

Letter of Findings Number: 08-0248P
Withholding Tax
For Tax Year 2004

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ISSUES

I. Withholding Tax—Imposition.

Authority: IC § 6-3-4-8; IC § 6-8.1-5-1.

Taxpayer protests the imposition of withholding tax.

II. Tax Administration—Negligence Penalty.

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

Taxpayer protests the imposition of a ten percent negligence penalty.

III. Tax Administration—Withholding Penalty.

Authority: IC § 2-5-3-1; IC § 6-3-2-2.8; IC § 6-3-4-13; IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

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 Indiana S Corporation with non-resident shareholders. The non-resident shareholders are a married couple. As the result of an investigation, the Indiana Department of Revenue ("Department") determined that Taxpayer had failed to withhold income tax on distributions to the non-resident shareholders. The Department issued proposed assessments for the base tax, interest, a ten percent negligence penalty, and a twenty percent failure to withhold penalty. Taxpayer protests these proposed assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Income Tax—Imposition.

DISCUSSION

Withholding tax is imposed by IC § 6-3-4-8. Taxpayer protests the imposition of withholding tax and interest on amounts distributed to its non-resident shareholders in 2004. Taxpayer states that the non-resident shareholders accounted for these amounts on the 2004 individual non-resident income tax return. The Department reviewed the 2004 non-resident return and determined that the non-resident shareholders did not remit any tax to Indiana and therefore did not account for the amounts distributed from Taxpayer to the non-resident shareholders.

Taxpayer states that the non-resident shareholders had at-risk losses which were applied to the 2004 non-resident returns. Those losses off set any income and the amount owed to Indiana by the non-resident shareholders was zero. 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).

Taxpayer provided documentation establishing that the non-residents did have losses which were applicable to the non-resident's 2004 income tax return. Accordingly, those losses did off set the Indiana income which was distributed by Taxpayer to the non-residents. The non-residents did not owe income tax to Indiana, due to the losses in question.

The Department notes that Taxpayer was required to withhold on distributions to its non-resident shareholders. Taxpayer did not withhold on those distributions. While Taxpayer has established that the Department ultimately received the correct amount of income tax from the non-resident shareholders, this was not the correct procedure. Taxpayer was required to withhold and did not do so. Taxpayer should have withheld and the non-resident shareholders should have applied its losses and requested a refund of withholding taxes on their non-resident individual income tax return.

In conclusion, Taxpayer should have withheld on its distributions to the non-resident shareholders. Taxpayer has established that the Department did ultimately receive the correct amount of tax. Taxpayer has satisfied the requirements of IC § 6-8.1-5-1(c). There is no withholding tax due for 2004. Since there is no base tax due, there is also no interest due on the base tax.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration—Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of a ten percent negligence penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

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.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

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.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). While it followed the incorrect method, Taxpayer provided sufficient explanation and documentation to establish that the method it did follow was reasonable. Taxpayer has affirmatively established that the failure was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is sustained.

III. Tax Administration—Withholding Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the twenty-percent penalty for failure to file Form WH-1 and remit withholding tax on its non-resident shareholders.

Taxpayer protests that its shareholders accounted for the taxes on their individual return. Taxpayer has provided documentation and explanation to establish that Indiana ultimately received the proper amount of tax on the distributions. Taxpayer believes that, since the Department ultimately received the correct amount of tax, there should be no penalty imposed.

Pursuant to IC § 6-3-2-2.8:

Notwithstanding any provision of [IC 6-3-1](#) through [IC 6-3-7](#), there shall be no tax on the adjusted gross income of the following:

(1) Any organization described in Section 501(a) of the Internal Revenue Code, except that any income of such organization which is subject to income tax under the Internal Revenue Code shall be subject to the tax under [IC 6-3-1](#) through [IC 6-3-7](#).

(2) Any corporation which is exempt from income tax under Section 1363 of the Internal Revenue Code and which complies with the requirements of [IC 6-3-4-13](#). However, income of a corporation described under this subdivision that is subject to income tax under the Internal Revenue Code is subject to the tax under [IC 6-3-1](#) through [IC 6-3-7](#). A corporation will not lose its exemption under this section because it fails to comply with [IC 6-3-4-13](#) but it will be subject to the penalties provided by [IC 6-8.1-10](#).

(3) Banks and trust companies, national banking associations, savings banks, building and loan associations, and savings and loan associations.

(4) Insurance companies subject to tax under [IC 27-1-18-2](#), including a domestic insurance company that elects to be taxed under [IC 27-1-18-2](#).

(5) International banking facilities (as defined in Regulation D of the Board of Governors of the Federal Reserve System (12 CFR 204)).

(Emphasis added).

According to IC § 6-3-4-13:

(a) Every 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. Such corporation so paying or crediting any nonresident shareholder:

(1) shall be liable to the state of Indiana for the payment of the tax required to be withheld under this section and shall not be liable to such shareholder for the amount withheld and paid over in compliance or intended compliance with this section; and

(2) when the aggregate amount due under [IC 6-3](#) and [IC 6-3.5](#) exceeds one hundred fifty dollars (\$150) per

quarter, then such corporation shall make return and payment to the department quarterly, on such dates and in such manner as the department shall prescribe, of the amount of tax which, under [IC 6-3](#) and [IC 6-3.5](#), it is required to withhold.

