

Letter of Findings Number: 02-20100714
Corporate Income Tax
For the 2002-2007 Tax Years

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 It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register.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 this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax—Depreciation.

Authority: IC § 6-3-1-3.5; IC § 6-8.1-5-1; I.R.C. § 167; I.R.C. § 168; I.R.C. § 179; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the Department's disallowance of certain adjustments related to real and personal property.

II. Adjusted Gross Income Tax—Net Operating Losses.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-2.6.

Taxpayer protests the Department's disallowance of certain adjustments that Taxpayer requested.

III. Tax Administration—Penalty.

Authority: IC § 6-3-4-4.1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of ten percent (10 percent) negligence and underpayment penalties.

STATEMENT OF FACTS

Taxpayer, incorporated in Indiana, engages in the leasing of commercial property. During the 2002-2007 years ("Tax Years"), Taxpayer owned and operated two properties located in Indiana. Taxpayer filed corporate income tax Form IT-20 returns with the Department of Revenue ("Department") for the 2003, 2004, and 2005 tax years. Taxpayer used one federal identification number ("FID") for the 2003 and 2004 returns, but used a different FID for the 2005 return. The Department did not receive any returns from Taxpayer for the 2002, 2006, and 2007 tax years.

In May 2009, the Department mailed Taxpayer notice that the Department had not received corporate income tax returns for the 2006, 2007, and 2008 tax years, and that the Department would perform a compliance audit for the Tax Years. The letter included a request for the missing returns. Taxpayer provided copies of 2006 and 2007 year returns shortly after receiving the Department's letter. During the Department's audit, Taxpayer provided copies of various other documents showing disbursements, interest paid on various loans, bank statements, and records of expenses. Taxpayer also provided a copy of Taxpayer's 2002 return.

As a result of the Department's audit, the Department assessed adjusted gross income tax with respect to Taxpayer's business activities. Taxpayer did not agree with portions of the Department's audit, prompting the Department to invite Taxpayer to provide further documentation in support of Taxpayer's position. Despite the Department's numerous requests, Taxpayer did not provide further documentary support for Taxpayer's disagreement. The Department, nevertheless, addressed the issues raised by Taxpayer, which led to reduction in the audit assessments for each of the Tax Years.

Approximately six months later, the Department received a letter from Taxpayer dated January 14, 2011. Taxpayer's letter explained that Taxpayer had retained a different accountant, who had reviewed Taxpayer's records and the Department's audit. As a result of that review, Taxpayer's accountant included certain documents produced subsequent to the Department's audit. After reviewing Taxpayer's additional documents, the Department agreed to perform a supplemental audit. The Department's supplemental audit only resulted in a reduction to the assessment for the 2007 tax year. All previously adjusted amounts for the 2002-2006 years remained the same.

The Department issued assessments based upon the supplemental audit. Those reduced assessments included interest and penalties. Taxpayer protested the revised assessments, as well as penalty and interest amounts. An administrative hearing was conducted. This Letter of Findings results. Further facts will be supplied as required.

I. Adjusted Gross Income Tax—Depreciation.

DISCUSSION

All tax assessments are prima facie evidence that the Department's claim for the 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).

To determine a taxpayer's Indiana adjusted gross income, Indiana begins with a taxpayer's federal taxable income, subject to modifications provided under IC § 6-3-1-3.5(b). During the hearing, Taxpayer provided documents modifying Taxpayer's claimed expenses pertaining to depreciation of certain real and personal property. Taxpayer's claims rely on adjustments to federal adjusted gross income allowed under Sections 167,

168, and 179 of the Internal Revenue Code.

While the information provided by Taxpayer during the hearing was insufficient to demonstrate that the total depreciation deduction should be adjusted to Taxpayer's claimed amounts, the information does show that some of Taxpayer's claimed expenses could qualify for a deduction from Taxpayer's gross income. However, the Taxpayer has not provided information sufficient to support Taxpayer's depreciation expense claims related to certain items, such as a pontoon boat, jet skis, televisions, and a "book balance" line item. Therefore, the Department sustains Taxpayer's protest in part, to the extent that the information Taxpayer provided during the hearing for certain documented expenses attributable to each of Taxpayer's two buildings supports an increase in claimed deductions based upon depreciation and amortization. However, the Department denies Taxpayer's protest to the extent that the information provided by Taxpayer not only does not account for all of the depreciation taken on the federal return, but also fails to adequately justify deduction of amounts attributable to the above-mentioned items.

