

**Letter of Findings: 08-0584; 08-0585; 08-0587**  
**Individual Income Tax**  
**For the Years 2004, 2005, 2006, and 2007**

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**ISSUES**

**I. Individual Income Tax – Imposition – Non-filer.**

**Authority:** IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayers protest the imposition of Indiana individual income tax liabilities.

**II. Tax Administration – Negligence Penalty.**

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

Taxpayers protest the imposition of the ten percent negligence penalty.

**STATEMENT OF FACTS**

Taxpayers are the two shareholders of an Indiana S corporation selling firearms and accessories. One taxpayer owns sixty-five percent of the total shares, and the other owns thirty-five percent of the total shares. Pursuant to an audit, the Indiana Department of Revenue ("Department") assessed the S corporation additional sales tax based on the best information available at the time of the audit, which resulted in an increase of corporate income, which, in turn, passed through to Taxpayers. During the audit, the Department also discovered that Taxpayers and their spouses had not been filing their federal and Indiana individual income tax returns since 2004. The auditor assessed Taxpayers and their spouses 2004, 2005, 2006, and 2007 joint Indiana income tax based upon the best information available. Taxpayers each protested the assessments. A hearing was held. This Letter of Findings ensues and jointly addresses each protest. Additional facts will be provided as necessary. Please refer to Letter of Findings 08-0586 regarding further information and issues raised by the S corporation's related sales tax protest.

**I. Individual Income Tax – Imposition – Non-filer.**

**DISCUSSION**

During the audit of the S corporation, the auditor discovered that Taxpayers had been non-filers since 2004. The auditor thus assessed Taxpayers' 2004, 2005, 2006, and 2007 adjusted gross income tax based upon the assessments of the S corporation's income. Taxpayers were assessed as joint filers and were accorded credits and deductions for the years in question. Taxpayers first protested that the S corporation's assessments were not correct, and, therefore, nor were the assessments on Taxpayers' income. Taxpayers further argued that their spouses are not shareholders and should not be liable for Taxpayers' income from the S corporation.

IC § 6-8.1-5-1(b), in part, states "[i]f the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to [IC 6-8.1-10](#) concerning the imposition of penalties and interest." All tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

**A. Individual Income**

The Letter of Findings 08-0586 addresses the S corporation's protest and sustained its protest in part and denied it in part. The revised assessment is pending a supplemental audit. Since Taxpayers are shareholders of the S corporation, the S corporation's income passes through to Taxpayers, the shareholders. Thus, Taxpayers' protest on the assessments of Indiana income tax is sustained to the extent that the supplemental audit of the S corporation reduces Taxpayers' income.

**B. Tax Liabilities of Taxpayers' Spouses**

Previously, Taxpayers and their spouses filed joint federal and state income tax returns. The Department thus assessed Taxpayers and their spouses' income tax jointly and also allowed joint credits and deductions for the years in question. Taxpayers, in the protest letter dated September 3, 2008, argued: "[spouses are] not [] shareholder[s] and thus there should not be a proposed assessment against [spouses] individually, regardless of filing status on prior state income tax returns."

Both Taxpayers were married and filed joint income tax returns prior to 2004. The spouses, like Taxpayers, are non-filers and are equally responsible for failure to file their 2004, 2005, 2006 and 2007 individual income tax

returns. The Department reasonably assessed Taxpayers and their spouses' joint income tax based on the best information available at the time of the audit.

#### FINDING

Taxpayers' protest is sustained to the extent the supplemental audit of the S corporation reduces Taxpayers' income. Taxpayers are denied on all other issues in Part I.

#### II. Tax Administration – Negligence Penalty.

#### DISCUSSION

Taxpayer also protests the assessment of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1, the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a tax return;
- (2) fails to pay the full amount of tax shown on the tax return;
- (3) fails to remit in a timely manner the tax held in trust for Indiana (e.g., a sales tax); or
- (4) fails to pay a tax deficiency determined by the Department to be owed by a taxpayer.

[45 IAC 15-11-2](#)(b) further 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.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), in part, as follows:

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.

The facts in the present case show that Taxpayers are non-filers since 2004. The Department could have imposed a one hundred percent penalty for Taxpayers' compliance failure. Taxpayers failed to provide sufficient documentation establishing that their failure to file Indiana individual income tax for the years in question was due to reasonable cause and not due to negligence.

#### FINDING

Taxpayers' protest on the imposition of the negligence penalty is respectfully denied.

#### SUMMARY

For the reasons discussed above, Taxpayers' protest is sustained to the extent the supplemental audit of the S corporation reduces Taxpayers' income. Taxpayers are denied on all other issues.

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