasons including that they insured Indiana property.

On June 21, 2012, the Indiana Supreme Court ruled that an insurance company must be 'doing business' in Indiana to be subject to the premiums tax. The court determined that Reinsurance Affiliates transactions occurring outside of Indiana, even if they involve insured risks located in Indiana, do not amount to business done in Indiana. As such, Reinsurance Affiliates were not subject to the premiums tax. Click here for our summary of the Indiana Supreme Court's decision.

On remand to the Indiana Tax Court, UPS argued that the Indiana Supreme Court's decision effectively imposed a physical presence standard for the premiums tax that created a 'tension' between the premiums tax and Indiana's corporate

income tax, which utilizes an economic presence standard. UPS also argued that the premiums tax physical presence requirement was discriminatory in violation of the Commerce Clause.

Physical presence required for both corporate income tax and premiums tax

The Tax Court found that there was no 'tension' between the corporate income tax and premiums tax because "each utilizes a physical presence standard." The court dismissed UPS's reliance on the 2008 decision in *MBNA v. Indiana Dep't of State Revenue* for support that the corporate income tax imposed an economic nexus requirement. The court stated that *MBNA* was limited to recognizing economic presence for Indiana's Financial Institutions Tax and that the decision did not address the corporate income tax.

The court found that the insurance premiums tax requires a physical presence for three main reasons: (1) the US Supreme Court has explained that a physical presence standard applies for purposes of a premiums tax, (2) Indiana and other states have routinely declined to impose a premiums tax when foreign insurers/reinsurers lacked a physical presence in the state, and (3) the parties failed to develop an argument for adopting an economic presence standard.

The court also found that obtaining a certificate of authority is not enough to establish a physical presence.

Physical presence requirement does not discriminate against out-of-state reinsurance companies

UPS also asserted that the premiums tax physical presence requirement was discriminatory under the US Commerce Clause because out-of-state reinsurance companies subject to the corporate income tax would have a higher tax liability than reinsurance companies doing business in Indiana and subject to the premiums tax.

The court found that a Commerce Clause analysis was not applicable because insurance transactions are protected from Commerce Clause challenges under federal law. The 1945 McCarran-Ferguson Act provides, in part, that "silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States." Accordingly, the tax court ruled that the premiums tax, which concerns the regulation and taxation of insurance, is immune from Commerce Clause challenges.

The takeaway

Business groups that include an insurance company should review their operations and filings in Indiana to determine if their current filing positions are aligned with the *UPS* cases. This is especially of concern for groups that have elected to file on a combined basis in Indiana.

Further, the principles in these cases may be applied in other states with similar nexus standards.

The court held that the *MBNA* decision has no bearing on the nexus standard for the Indiana corporate income tax. The rationale in this opinion may help to defend against a *Geoffrey*-type nexus standard for Indiana corporate tax purposes.

Let's talk

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