

**Letter of Findings Number: 10-0109P**  
**Individual Income Tax-Penalty**  
**For the Year 2006**

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**ISSUE**

**I. Tax Administration–Negligence Penalty.**

**Authority:** I.R.C. § 1033; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of the ten percent negligence penalty.

**STATEMENT OF FACTS**

Taxpayer is an individual. Taxpayer owned an interest in an S corporation. The S corporation owned real estate. In 2006, a portion of the real estate was involuntarily converted. As a result of the involuntary conversion, the S corporation realized a gain on the sale of the real estate.

Under I.R.C. § 1033(a)(2), an entity which owns property that is the subject of an involuntary conversion may elect to not recognize the gain resulting from involuntary conversion. However, in order to qualify for such nonrecognition, replacement property for the involuntarily-converted property must be purchased within two years from the end of the tax year in which the involuntary conversion occurs.

The S corporation was unable to purchase replacement property within the permitted time period. As a result, the S corporation was required to recognize the gain from the involuntary conversion. Taxpayer amended his 2006 individual income tax return to reflect this gain. Taxpayer paid the tax and interest resulting from the gain; however, Taxpayer was also assessed a ten percent negligence penalty. Taxpayer protested the penalty, the Indiana Department of Revenue conducted an administrative hearing, and this Letter of Findings results.

**I. Tax Administration–Negligence Penalty.**

**DISCUSSION**

Taxpayer protests the imposition of the ten percent negligence penalty on Taxpayer's failure to remit the full amount of individual income tax on or before the due date for payment.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, [45 IAC 15-11-2](#) further provides:

(b) "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.

(c) 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.

Taxpayer treated the income that created the tax (and resulting penalty) in accordance with a federal statute permitting a conditional deferral of that income. Taxpayer's treatment of the income in question was the result of following federal income tax statutes permitting his treatment of that income. Thus, the Taxpayer acted with reasonable business care with regard to his 2006 income tax reporting and subsequent late payment of a portion of the tax liability.

**FINDING**

Taxpayer's protest is sustained.

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