

**Letter of Findings: 09-0758  
Withholding Tax  
For 2006, 2007, and 2008**

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**ISSUES**

**I. Illinois Resident – Withholding Tax.**

**Authority:** IC § 6-3-2-1; IC § 6-3-2-1(a); IC § 6-8.1-5-1(c); [45 IAC 3.1-1-25](#); Income Tax Information Bulletin 33 (August 2008).

Taxpayer argues that it was not required to withhold adjusted gross income tax on behalf of its sales manager who resides in Illinois.

**II. Ten-Percent Negligence Penalty.**

**Authority:** IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(4); IC § 6-8.1-10-2.1(d); [45 IAC 15-11-2\(b\)](#); [45 IAC 15-11-2\(c\)](#).

Taxpayer asks that the Department exercise its discretionary authority to abate the ten-percent negligence penalty.

**STATEMENT OF FACTS**

Taxpayer is an Indiana business which manufactures packaging materials. The Indiana Department of Revenue (Department) conducted an audit review of Taxpayer's business records and tax returns in order to determine whether Taxpayer had correctly withheld tax for its employees. The audit concluded that Taxpayer should have been withholding adjusted gross income tax on behalf of its sales manager. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for its protest. This Letter of Findings results.

**I. Illinois Resident – Withholding Tax.**

**DISCUSSION**

Taxpayer's sales manager lives in Illinois. The sales manager has an office at Taxpayer's Indiana location. The audit concluded that "[a]lthough the manager is an Illinois resident he is earning his salary in [Indiana] hence his wages are taxable to Indiana where he works not Illinois where he lives."

Taxpayer objected arguing that the sales manager "only works out of the [Indiana] office an average of two days per month" and that for the "remaining days, the office is used by others at the plant for meetings, used by any out-of-town visitors to the plant, or is vacant."

Taxpayer points out that it has "a significant customer base in... Illinois, Indiana, Iowa, Kentucky, Michigan, Ohio, Pennsylvania and Wisconsin..." and that the manager is responsible for sales made into those states.

Taxpayer argues that because of the "sales manager's minimal contact with the [Indiana] physical plant (only about two days per month), the sales manager's wages should not be subject to Indiana withholding tax." In the alternative, "Taxpayer contends that only the portion of the sales manager's wages derived from Indiana sources should be subject to Indiana withholding tax."

The Department's audit based the assessment on [45 IAC 3.1-1-25](#) which states in part as follows:

All persons who are not residents of Indiana are required to report that portion of their entire income directly or constructively from or attributable to business, activities or any other source within Indiana, with the exception of nonresident members of the armed forces receiving compensation for military duty in Indiana. These latter persons will not be subject to the adjusted gross income tax on their military pay. A nonresident must include on his tax return all gross income received from a business, activities or any other source in Indiana whether taxable or not.

However, the audit assessed withholding tax on the entire amount of wages paid to the sales manager.

Taxpayer responds to this 100 percent assessment citing to IC § 6-3-2-1(a) which states in relevant part;

Each taxable year, a tax at the rate of three and four-tenths percent (3.4 [percent]) of adjusted gross income is imposed upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person. (Taxpayer's emphasis).

Subsequent to Taxpayer's initial protest letter, Taxpayer submitted information purporting to establish that the sales manager's income was reported on the manager's Illinois tax returns for all the years at issue and that no credit was taken for income earned in Indiana.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

The Department is unable to accept Taxpayer's suggestion that it was not required to withhold Indiana adjusted gross income tax on behalf of its sales managers. Both the administrative regulation, [45 IAC 3.1-1-25](#), and the statute, IC § 6-3-2-1, are clear on this issue. Summarizing the statutory and administrative authority, the Department's Income Tax Information Bulletin 33 (August 2008) is concise; "The withholding of income taxes is required for all nonresidents employed in Indiana except for legal residents of states complying with Indiana's reciprocity statute, [IC 6-3-5-1](#)." Illinois is not one of the states which complies with the reciprocity statute. "Indiana has established reciprocity agreements with Kentucky, Michigan, Ohio, Pennsylvania, and Wisconsin concerning the collection of income tax from nonresidents employed in Indiana." Id.

However, Taxpayer has established that it was not required to withhold adjusted gross income tax on 100 percent of the sales manager's wages. Pursuant to IC § 6-8.1-5-1(c), Taxpayer has provided sufficient information to establish that not all of the sales manager's wages were "attributable to business activities or any other source within Indiana...." [45 IAC 3.1-1-25](#).

Based on the amount of time the sales manager spends at Taxpayer's Indiana location and on the amount of time the manager spends in Indiana – but outside the office – Taxpayer suggests that 20 percent of the sales manager's wages were attributable to Indiana activity. In part, Taxpayer bases this percentage on the premise that during 2006, 15 percent of its sales were made in Indiana, during 2007, 19 percent of its sales were made in Indiana, and that during 2008, 18 percent of its sales were made in Indiana.

The audit division is requested to review Taxpayer's documentation, make a determination as to the amount of the sales manager's wages that were attributable to the manager's Indiana activity, and to make whatever adjustments to the original audit as it deems appropriate.

#### **FINDING**

Subject to the results of the supplemental audit review, Taxpayer's protest is sustained.

### **II. Ten-Percent Negligence Penalty.**

#### **DISCUSSION**

The original audit assessed a penalty "[d]ue to taxpayer negligence in not recognizing its withholding obligations concerning out-of-state residents with taxable nexus in Indiana...." Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(4) requires a ten-percent penalty if the taxpayer "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."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to... pay the full amount of tax shown on the person's return... or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

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...."

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.

Taxpayer is a substantial, sophisticated, Indiana business paying a substantial salary to its sales manager. As such, it had an obligation to understand its reporting and withholding obligations and to comport with Indiana law on the subject. Based on a review of the "facts and circumstances" and after a "case-by-case" review of the circumstances surrounding the original withholding deficiency, the Department is unable to agree that Taxpayer exercised "ordinary business" care when it failed to withhold any adjusted gross income tax on behalf of its sales manager.

#### **FINDING**

Taxpayer's protest respectfully denied.

#### **SUMMARY**

Taxpayer's challenge to the original audit assessment is sustained, Taxpayer was not required to withhold on 100 percent of its sales manager's wages. The Department's audit review section will review and recalculate Taxpayer's withholding obligation. However, Taxpayer's objection to the ten-percent negligence penalty is not sustained; the penalty remains.