

**Letter of Findings: 08-0210P**  
**Withholding Tax**  
**For the Tax Year 2004**

**NOTICE:** Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUE**

**I. Withholding Tax - Twenty-Percent Penalty.**

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; 2004 IT-20S Indiana S-Corporation Income Tax Booklet.

Taxpayer seeks abatement of the twenty-percent penalty for failure to file Form WH-1 and remit withholding tax on non-resident shareholders.

**STATEMENT OF FACTS**

Taxpayer is an S-Corporation. Taxpayer failed to file Form WH-1s for the year ending December 31, 2004. The Indiana Department of Revenue ("Department") assessed a twenty-percent penalty for each year pursuant to IC § 6-8.1-10-2.1(h). Taxpayer protests the imposition of penalty. Further facts will be supplied as required.

**I. Withholding Tax - Twenty-Percent Penalty.**

**DISCUSSION**

Taxpayer believes that it is entitled to abatement of the twenty-percent penalty for failure to file Form WH-1. Taxpayer protests that the non-resident shareholder is a resident of California, which is a reverse-credit state. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The Department imposed the twenty percent penalty pursuant to IC § 6-8.1-10-2.1, which states:

(a) If a person:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department;

the person is subject to a penalty.

(b) Except as provided in subsection (g), the penalty described in subsection (a) is ten percent (10 [percent]) of:

- (1) the full amount of the tax due if the person failed to file the return;
- (2) the amount of the tax not paid, if the person filed the return but failed to pay the full amount of the tax shown on the return;
- (3) the amount of the tax held in trust that is not timely remitted;
- (4) the amount of deficiency as finally determined by the department; or
- (5) the amount of tax due if a person failed to make payment by electronic funds transfer, overnight courier, or personal delivery by the due date.

(c) For purposes of this section, the filing of a substantially blank or unsigned return does not constitute a return.

(d) If a person subject to the penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

(e) A person who wishes to avoid the penalty imposed under this section must make an affirmative showing of all facts alleged as a reasonable cause for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust, in a written statement containing a declaration that the statement is made under penalty of perjury. The statement must be filed with the return or payment within the time prescribed for protesting departmental assessments. A taxpayer may also avoid the penalty imposed under this section by obtaining a ruling from the department before the end of a particular tax period on the amount of tax due for that tax period.

(f) The department shall adopt rules under [IC 4-22-2](#) to prescribe the circumstances that constitute reasonable cause and negligence for purposes of this section.

(g) A person who fails to file a return for a listed tax that shows no tax liability for a taxable year, other than an

information return (as defined in section 6 of this chapter), on or before the due date of the return shall pay a penalty of ten dollars (\$10) for each day that the return is past due, up to a maximum of two hundred fifty dollars (\$250).

**(h) A corporation which otherwise qualifies under [IC 6-3-2-2.8\(2\)](#) but fails to withhold and pay any amount of tax required to be withheld under [IC 6-3-4-13](#) shall pay a penalty equal to twenty percent (20 [percent]) of the amount of tax required to be withheld under [IC 6-3-4-13](#). This penalty shall be in addition to any penalty imposed by section 6 of this chapter.**

(i) Subsections (a) through (c) do not apply to a motor carrier fuel tax return. **(Emphasis added).**

Of relevance is the provision found on Page 3 of the IT-20S Indiana S-Corporation Income Tax Booklet for 2004, which states:

Individual Shareholders - An S corporation must withhold state income tax at the rate of 3.4% on the amount it pays or credits any of its nonresident and part-year nonresident individual shareholders as dividends or as their share of the corporation's undistributed taxable income (on current-year earnings) derived from Indiana sources. **This does not apply to residents of reverse credit states (Arizona, California - see note, Oregon, District of Columbia) who are subject to and pay income taxes at rates of 3.4% or higher to their resident state.**

**(Emphasis added.)**

**Note: Indiana state withholding is required whenever a California resident shareholder is included in an Indiana composite adjusted gross income tax return.**

**(Emphasis in original.)**

In this case, the non-resident shareholder is a resident of California, which is a reverse credit state. Taxpayer provided a copy of the non-resident shareholder's 2004 Indiana IT-40 PNR individual tax return. This is not a composite adjusted gross income tax return as referred to in the note on page three of the IT-20S Corporation Income Tax Booklet. Taxpayer provided a copy of the non-resident shareholder's 2004 California state income tax return. In such circumstances, Taxpayer was not required to withhold state income tax on that shareholder, as explained by the filing instructions in the 2004 IT-20S Indiana S-Corporation Income Tax Booklet. Taxpayer has met its burden under IC § 6-8.1-5-1(c).

#### **FINDING**

Taxpayer's protest is sustained.

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