This Week in State Tax (TWIST)

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Indiana: DoR Issues Ruling on Toll Manufacturing, Treaty Protection, and Apportionment Factors

The Indiana Department of State Revenue (Department) recently addressed the corporate tax treatment of finished goods sold as part of a toll manufacturing process. The taxpayer, a foreign corporation, was a partner in U.S. partnership which operated a manufacturing facility in Indiana. The taxpayer entered into a toll manufacturing arrangement with the partnership (Toll Manufacturer) under which the Toll Manufacturer manufactured goods in the U.S. using raw materials and work-in-process inventory that remained owned by the taxpayer for the duration of the manufacturing process. Once complete, the taxpayer sold the finished goods to the Toll Manufacturer, which then resold the goods to customers. The taxpayer was generally protected from U.S. income tax under a tax treaty.

For corporate adjusted gross income tax purposes, Indiana uses federal taxable income as its starting point. The Department found that because the taxpayer was treaty protected, and the profit/loss from the finished goods sales were not included on the taxpayer's federal taxable income, the profit/loss from the finished good sales would also be excluded for purposes of Indiana adjusted gross income. However, taxpayer was not treaty protected on its income that flowed-up from the Toll Manufacturer. As a result, the income it received from its ownership interest in the Toll Manufacturer was required to be included in federal taxable income, and consequently in Indiana corporate adjusted gross income. The Department further ruled that the Indiana apportionment percentage must be based entirely on the partnership's receipts; the taxpayer's treaty-protected income was not included in the calculation. Please contact Marc Caito with questions about Revenue Ruling 2024-02CCP.