

**Letter of Findings Number: 06-0143  
Individual Income Tax  
For Tax Period 2003**

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**ISSUES**

**I. Individual Income Tax—Addback of Taxes**

**Authority:** IC § 4-33-2-2; IC § 4-33-13-1; IC § 6-3-1-3.5; IC § 6-8.1-5-1; *Azta Indiana Gaming Corp. v. Indiana Dept. of State Revenue*, 806 N.E.2d 381 (Ind. Tax Ct. 2004); Colo. Rev. Stat. § 12-47.1-103 (2006); Colo. Rev. Stat. § 12-47.1-601; Miss. Code Ann. § 75-76-5 (2006); Miss. Code Ann. § 75-76-177; Miss. Code Ann. § 75-76-183; Miss. Code Ann. § 75-76-191; Miss. Code Ann. § 75-76-195; Nev. Rev. Stat. Ann. § 463.0161 (Matthew Bender 2006); Nev. Rev. Stat. Ann. § 463.370; Nev. Rev. Stat. Ann. § 463.380, Nev. Rev. Stat. Ann. § 463.383, and Nev. Rev. Stat. Ann. § 463.385.

Taxpayer protests the addition of four states' gaming taxes as taxes based on or measured by income.

**II. Tax Administration—Penalty**

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

Taxpayer protests the imposition of the ten percent penalty for negligence.

**STATEMENT OF FACTS**

Taxpayer is a married couple. Taxpayer owns all the shares of an S corporation ("S Corp"). S Corp further owns limited liability companies (separately and collectively "LLC") that conduct gaming in four states.

Because S Corp operated in several states, it apportioned its net income to the various states in which it derived income. In determining its net income, S Corp did not add back gaming taxes from the jurisdictions in which it derived its income. Taxpayer filed an Indiana income tax return, including income derived from S Corp without any addition of gaming taxes.

Later, Taxpayer filed an amended income tax return. On the amended return, Taxpayer added Indiana riverboat wagering taxes to Taxpayer's share of income from S Corp. However, Taxpayer added no gaming taxes from other jurisdictions.

The Department conducted an audit of Taxpayer's returns for the year at issue. As a result of the audit, the Department determined that gaming taxes from all jurisdictions should be added back to Taxpayer's income received from S Corp. The Department assessed Taxpayer additional tax, penalty, and interest, which Taxpayer protested. Taxpayer separately protested the initial inclusion of a capital gain, which Taxpayer now asserts should not have been included as income on the return. Without further discussion, Taxpayer is sustained on this issue.

The Department conducted a hearing on the protest. Additional facts will be supplied as necessary.

**I. Individual Income Tax—Addback of income taxes**

Taxpayer's second point of contention is the adding back of gaming taxes from four jurisdictions in which S Corp derived income from gaming operations. The addition of income taxes from these jurisdictions—Indiana, Colorado, Mississippi, and Nevada—will be discussed in turn.

**A. INDIANA**

First, Taxpayer protests the addition of Indiana riverboat wagering taxes as a tax "based on or measured by income." IC § 6-3-1-3.5(a) states that adjusted gross income for individuals is federal adjusted gross income with certain modifications. IC § 6-3-1-3.5(a)(2) provides that adjusted gross income is modified to:

Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 62 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States.

IC § 4-33-13-1(b) provided for a twenty percent tax on a riverboat's adjusted gross receipts. IC § 4-33-2-2 defines "adjusted gross receipts" as:

(1) the total of all cash and property (including checks received by a licensee) whether collected or not, received by a licensee from gaming operations; minus

(2) the total of:

(A) all cash paid out as winnings to patrons; and

(B) uncollectible gaming receivables, not to exceed the lesser of:

(i) a reasonable provision for uncollectible patron checks received from gaming operations; or

(ii) two percent [] of the total of all sums, including checks, whether collected or not, less the amount paid out as winnings to patrons.

For purposes of this section, a counter or personal check that is invalid or unenforceable under this article is considered cash received by the licensee or operating agent from gaming operations.

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." *Azta 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.

#### **B. COLORADO**

Second, Taxpayer also protests the addition of Colorado gaming taxes to the S Corp's income. Under Colo. Rev. Stat. § 12-47.1-601 (2006):

(1) There is hereby imposed a gaming tax on the adjusted gross proceeds of gaming allowed by this article. The tax shall be set by rule promulgated by the commission. In no event shall the tax exceed forty percent of the adjusted gross proceeds. In setting the tax rate the commission shall consider the need to provide moneys to the cities of Central, Black Hawk, and Cripple Creek for historic restoration and preservation; the impact on the communities and any state agency including, but not limited to, infrastructure, law enforcement, environment, public health and safety, education requirements, human services, and other components due to limited gaming; the impact on licensees and the profitability of their operations; the profitability of the other "for profit" forms of gambling in this state; the profitability or similar forms of gambling in other states; and the expenses of the commission and the division for their administration and operation. The commission shall also consider the following....

