

Letter of Findings: 09-0497
Individual Adjusted Gross Income Tax
For the Years 2005, 2006, 2007

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ISSUE

I. Adjusted Gross Income Tax – Basis Calculation.

Authority: IC § 6-2.5-3-2; IC § 6-3-1-3.5; 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); I.R.C. § 1012; I.R.C. § 1016; I.R.C. § 1366; I.R.C. § 1367.

Taxpayer protests the imposition of income tax based on the disallowance of previously-claimed losses.

STATEMENT OF FACTS

Taxpayer is the sole shareholder of an Indiana subchapter S corporation that owns and operates several sandwich and pizza restaurants in Indiana and Michigan. Taxpayer files a joint income tax return with his spouse (jointly referred to also as "Taxpayer"). During the 2005 through 2007 tax years, Taxpayer reported losses from the S corporation. The Indiana Department of Revenue ("Department") audited Taxpayer and disallowed the previously-claimed losses. As a result, the Department assessed additional Indiana income tax against Taxpayer. Taxpayer protested the proposed assessment. The Department conducted an administrative hearing, and this Letter of Findings results. Additional facts will be provided as necessary.

I. Adjusted Gross Income Tax – Basis Calculation.

DISCUSSION

Taxpayer protests the assessment of additional Indiana income tax. In particular, Taxpayer protests the Department's determination that he had no basis in the S corporation against which to deduct losses. The issue in this protest is how much (if any) loss from the S corporation was allowable.

As a threshold issue, 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).

Pursuant to IC § 6-3-1-3.5, the Indiana income tax rules piggyback on the federal income tax statutes and regulations. Therefore, the federal rules and case law are generally applicable to determine individual shareholder's tax liability.

I.R.C. § 1366 establishes that an S corporation's shareholders are entitled to deduct the S corporation's operating loss, passed through to them, up to the amount of their adjusted basis in corporate stock plus the adjusted basis of the corporation's debt. I.R.C. § 1366 (d) sets forth the limitations and, in relevant part, states:

(d) Special rules for losses and deductions.

(1) Cannot exceed shareholder's basis in stock and debt. The aggregate amount of losses and deductions taken into account by a shareholder under subsection (a) for any taxable year shall not exceed the sum of

(A) the adjusted basis of the shareholder's stock in the S corporation (determined with regard to paragraphs (1) and (2)(A) of section 1367(a) for the taxable year), and

(B) the shareholder's adjusted basis of any indebtedness of the S corporation to the shareholder

(determined without regard to any adjustment under paragraph (2) of section 1367(b) for the taxable year).

Therefore, in general, income and/or deductions from an S corporation pass through to the shareholders based on their ownership of the S corporation. However, I.R.C. § 1366(d)(1) provides that losses are limited to the sum of the shareholder's basis in the S corporation stock and the shareholder's basis in "any indebtedness of the S corporation to the shareholder." I.R.C. § 1012 provides that, in general, "[t]he basis of property shall be the cost of such property." Thus, if a person purchases an interest in an S corporation, the purchase price of the interest—rather than the pre-purchase property, income, and expenses of the S corporation—becomes the basis. I.R.C. § 1016(a)(17) and I.R.C. § 1367 provide for adjustments to basis—generally, receipts and expenses of the S corporation.

Subsequent to hearing, Taxpayer presented additional documentation that elaborated on its previously submitted worksheets. Taxpayer established that various transactions related to the S corporation established a basis in the S corporation and/or S corporation indebtedness that permitted a deduction for losses for each of the tax years.

Based on Taxpayer's submitted documentation, Taxpayer's protest is sustained. Taxpayer's losses are permitted to the extent listed in the documentation provided by Taxpayer.

FINDING

Taxpayer's protest is sustained.

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