DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0361 AGI

ADJUSTED GROSS INCOME TAX
FOR TAX PERIODS: 1997

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ISSUES

Adjusted Gross Income Tax: Tax Add-back

Authority: IC 6-3-2-1, 26 U.S.C.A. Sec. 465.

Taxpayer protests the increase in the 1997 Indiana Tax Add-back.

Statement of Facts

Taxpayers have been full-time residents of Tennessee continuously since January, 1995. Taxpayers own stock in four S corporations which are domiciled and conduct business in Indiana. Taxpayers filed nonresident Indiana individual income tax returns for the years 1995, 1996 and 1997, reporting Taxpayer's share of income and loss allocable from each of these S Corporations. The Indiana Department of Revenue conducted an examination of the tax returns filed by one of the S corporations for the years 1995, 1996 and 1997. In the course of that examination, the Auditor reviewed and proposed an adjustment to the individual tax returns filed by Taxpayers. Taxpayers protested this proposed adjustment.

Adjusted Gross Income Tax: Tax Add-back

Discussion

26 U.S.C.A. Sec. 465 limits the deductibility of losses allocable to a shareholder of an S corporation to the amount that the shareholder is at risk with respect to his investment in that S corporation. Generally, the shareholder's at risk amount is equal to the shareholder's adjusted cost basis in the S corporation stock. As of January 1, 1997, Taxpayers had zero adjusted cost basis in the S corporation stock which was audited by the Indiana Department of Revenue. Taxpayers submitted an Internal Revenue Service 1997 "At-Risk Limitations" form which shows that the S corporation had a loss of $352,032 in 1997. The form also indicates that Taxpayers had no income at risk in the corporation and did not have a deductible loss. The amount of the add back is properly suspended together with the allocable losses from the corporation and carried forward. It would be added back if and when the Taxpayer is allowed, under Code section 465, to deduct those suspended losses in computing federal adjusted gross income. If the Taxpayer is allowed to deduct a portion of the suspended losses in a future year, the Taxpayer must add back in that year a pro-rata amount of the suspended add back.

Finding

Taxpayer's protest is sustained.

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