The term "adjusted gross proceeds" is defined by Colo. Rev. Stat. § 12-47.1-103 as follows

"Adjusted gross proceeds", except with respect to games of poker, means the total amount of all wagers made by players on limited gaming less all payments to players; and payment to players shall include all payments of cash premiums, merchandise, tokens, redeemable game credits, or any other thing of value.

With respect to games of poker, "adjusted gross proceeds" means any sums wagered in a poker hand which may be retained by the licensee as compensation which must be consistent with the minimum and maximum amounts established by the Colorado limited gaming control commission.

The definition of "adjusted gross proceeds" under Colorado law—the basis for Colorado's gaming tax—is similar to the Indiana definition of "adjusted gross receipts" upon which Indiana riverboat wagering tax is based. Each tax is based on wagers less winnings and other minor adjustments. As noted previously, the Indiana Tax Court held that the Indiana riverboat wagering tax was a tax "based on or measured by income and levied at the state level by any state of the United States." Because Colorado's gaming tax are similar to Indiana's riverboat wagering tax in that both taxes are imposed on proceeds from gaming less winnings and other minor modifications, the Colorado gaming tax is a tax based on or measured by income, and therefore should be added back to S Corp's income in order to determine Taxpayer's adjusted gross income.

#### **C. MISSISSIPPI**

Third, Taxpayer asserts that Mississippi's gaming taxes are not taxes "based on or measured by income." In particular, Taxpayer argues that Mississippi's taxes are hybrid taxes, imposed on both the revenues of gaming establishments and on the number of games that the gaming establishment operates.

Taxpayer is correct in noting that Mississippi imposes both types of taxes or fees on gaming operators. One of the tax provisions, imposed under Miss. Code Ann. § 75-76-177 (2006), states in relevant part:

(1) From and after August 1, 1990, there is hereby imposed and levied on each gaming licensee a license fee based upon all the gross revenue of the licensee as follows:

(a) Four percent [] of all the gross revenue of the licensee which does not exceed Fifty Thousand Dollars (\$ 50,000.00) per calendar month;

(b) Six percent [] of all the gross revenue of the licensee which exceeds Fifty Thousand Dollars (\$ 50,000.00) per calendar month and does not exceed One Hundred Thirty-four Thousand Dollars (\$ 134,000.00) per calendar month; and

(c) Eight percent [] of all the gross revenue of the licensee which exceeds One Hundred Thirty-four Thousand Dollars (\$ 134,000.00) per calendar month.

Certain local jurisdictions impose parallel local taxes on a gaming operator's gross revenues under Miss. Code Ann. § 75-76-195 and other non-codified statutory provisions.

Miss.Code Ann. § 75-76-5 defines "gross revenue" as:

"Gross revenue" means the total of all of the following, less the total of all cash paid out as losses to patrons and those amounts paid to purchase annuities to fund losses paid to patrons over several years by independent financial institutions:

(i) Cash received as winnings;

(ii) Cash received in payment for credit extended by a licensee to a patron for purposes of gaming; and

(iii) Compensation received for conducting any game in which the licensee is not party to a wager.

For the purposes of this definition, cash or the value of noncash prizes awarded to patrons in a contest or tournament are not losses.

In addition to taxes imposed on gross revenues, gaming operators are subject to license fees. One of these fees, a \$5,000 license fee, is due annually from gaming operators under Miss. Code Ann. § 75-76-183. A second fee is a per table fee imposed on gaming operators. That provision, Miss. Code. Ann. § 75-76-191, states in

relevant part:

Additional license fee imposed on applicants for state gaming license based on number of games operated  
 (1) In addition to any other state gaming license fees provided for in this chapter, from and after August 1, 1990, there is hereby imposed and levied on each applicant for a state gaming license a license fee to be determined on the basis of the following annual rates:

(a) From establishments operating or to operate ten (10) games or less: Those establishments operating or to operate one (1) game, the sum of Fifty Dollars (\$ 50.00).

[other rates for additional games omitted]

Additional local fees that parallel these license fees are also imposed on gaming operators.

With respect to the taxes imposed under Miss. Code Ann. §§ 75-76-177, -195, and the various local provisions that use gross revenues as a tax base, the taxes are imposed on gaming revenues and are similar to Indiana's riverboat wagering tax. Both taxes are determined by gaming revenues less customer winnings, with some minor modifications. Under the Tax Court's holding in *Aztar Indiana*, the Mississippi gaming taxes imposed under Miss. Rev. Stat. §§ 75-76-177, -195, and local provisions based on gaming revenues, are "taxes based on or measured by income and levied at the state level by any state of the United States," and therefore should be added back to S Corp's income.

