

Letter of Findings Number: 04-0418
Nonresident Withholding Tax
For Tax Periods: 2001-2002

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ISSUES

I. Nonresident Withholding Tax—Addback of Income Taxes

Authority: IC § 6-3-1-3.5; *Aztar Indiana Gaming Corp. v. Indiana Dept. of State Revenue*, 806 N.E.2d 381 (Ind. Tax Ct. 2004).

Taxpayer protests the addback of riverboat wagering taxes in determining the adjusted gross income of shareholders for withholding tax purposes.

II. Nonresident Withholding Tax—Computation

Authority: IC § 6-3-4-13.

Taxpayer argues that any losses incurred by it prior to adjustments be used to offset the adjustments for determining its ultimate withholding tax liability.

III. Tax Administration—Penalty

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an S corporation that operated a casino in Indiana. Taxpayer is owned by a nonresident individual. During the years in question, Taxpayer computed its nonresident shareholder withholding tax liability without adding back riverboat wagering taxes in computing the amount of income subject to withholding. The Department assessed withholding tax liability based on the share of riverboat wagering tax paid by Taxpayer. Taxpayer protested the addback of riverboat wagering taxes, the computation of its liability, and the negligence penalty.

I. Nonresident Withholding Tax—Addback of income taxes

DISCUSSION

With respect to the validity of the assessment, the Indiana Tax Court has determined that the riverboat wagering tax is a tax "based on or measured by income and levied at the state level by any state of the United States." *Aztar Indiana Gaming Corp. v. Indiana Dept. of State Revenue*, 806 N.E.2d 381, 386 (Ind. Tax Ct. 2004). Accordingly, with respect to individuals, the tax must be added back per IC § 6-3-1-3.5(a)(2) in order to determine the individual's adjusted gross income—the basis for withholding tax liability.

FINDING

Taxpayer's protest is denied.

II. Nonresident Withholding Tax—Computation

DISCUSSION

Taxpayer has also protested the amount of the assessment. Taxpayer's argument is that the losses at the withholding entity level (in this case, the S corporation) must be considered in determining its withholding liability. In other words, the net income of Taxpayer is the basis for determining any withholding tax liabilities, not just the taxes added back. An example of Taxpayer's argument—though presented by Taxpayer in a narrative form rather than a numerical form—is as follows: if a taxpayer incurred a \$10,000,000 loss, but had \$4,000,000 of taxes added back, then its liability would be based on a \$6,000,000 loss rather than \$4,000,000. If a taxpayer incurred a \$10,000,000 loss but had \$19,000,000 of taxes added back, its liability would be based on \$9,000,000 rather than \$19,000,000.

IC § 6-3-4-13(a) states in relevant part that "[e]very corporation which is exempt from tax under [IC 6-3](#) pursuant to [IC 6-3-2-2.8](#)(2) shall, at the time that it pays or credits amounts to any of its nonresident shareholders as dividends or as their share of the corporation's undistributed taxable income, withhold the amount prescribed by the department."

Here, the net income (including the addback for riverboat wagering taxes and its income or loss before the addback of riverboat wagering taxes) for withholding tax purposes is its "dividends or undistributed taxable income" within the meaning of IC § 6-3-4-13. Accordingly, the corporation's liability for withholding is limited to its net income rather than the total amount of taxes added back if the corporation had a loss prior to the taxes added back, as illustrated in the example provided above.

However, if the corporation had a profit or zero income prior to the addback, then the full amount of taxes added back are subject to withholding obligations. For instance, if a taxpayer had an income of \$5,000,000 prior to addback and added back \$10,000,000 of taxes, then the assessment on the \$10,000,000 of tax added back is

proper because the difference in tax is between \$15,000,000 of income and the \$5,000,000 previously reported.

FINDING

Taxpayer's protest is sustained subject to audit review of the amount of net income.

III. Tax Administration—Penalty

DISCUSSION

Taxpayer also protests the imposition of the penalty for negligence for the years in question. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, [45 IAC 15-11-2](#), further provides:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

With respect to the penalty, Taxpayer has presented sufficient legal and factual reasons that it acted with reasonable care expected of taxpayers generally, and thus the penalty should be waived.

FINDING

Taxpayer's protest is sustained.

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