

**Letter of Findings Number: 10-0308**  
**Income Tax**  
**For Tax Years 2005-07**

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**ISSUES**

**I. Adjusted Gross Income Tax—Combined Return.**

**Authority:** IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-8.1-5-1.

Taxpayer protests the determination that it should have filed combined adjusted gross income tax returns with two related entities.

**II. Tax Administration—Negligence Penalty.**

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

Taxpayer protests the imposition of ten percent negligence penalties.

**STATEMENT OF FACTS**

Taxpayer is a corporation doing business in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer should have been filing combined Indiana adjusted gross income tax ("AGIT") returns for the tax years 2005, 2006, and 2007, with two related entities, rather than single entity returns for itself. Therefore, the Department calculated Indiana AGIT on a combined basis including Taxpayer and those entities, and issued proposed assessments for additional AGIT, penalties, and interest for those tax years. Taxpayer protests that its Indiana AGIT was properly reported as a single entity and that the proposed assessments are incorrect. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Adjusted Gross Income Tax—Combined Return.**

**DISCUSSION**

Taxpayer protests the Department's determination to require combined returns which include Taxpayer and two related entities, rather than the single entity returns which Taxpayer originally filed for the tax years 2005-07. The Department based its determination on several factors. Taxpayer states that the single entity returns fairly reflect its Indiana income and that the Department's combination results in an unfair reflection of its Indiana income. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The adjusted gross income tax is imposed under IC § 6-3-2-1, which states:

(a) 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.

(b) Except as provided in section 1.5 of this chapter, each taxable year, a tax at the rate of eight and five-tenths percent (8.5 [percent]) of adjusted gross income is imposed on that part of the adjusted gross income derived from sources within Indiana of every corporation.

Also of relevance is IC § 6-3-2-2, which states in relevant parts:

(a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) income from doing business in this state;
- (3) income from a trade or profession conducted in this state;
- (4) compensation for labor or services rendered within this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

...

(i) If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) separate accounting;
- (2) the exclusion of any one (1) or more of the factors;
- (3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or
- (4) the employment of any other method to effectuate an equitable allocation and apportionment of the

taxpayer's income.

....

As the result of its audit, the Department determined that the amounts which Taxpayer paid to the related entities for various reasons distorted Taxpayer's Indiana AGIT. The Department listed several factors which led to this conclusion.

Taxpayer protests that the Department's determination resulted in distortion, rather than achieving the stated goal of curing distortion. At hearing, Taxpayer provided additional analysis and documentation for its protest. After review of the audit report and Taxpayer's protest, it is clear that the Department did have legitimate concerns about possible distortion of Taxpayer's AGIT. It is also clear that Taxpayer has provided sufficient documentation and analysis to successfully address the Department's concerns as stated in the audit report. Taxpayer has therefore met the burden imposed by IC § 6-8.1-5-1(c).

**FINDING**

Taxpayer's protest is sustained.

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

**DISCUSSION**

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

....

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

....

the person is subject to a penalty.

The Department 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.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

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.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Since Taxpayer was sustained in full in Issue I above, there was no failure to pay a deficiency and Taxpayer has demonstrated that it exercised ordinary business care in executing its Indiana income tax responsibilities, as required by [45 IAC 15-11-2\(c\)](#).

**FINDING**

Taxpayer's protest is sustained.

**CONCLUSION**

Taxpayer's protest is sustained on Issue I regarding adjusted gross income tax. Taxpayer's protest is sustained on Issue II regarding imposition of negligence penalties.

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