

Letter of Findings: 03-20110036P
Withholding Tax
For the Tax Years Ending December 31, 2008, and 2009

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Withholding Tax - Penalty.

Authority: IC § 2-5-3-1; IC § 6-3-2-2.8; IC § 6-3-4-13; IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer seeks abatement of the twenty-percent penalty for failure to file a Form WH-1 and remit withholding tax on its non-resident shareholder.

STATEMENT OF FACTS

Taxpayer is an S corporation. Taxpayer failed to file a Form WH-1 and withhold tax on its non-resident shareholder for the years ending December 31, 2008, and 2009. Taxpayer was assessed a twenty-percent penalty pursuant to IC § 6-8.1-10-2.1(h). Taxpayer also failed to file a composite schedule with its Form IT-20S for these years and was assessed a \$500 per return penalty for the failure to list its nonresident shareholder on the composite schedule pursuant to IC § 6-8.1-10-2.1(j).

I. Withholding Tax - Penalty.

DISCUSSION

Taxpayer argues that it is entitled to abatement of the twenty-percent penalty for failure to file a Form WH-1 and remit withholding tax on its non-resident shareholder.

Pursuant to IC § 6-3-2-2.8:

Notwithstanding any provision of [IC 6-3-1](#) through [IC 6-3-7](#), there shall be no tax on the adjusted gross income of the following:

(1) Any organization described in Section 501(a) of the Internal Revenue Code, except that any income of such organization which is subject to income tax under the Internal Revenue Code shall be subject to the tax under [IC 6-3-1](#) through [IC 6-3-7](#).

(2) Any corporation which is exempt from income tax under Section 1363 of the Internal Revenue Code and which complies with the requirements of [IC 6-3-4-13](#). However, income of a corporation described under this subdivision that is subject to income tax under the Internal Revenue Code is subject to the tax under [IC 6-3-1](#) through [IC 6-3-7](#). A corporation will not lose its exemption under this section because it fails to comply with [IC 6-3-4-13](#) but it will be subject to the penalties provided by [IC 6-8.1-10](#).

(3) Banks and trust companies, national banking associations, savings banks, building and loan associations, and savings and loan associations.

(4) Insurance companies subject to tax under [IC 27-1-18-2](#), including a domestic insurance company that elects to be taxed under [IC 27-1-18-2](#).

(5) International banking facilities (as defined in Regulation D of the Board of Governors of the Federal Reserve System (12 CFR 204)). **(Emphasis added).**

According to IC § 6-3-4-13:

(a) Every corporation which is exempt from tax under [IC 6-3](#) pursuant to [IC 6-3-2-2.8](#)(2) shall, at the time that it pays or credits amounts to any of its nonresident shareholders as dividends or as their share of the corporation's undistributed taxable income, withhold the amount prescribed by the department. Such corporation so paying or crediting any nonresident shareholder:

(1) shall be liable to the state of Indiana for the payment of the tax required to be withheld under this section and shall not be liable to such shareholder for the amount withheld and paid over in compliance or intended compliance with this section; and

(2) when the aggregate amount due under [IC 6-3](#) and [IC 6-3.5](#) exceeds one hundred fifty dollars (\$150) per quarter, then such corporation shall make return and payment to the department quarterly, on such dates and in such manner as the department shall prescribe, of the amount of tax which, under [IC 6-3](#) and [IC 6-3.5](#), it is required to withhold.

(b) Every corporation shall, at the time of each payment made by it to the department pursuant to this section, deliver to the department a return upon such form as shall be prescribed by the department showing the total amounts paid or credited to its nonresident shareholders, the amount withheld in accordance with the provisions of this section, and such other information as the department may require. Every corporation withholding as provided in this section shall furnish to its nonresident shareholders annually, but not later than the fifteenth day of the third month after the end of its taxable year, a record of the amount of tax

withheld on behalf of such shareholders on forms to be prescribed by the department.

(c) All money withheld by a corporation, pursuant to this section, shall immediately upon being withheld be the money of the state of Indiana and every corporation which withholds any amount of money under the provisions of this section shall hold the same in trust for the state of Indiana and for payment thereof to the department in the manner and at the times provided in [IC 6-3](#). Any corporation may be required to post a surety bond in such sum as the department shall determine to be appropriate to protect the state of Indiana with respect to money withheld pursuant to this section.

(d) The provisions of [IC 6-8.1](#) relating to additions to tax in case of delinquency and penalties shall apply to corporations subject to the provisions of this section, and for these purposes any amount withheld, or required to be withheld and remitted to the department under this section, shall be considered to be the tax of the corporation, and with respect to such amount it shall be considered the taxpayer.

(e) Amounts withheld from payments or credits to a nonresident shareholder during any taxable year of the corporation in accordance with the provisions of this section shall be considered to be a part payment of the tax imposed on such nonresident shareholder for his taxable year within or with which the corporation's taxable year ends. A return made by the corporation under subsection (b) shall be accepted by the department as evidence in favor of the nonresident shareholder of the amount so withheld from the shareholder's distributive share.

(f) This section shall in no way relieve any nonresident shareholder from the shareholder's obligation of filing a return or returns at the time required under [IC 6-3](#) or [IC 6-3.5](#), and any unpaid tax shall be paid at the time prescribed by section 5 of this chapter.

(g) Instead of the reporting periods required under subsection (a), the department may permit a corporation to file one (1) return and payment each year if the corporation pays or credits amounts to its nonresident shareholders only one (1) time each year. The withholding return and payment are due on or before the fifteenth day of the third month after the end of the taxable year of the corporation.