With respect to license fees imposed pursuant to M.R.S. §§ 75-76-183, -191, along with other local provisions that impose annual fees on tables and/or operation of a gaming location, these taxes are based on the mere operation of a table and/or riverboat, regardless of how much revenue or net income each table or riverboat earns. Because these license fees are not determined by gross or net income, the fees are not taxes based on or measured by income, and thus should not be added back to S Corp's income.

Though Taxpayer made an argument regarding whether Mississippi gaming taxes are taxes "based on or measured by income," Taxpayer has not provided evidence to document how much S Corp paid under each of the possible taxes or fees imposed by Mississippi or its various local jurisdictions. Thus, Taxpayer has not met its burden of demonstrating that the assessment was incorrect under IC § 6-8.1-5-1 and therefore is denied with respect to their protest of Mississippi gaming taxes.

#### **D. NEVADA**

Fourth, Taxpayer protests the addition of Nevada gaming taxes to the income earned by S Corp. Taxpayer argues that Nevada gaming taxes are hybrid taxes imposed on both the revenues earned by gaming operators and on the number of games or machines that the gaming operator has available for customers.

The first tax imposed under Nevada law is a monthly percentage fee. Under Nev. Rev. Stat. Ann. § 463.370 (Matthew Bender 2006),

1. Except as otherwise provided in NRS 463.373, the Commission shall charge and collect from each licensee a license fee based upon all the gross revenue of the licensee as follows:

- (a) Three and one-half percent of all the gross revenue of the licensee which does not exceed \$50,000 per calendar month;
- (b) Four and one-half percent of all the gross revenue of the licensee which exceeds \$50,000 per calendar month and does not exceed \$134,000 per calendar month; and
- (c) Six and three-quarters percent of all the gross revenue of the licensee which exceeds \$134,000 per calendar month.

Nev. Rev. Stat. Ann. § 463.0161 defines gross revenues as:

1. "Gross revenue" means the total of all:

- (a) Cash received as winnings;
- (b) Cash received in payment for credit extended by a licensee to a patron for purposes of gaming; and
- (c) Compensation received for conducting any game in which the licensee is not party to a wager,

less the total of all cash paid out as losses to patrons, those amounts paid to fund periodic payments and any other items made deductible as losses by NRS 463.3715. For the purposes of this section, cash or the value of noncash prizes awarded to patrons in a contest or tournament are not losses, except that losses in a contest or tournament conducted in conjunction with an inter-casino linked system may be deducted to the extent of the compensation received for the right to participate in that contest or tournament.

2. The term does not include:

- (a) Counterfeit facsimiles of money, chips, tokens, wagering instruments or wagering credits;
- (b) Coins of other countries which are received in gaming devices;
- (c) Any portion of the face value of any chip, token or other representative of value won by a licensee from a patron for which the licensee can demonstrate that it or its affiliate has not received cash;
- (d) Cash taken in fraudulent acts perpetrated against a licensee for which the licensee is not reimbursed;
- (e) Cash received as entry fees for contests or tournaments in which patrons compete for prizes, except for a contest or tournament conducted in conjunction with an inter-casino linked system;
- (f) Uncollected baccarat commissions; or
- (g) Cash provided by the licensee to a patron and subsequently won by the licensee, for which the licensee can demonstrate that it or its affiliate has not been reimbursed.

...

Nev. Rev. Stat. Ann. §§ 463.380, 463.383, and 463.385 provide for per table and per slot machine fees.

With respect to the tax imposed under Nev. Rev. Stat. Ann. § 463.370, the tax is imposed on gaming revenues and is similar to Indiana's riverboat wagering tax. Both taxes are determined by gaming revenues, with some minor modifications. Under the Tax Court's holding in *Aztar Indiana*, the Nevada gaming tax imposed under Nev. Rev. Stat. Ann. § 463.370 is a tax "based on or measured by income and levied at the state level by any state of the United States," and therefore should be added back to S Corp's income.

With respect to fees imposed pursuant to Nev. Rev. Stat. Ann. §§ 463.380, 463.383, and 463.385, these fees are based on the operation of a table or slot machine, regardless of how much revenue or net income each table or slot machine earns. Because these fees are not determined by gross or net income, the fees are not taxes based on or measured by income, and thus should not be added back to S Corp's income.

Though Taxpayer made an argument regarding whether Nevada gaming taxes are taxes "based on or measured by income," Taxpayer has not provided evidence to document how much S Corp paid under each of the possible taxes or fees imposed by Nevada. Thus, Taxpayer has not met its burden of demonstrating that the assessment was incorrect under IC § 6-8.1-5-1 and therefore is denied with respect to their protest of Nevada gaming taxes.

### FINDING

Taxpayer's protest is denied

## II. 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 information that they 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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