(b) Every corporation shall, at the time of each payment made by it to the department pursuant to this section, deliver to the department a return upon such form as shall be prescribed by the department showing the total amounts paid or credited to its nonresident shareholders, the amount withheld in accordance with the provisions of this section, and such other information as the department may require. Every corporation withholding as provided in this section shall furnish to its nonresident shareholders annually, but not later than the fifteenth day of the third month after the end of its taxable year, a record of the amount of tax withheld on behalf of such shareholders on forms to be prescribed by the department.

(c) All money withheld by a corporation, pursuant to this section, shall immediately upon being withheld be the money of the state of Indiana and every corporation which withholds any amount of money under the provisions of this section shall hold the same in trust for the state of Indiana and for payment thereof to the department in the manner and at the times provided in [IC 6-3](#). Any corporation may be required to post a surety bond in such sum as the department shall determine to be appropriate to protect the state of Indiana with respect to money withheld pursuant to this section.

(d) The provisions of [IC 6-8.1](#) relating to additions to tax in case of delinquency and penalties shall apply to corporations subject to the provisions of this section, and for these purposes any amount withheld, or required to be withheld and remitted to the department under this section, shall be considered to be the tax of the corporation, and with respect to such amount it shall be considered the taxpayer.

(e) Amounts withheld from payments or credits to a nonresident shareholder during any taxable year of the corporation in accordance with the provisions of this section shall be considered to be a part payment of the tax imposed on such nonresident shareholder for his taxable year within or with which the corporation's taxable year ends. A return made by the corporation under subsection (b) shall be accepted by the department as evidence in favor of the nonresident shareholder of the amount so withheld from the shareholder's distributive share.

(f) This section shall in no way relieve any nonresident shareholder from the shareholder's obligation of filing a return or returns at the time required under [IC 6-3](#) or [IC 6-3.5](#), and any unpaid tax shall be paid at the time prescribed by section 5 of this chapter.

(g) Instead of the reporting periods required under subsection (a), the department may permit a corporation to file one (1) return and payment each year if the corporation pays or credits amounts to its nonresident shareholders only one (1) time each year. The withholding return and payment are due on or before the fifteenth day of the third month after the end of the taxable year of the corporation.

(h) If a distribution will be made with property other than money or a gain is realized without the payment of money, the corporation shall not release the property or credit the gain until it has funds sufficient to enable it to pay the tax required to be withheld under this section. If necessary, the corporation shall obtain such funds from the shareholders.

(i) If a corporation fails to withhold and pay any amount of tax required to be withheld under this section and thereafter the tax is paid by the shareholders, such amount of tax as paid by the shareholders shall not be collected from the corporation but it shall not be relieved from liability for interest or penalty otherwise due in respect to such failure to withhold under [IC 6-8.1-10](#).

(j) A corporation described in subsection (a) may file a composite adjusted gross income tax return on behalf of some or all nonresident shareholders if it complies with the requirements prescribed by the department for filing a composite return.

(Emphasis added).

IC § 6-8.1-10-2.1 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).**

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment – including the negligence penalty – is presumptively valid.

Departmental regulation [45 IAC 15-11-2\(b\)](#) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id.*

IC § 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation [45 IAC 15-11-2\(c\)](#) requires that 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...."

Pursuant to IC § 2-5-3-1:

It is hereby declared to be the policy of the general assembly of the state of Indiana to promote a revenue raising structure in Indiana that will provide adequate revenues to carry on the efficient operation of the state, county, and city governments and at the same time will assure that its burdens will be shared equitably by all taxpayers. It is further declared to be the policy of the general assembly of the state of Indiana to encourage and bring about the accomplishment of enforcement policies and administrative practices that will result in maximum return from existing taxes to the state of Indiana at a minimum cost to the taxpayers.

In imposing the twenty-percent penalty for failure to file Form WH-1 and remit withholding tax on non-resident shareholders the Department is enforcing a provision of the Indiana Code in order to ensure the continued compliance with Indiana law. The requirement of filing a Form WH-1 and the withholding on Taxpayer's non-resident shareholders is the state's way of ensuring that the Department is provided with information it needs to carry out its objectives in the most efficient manner. While Taxpayer has been sustained on Issue I and Issue II above, it remains that Taxpayer should have withheld on its distributions to its non-resident shareholders. If Taxpayer had properly withheld and the non-resident shareholders had properly requested refund on their individual return, this entire protest and hearing process would not have been necessary. As provided by IC § 6-8.1-10-2.1(d), the twenty percent penalty remains appropriate.

Taxpayer has not met its burden under IC § 6-8.1-5-1(c) and [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer is sustained on Issue I and Issue II. The base tax and the ten percent negligence penalty will be

waived. Taxpayer is denied on Issue III. The twenty percent penalty for failure to withhold remains as issued.

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