

Letter of Findings: 09-0120P
Income Tax
For the Tax Years 2005 and 2006

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ISSUES

I. Income Tax—Social Security Benefits Subject to Indiana Individual Income Tax.

Authority: [IC 6-3-1-3.5\(a\)](#); [IC 6-3-1-3.5\(a\)\(12\)](#); IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

Taxpayer disputes the purported taxation of Social Security benefits.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-3-4-4.1; IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of negligence penalties for the 2005 and 2006 tax years.

STATEMENT OF FACTS

Taxpayer is an Indiana resident. In 2006, Taxpayer collected \$14,024 in Social Security benefits, but failed to report \$11,920 of that amount as taxable income on his Federal income tax return. A subsequent audit of his 2006 Federal return brought this underreporting to Taxpayer's attention. Taxpayer also filed IT-40 Individual Income Tax Form for the 2006 tax year, but did not include the \$11,920 on his Indiana return either. Taxpayer maintains that the \$11,920 consists of Social Security Benefits and is not subject to Indiana individual income tax.

The Department issued proposed assessments based upon taxpayer's underreporting. The assessments for the 2006 tax year included Indiana income tax and interest due, along with an underpayment penalty.

Taxpayer claimed a bad debt deduction on Taxpayer's 2005 Federal return. Taxpayer's claim was denied. The Department imposed the ten percent negligence penalty for underpayment for the 2005 tax year.

Taxpayer protests the imposition of tax, interest, and the negligence penalties.

DISCUSSION

I. Income Tax—Social Security Benefits Subject to Indiana Individual Income Tax.

Tax assessments are presumed to be accurate. IC § 6-8.1-5-1(c). The Taxpayer bears the burden of proving that any assessment is incorrect. Id. All exemptions are to be strictly construed against the Taxpayer. Indiana Dep't of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

[IC 6-3-1-3.5\(a\)](#) provides the starting point for determining Taxpayer's taxable income. That code section states "[w]hen used in [IC 6-3](#), the term 'adjusted gross income' shall mean the following: (a) In the case of all individuals 'adjusted gross income' (as defined by Section 62 of the Internal Revenue Code)...." Once the taxpayer's Indiana adjusted gross income is determined, that amount is subject to certain adjustments, including any applicable deductions.

[IC 6-3-1-3.5\(a\)\(12\)](#) allows the Indiana taxpayer to "[s]ubtract an amount equal to the amount of federal Social Security and Railroad Retirement benefits included in the taxpayer's federal gross income...."

Taxpayer correctly asserts that Taxpayer received \$14,024 in Social Security benefits and that none of the \$14,024 is subject to the state's individual income tax. In response to the Department's invitation, Taxpayer provided the Federal form showing Taxpayer's receipt of the aforementioned benefit payment. However, Taxpayer does not provide any further support to Taxpayer's assertion that the Department's assessments are incorrect. The Department determined Taxpayer's income tax, as well as a credit against that amount.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration—Negligence Penalty.

Taxpayer protests the imposition of the ten percent negligence penalties for the tax years in question. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

The Department also 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.

The Department may waive the negligence penalty as provided in [45 IAC 15-11-2\(c\)](#), 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.

In this case, Taxpayer incurred deficiencies in estimated tax reporting which the Department determined were due to negligence under [45 IAC 15-11-2](#)(b), and were subject to a penalty under IC § 6-3-4-4.1(c) and IC § 6-8.1-10-2.1(a). Within the proffer of protest, Taxpayer asserts that Taxpayer "inadvertently unreported" the Social Security benefits on the 2006 Federal and Indiana income tax returns. Under IC § 6-8.1-5-1(b), "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." With respect to the 2006 tax year, Taxpayer has not affirmatively established that Taxpayer's failure to pay the deficiencies was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2](#)(c).

Therefore, Taxpayer's protest as to the 2006 tax year is respectfully denied.

Addressing the bad debt deduction claim made in Taxpayer's 2005 Federal return, Taxpayer argues that, because the Internal Revenue Service did not impose a penalty, the Department should remove the penalty imposed as a result of Taxpayer's underpayment. Taxpayer has affirmatively established that Taxpayer's failure to pay the 2005 deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2](#)(c).

Therefore, Taxpayer's protest as to the 2005 tax year is sustained.

FINDING

In summary, Taxpayer's protest of the Department's assessment of tax, interest, and penalty associated with unreported income for the 2006 tax year is denied.

Taxpayer's protest of the imposition of a negligence penalty associated with a deficiency in reporting for the 2005 tax year is sustained.

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