Therefore, Taxpayer's protest is sustained in part, subject to audit verification, for the depreciation deduction for certain expenses, but is denied in part as to the total amount of adjustment requested. The Department will return the file to the audit division to incorporate the allowable amount of adjustments to the depreciation deduction.

FINDING

Taxpayer's protest is denied in part and sustained in part subject to audit verification.

II. Adjusted Gross Income Tax—Net Operating Losses.

DISCUSSION

During the hearing, Taxpayer submitted revised Schedule IT-20NOL statements, based upon Taxpayer's revised claims related to alleged depreciation and other expenses. Taxpayer maintains its entitlement to a carryback of these net operating losses (NOLs), which operate to reduce Taxpayer's Indiana adjusted gross income to zero (\$0.00).

IC § 6-3-2-2.6 outlines the deduction afforded to taxpayers for NOLs, as well as the filing and reporting requirements for certain modifications, such as those adjustments for depreciation provided in IC § 6-3-1-3.5.

Taxpayer has provided sufficient documentation to demonstrate the possible validity of some of Taxpayer's expense deductions. Therefore, the Department sustains Taxpayer's protest in part, subject to audit verification, for the NOL carryback of some of Taxpayer's claimed expenses, but denies in part as to the total NOLs claimed on Taxpayer's Schedule IT-20NOL statements.

FINDING

Taxpayer's protest is sustained in part and denied in part subject to audit verification.

III. Tax Administration—Penalty.

DISCUSSION

Taxpayer protests the Department's imposition and assessment of two penalty amounts added to Taxpayer's income tax liabilities for the Tax Years. The Department imposed a ten percent (10 percent) negligence penalty for each of the Tax Years based upon Taxpayer's failure to file income tax returns for a number of the Tax Years. The Department has also issued penalty assessments for the 2004, 2006, and 2007 tax years for failing to file Form IT-2220 pursuant to underpayment of corporate income tax. IC § 6-3-4-4.1.

Under IC § 6-8.1-10-2.1, 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.

Penalty waiver is permitted if the taxpayer shows that the failure to file a return or 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. [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 [\[IC 6-8.1-10-2.1\]](#) 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 argues that the Department should abate the penalties in this case. Taxpayer bases its argument on assertions related to the validity of its claimed depreciation expenses, Taxpayer's additional documentation, and its resulting corrections and reductions to income for each of the Tax Years.

While the Department commends Taxpayer on its efforts to maintain its own working relationship with its accounting firm, Taxpayer's failure to provide documentation in response to Department's numerous requests during the Department's audit did not meet the duty of reasonable care expected of a taxpayer.

Further, if the taxpayer fails to pay the full amount of tax due on the tax return on or before the due date of the return, or make estimated income tax payments pursuant to IC § 6-3-4-4.1, the tax due is subject to penalty and interest. Taxpayer failed to file returns for three of the Tax Years. Taxpayer did not file those returns until it received the Department's notice. Taxpayer has not provided information or explanation sufficient to show reasonable cause for the abatement of negligence or underpayment penalties.

FINDING

Taxpayer's protest is denied.

CONCLUSION

Based upon Taxpayer's additional information and documents provided during the hearing, the Department sustains Taxpayer's protest in part, subject to audit verification, for the depreciation deduction for certain expenses, but denies Taxpayer's protest in part as to the amount of the total adjustment requested. The Department also sustains Taxpayer's protest in part with respect to the effect of those depreciation deduction modifications on Taxpayer's claimed net operating losses, but denies Taxpayer's protest for the entire amount of NOLs claimed. The Department will return the file to the audit division to incorporate the allowable amount of adjustments to the depreciation add-back. However, Taxpayer has not provided information or explanation sufficient to show reasonable cause for the abatement of negligence or underpayment penalties, so the Department denies Taxpayer's protest with respect to penalties assessed.

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