

Supplemental Letter of Findings Number: 08-0431P
Withholding Tax
For Tax Years 2005-06

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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.

STATEMENT OF FACTS

Taxpayer is an out-of-state S Corporation with non-resident shareholders and operations in Indiana. The S Corporation does business in Indiana. As the result of an investigation, the Indiana Department of Revenue ("Department") determined that Taxpayer had failed to withhold an adequate amount of income tax on distributions to the non-resident shareholders for the tax years 2005 and 2006. 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 the proposed assessments for base tax, interest, and ten percent negligence penalty. Due to a misunderstanding of what was being protested, the Department issued a Letter of Findings which addressed only the protest of the twenty percent failure to withhold penalty. That protest was denied. Taxpayer requested a rehearing to address the imposition of base tax, interest, the ten percent negligence penalty. The request for rehearing was granted and an administrative hearing was held. This Supplemental Letter of Findings results from that hearing. 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 2005 and 2006. Taxpayer states that the non-resident shareholders accounted for these amounts on their 2005 and 2006 individual non-resident income tax returns. The Department reviewed the 2005 and 2006 non-resident returns and determined that the non-resident shareholders did not remit adequate amounts of tax to Indiana and therefore did not account for the entire amounts distributed from Taxpayer to the non-resident shareholders.

Taxpayer states that one of the non-resident shareholders had at-risk losses which were applied to that shareholder's 2005 and 2006 non-resident returns. Those losses offset all of the shareholder's Indiana income for 2005 and offset some of the amount of Indiana income for 2006. These losses resulted in no tax due for 2005 and less tax due in 2006 than should have been withheld by Taxpayer. 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 2005 and 2006 income tax returns. Accordingly, those losses did offset 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.

Still, the non-resident shareholders did file returns with Indiana and remitted payment to Indiana in 2006. A review of the documentation shows that the non-resident shareholders had Indiana losses which were available for 2005 and 2006. Also, Taxpayer has since corrected its withholding procedures to comply with Indiana's requirements. This correction and the documentation provided which establishes that Indiana ultimately did receive the proper amount of tax meet the requirements of IC § 6-8.1-5-1(c).

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 2005 and 2006. 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.

CONCLUSION

Taxpayer is sustained in Issue I regarding imposition of base tax and interest. Taxpayer is sustained in Issue II regarding imposition of ten percent negligence penalty. The protest of twenty percent failure to withhold penalty remains denied, as determined in the original Letter of Findings.

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