(h) If a distribution will be made with property other than money or a gain is realized without the payment of money, the corporation shall not release the property or credit the gain until it has funds sufficient to enable it to pay the tax required to be withheld under this section. If necessary, the corporation shall obtain such funds from the shareholders.

(i) If a corporation fails to withhold and pay any amount of tax required to be withheld under this section and thereafter the tax is paid by the shareholders, such amount of tax as paid by the shareholders shall not be collected from the corporation but it shall not be relieved from liability for interest or penalty otherwise due in respect to such failure to withhold under [IC 6-8.1-10](#).

(j) A corporation described in subsection (a) shall file a composite adjusted gross income tax return on behalf of all nonresident shareholders. The composite return must include each nonresident individual shareholder regardless of whether or not the nonresident individual shareholder has other Indiana source income.

(k) If a corporation described in subsection (a) does not include all nonresident shareholders in the composite return, the corporation is subject to the penalty imposed under [IC 6-8.1-10-2.1\(j\)](#).

IC § 6-8.1-10-2.1 states:

(a) If a person:

- (1) fails to file a return for any of the listed taxes;
- (2) 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;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department;

the person is subject to a penalty.

(b) Except as provided in subsection (g), the penalty described in subsection (a) is ten percent (10 [percent]) of:

- (1) the full amount of the tax due if the person failed to file the return;
- (2) the amount of the tax not paid, if the person filed the return but failed to pay the full amount of the tax shown on the return;
- (3) the amount of the tax held in trust that is not timely remitted;
- (4) the amount of deficiency as finally determined by the department; or
- (5) the amount of tax due if a person failed to make payment by electronic funds transfer, overnight courier, or personal delivery by the due date.

(c) For purposes of this section, the filing of a substantially blank or unsigned return does not constitute a return.

(d) If a person subject to the penalty imposed under this section can show that the failure to file a return, pay

the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

(e) A person who wishes to avoid the penalty imposed under this section must make an affirmative showing of all facts alleged as a reasonable cause for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust, in a written statement containing a declaration that the statement is made under penalty of perjury. The statement must be filed with the return or payment within the time prescribed for protesting departmental assessments. A taxpayer may also avoid the penalty imposed under this section by obtaining a ruling from the department before the end of a particular tax period on the amount of tax due for that tax period.

(f) The department shall adopt rules under [IC 4-22-2](#) to prescribe the circumstances that constitute reasonable cause and negligence for purposes of this section.

(g) A person who fails to file a return for a listed tax that shows no tax liability for a taxable year, other than an information return (as defined in section 6 of this chapter), on or before the due date of the return shall pay a penalty of ten dollars (\$10) for each day that the return is past due, up to a maximum of two hundred fifty dollars (\$250).

(h) A corporation which otherwise qualifies under [IC 6-3-2-2.8\(2\)](#) but fails to withhold and pay any amount of tax required to be withheld under [IC 6-3-4-13](#) shall pay a penalty equal to twenty percent (20 [percent]) of the amount of tax required to be withheld under [IC 6-3-4-13](#). This penalty shall be in addition to any penalty imposed by section 6 of this chapter.

(i) Subsections (a) through (c) do not apply to a motor carrier fuel tax return.

(j) If a partnership or an S corporation fails to include all nonresidential individual partners or nonresidential individual shareholders in a composite return as required by [IC 6-3-4-12\(h\)](#) or [IC 6-3-4-13\(j\)](#), a penalty of five hundred dollars (\$500) per partnership or S corporation is imposed on the partnership or S corporation. (Emphasis added)

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.

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 penalties 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...."

Pursuant to IC § 2-5-3-1:

It is hereby declared to be the policy of the general assembly of the state of Indiana to promote a revenue raising structure in Indiana that will provide adequate revenues to carry on the efficient operation of the state, county, and city governments and at the same time will assure that its burdens will be shared equitably by all taxpayers. It is further declared to be the policy of the general assembly of the state of Indiana to encourage and bring about the accomplishment of enforcement policies and administrative practices that will result in maximum return from existing taxes to the state of Indiana at a minimum cost to the taxpayers.

In imposing the twenty-percent penalty for failure to file Form WH-1 and remit withholding tax on non-resident shareholders the Department is enforcing a provision of the Indiana Code in order to ensure the continued compliance with Indiana law. The requirement of filing a Form WH-1 and the withholding on Taxpayer's non-resident shareholders is the state's way of ensuring that the Department is provided with information it needs to carry out its responsibilities in the most efficient manner. The withholding requirements imposed upon Taxpayer in this instance are more efficient than the unreasonably burdensome method of the Department trying to match non-resident shareholders to their respective S corporations in order to ensure that voluntary compliance with the Indiana tax laws has occurred.

Taxpayer states that it has a unique ownership situation. Taxpayer has two shareholders, a husband and a wife. The husband is an Indiana resident but the wife is not an Indiana resident. Taxpayer asserts that its ownership situation led it to not withhold and to not file the composite schedule, which resulted in Taxpayer's penalties. Taxpayer's tax preparer noted that it filed composite returns and withheld on behalf of the preparer's other clients. Based on the unusual ownership situation and the tax preparer's demonstration that he knew the Department's reporting requirements and otherwise complied with those requirements, Taxpayer has demonstrated that it acted with reasonable care in its tax payment and filing duties for the years at issue.

However, Taxpayer, along with other similarly situated taxpayers, is reminded that nonresident shareholder withholding, composite return filing for nonresident shareholders, and inclusion of all S corporation nonresident shareholders is mandatory under Indiana law with very limited exceptions. While the Department recognized

reasonable cause in Taxpayer's circumstances, the Department may not recognize reasonable cause for similarly-situated taxpayers after publication of this Letter of Findings.

FINDING

Taxpayer's protest is sustained.

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