

Letter of Findings: 01-20130141
Individual Income Tax
For the Years 2009, 2010, and 2011

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ISSUE

I. Business Expenses and Deductions – Individual Income Tax.

Authority: IC § 6-3-2-1(a); IC § 6-8.1-5-1(c); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 3.1-1-2\(2\)](#); I.R.C. § 61; I.R.C. § 101.

Taxpayers argue that the Department of Revenue incorrectly relied on bank deposit records in order to calculate Taxpayers' gross income.

STATEMENT OF FACTS

Husband and wife Taxpayers filed federal and state income tax returns for the years 2009, 2010, and 2011. On their joint returns, Taxpayers reported business income from capital gains, dividend income, and taxable interest income. For simplicity's sake, this Letter of Findings will hereinafter refer to husband and wife as "Taxpayer."

Taxpayer also owned an automobile parts store. The store sells brakes, chassis accessories, control arms, disk brake kits, front suspensions, and rear suspensions. Taxpayer reported the income from its retail store on Taxpayer's federal return.

The Department of Revenue conducted an individual income tax audit. The audit resulted in the assessment of additional Indiana income tax. Taxpayer disagreed with the additional assessment and submitted a protest to that effect. An administrative hearing was conducted and this Letter of Findings results.

I. Business Expenses and Deductions – Individual Income Tax.

DISCUSSION

In reviewing Taxpayer's state and federal returns, the Department's audit concluded that the returns did not reconcile; the 2009, 2010, and 2011 returns underreported the amount of federal adjusted gross income. The Department determined that Taxpayer failed to report all of the gross receipts received from the automobile parts store.

The Taxpayer's total gross receipts reported on the federal return were compared to the total audited income. The audit "was prepared in order to correctly reflect gross receipts which ultimately reflect the [T]axpayer's Indiana adjusted gross income." The audit adjustment led to the finding that Taxpayer owed additional state income tax.

During the course of the audit preparation, Taxpayer's representative provided a "work paper" that purportedly contained "various deductions" which Taxpayer argued should be taken from the amount of additional gross income. The deductions included "returns and allowances, shipping costs, travel costs, equipment purchases, and various costs to repair equipment." However, the Department found that Taxpayer's representative "failed to provide any support documentation to verify these deductions on work paper provided." The audit report continues, "It could not be determined if these deductions had already been reported . . ." The audit report concludes that the claimed "deductions were not considered in the calculation of the additional taxable income in the audit years 2009, 2010, and 2011."

Indiana imposes its state income tax in the following manner. IC § 6-3-2-1(a) states that "[e]ach 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." (**Emphasis added**).

As authority for its decision to assess additional tax, the audit report cited to [45 IAC 3.1-1-2\(2\)](#) which states: "Gross Income" Defined for Individuals. Indiana residents must report all income as defined by § 61 of the Internal Revenue Code. Sources of income include, but are not limited to:

- (1) Compensation for services, including fees, commissions and similar items
- (2) Gross income derived from business
- (3) Gains derived from dealings in property
- (4) Interest
- (5) Rents
- (6) Royalties
- (7) Dividends
- (8) Alimony and separate maintenance payments

- (9) Annuities
- (10) Income from life insurance and endowment contracts
- (11) Pensions
- (12) Income from discharge of indebtedness
- (13) Distributive share of partnership gross income
- (14) Distributive share of taxable income from an electing small business corporation
- (15) Income in respect of a decedent
- (16) Income from an interest in an estate or trust

Nonresidents and part-year residents are also required to report gross income, as defined above, from all sources. These [taxpayers] are afforded a deduction for non-Indiana income as explained in Regulation 6-3-1-3.5(a)(050).

In particular, the audit cites to the provision which requires that each taxpayer include "Gross income derived from business" and concludes that Taxpayer had failed to do so.

The Indiana regulation cross-references the federal provision, I.R.C. § 61, which provides:

(a) General definition.--Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

- (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
- (2) Gross income derived from business;
- (3) Gains derived from dealings in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowment contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.

(b) Cross references. For items specifically included in gross income, see part II (sec. 71 and following). For items specifically excluded from gross income, see part III (sec. 101 and following).

However, Taxpayer objects stating that, "in no case should bank deposits be equated to gross income."

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Taxpayer claims that various amounts should be excluded from the amount of gross income as determined by the audit. As noted above, [45 IAC 3.1-1-2\(2\)](#) provides that "gross income" includes all income as defined as defined by I.R.C. § 61. I.R.C. § 61 provides that "gross income" consists of all income "from whatever source derived . . ." with specific exemptions defined in I.R.C. § 101 and following. The exemptions set in I.R.C. § 101 and following include certain death benefits, employee gifts, compensation for injuries, and the rental value of parsonages.

Taxpayer argues that the audit erred when it included in "gross income" certain receipts. For example, Taxpayer states that when its automobile repair business receives money from its customers to pay for shipping costs, those receipts should not be included as gross income.

Unfortunately, Taxpayer has not cited to any particular legal authority for the claims that the audit erred in including in "gross income" the items challenged. Taxpayer may well be correct but – as stated in the letter sent to Taxpayer's representative at the outset of the administrative hearing process:

This administrative hearing is your opportunity to carefully, fully, and precisely define the legal and factual issues in dispute. It is also your opportunity and responsibility to provide the Hearing Officer a complete, well-organized record of any and all documents needed to support your position. That complete record may be provided in advance of the hearing, at the time of the hearing, or – if necessary – within a brief and well defined period of time following the hearing.

The law does not permit the Department to find in favor of Taxpayer on any of the contested issues because Taxpayer has not met the burden under IC § 6-8.1-5-1(c) of establishing that the initial assessment was "wrong."

FINDING

Taxpayer's protest is respectfully denied.

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