

**Letter of Findings: 01-20130629**  
**Individual Income Tax**  
**For the Years 2010 and 2011**

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**I. Individual Income Tax – Subchapter S Corporation Receipts.**

**Authority:** [IC 6-3-1-3.5](#); [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); Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue erred when it determined that Taxpayer owed additional individual income tax.

**STATEMENT OF FACTS**

Taxpayer owns an Indiana combination gas station, delicatessen, and convenience store. The Department of Revenue ("Department") conducted a sales and income tax audit of this business. That audit found that the business made more sales than originally reported which "flowed through" to Taxpayer as the sole owner of the S Corporation. The audit determined that Taxpayer owed additional individual income tax.

Taxpayer disagreed with the results of both the business and individual audit results and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. Taxpayer's protest of the business assessment is dealt with in a separate, companion Letter of Findings (04-20130623).

This Letter of Findings addresses the Taxpayer's objection to the assessment of additional individual income tax.

**I. Individual Income Tax – Subchapter S Corporation Receipts.**

**DISCUSSION**

Taxpayer maintains that he does not owe additional income tax because the audit of his gas station/convenience store business was flawed.

As explained in Taxpayer's original protest letter:

The increases are based on a sales tax audit wherein sales were artificially inflated based on cost of goods sold percentage which did not account for changes in inventory, ignored [T]axpayer's representation as to sales amounts, did not tie sales to bank deposits, and applied the same inflation factor to other years without demonstrating that each year was similar.

Taxpayer's objection addresses the conclusion set out in the audit report. That audit report states:

An examination was made of the [S Corporation's] corporate income tax returns which include federal income tax return information for the years 2010 and 2011. The examination revealed that the percentage of cost of goods sold to total sales was 90[percent] for 2010 and 93[percent] for 2011. There is an established percentage of cost of goods sold to total sales for food and beverage stores, which is 74[percent]. The audit accepted the cost of goods sold amounts per the federal return information which would indicate that the total sales amounts per the federal return information and the total [convenience] store sales amounts per the sales tax returns are understated. Applying the established percentage to the purchases from the costs of goods sold reveals adjustment to total sales for federal taxable income and total [convenience] store sales for the sales tax returns. With the acceptance of the Cost of Goods Sold as reported, the additional total [convenience] store sales is also considered by audit to be the additional net income for the corporation . . .

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).

Simply stated, an S Corporation – such as Taxpayer's combination gas station/convenience store – is a "Corporation whose income is taxed through its shareholders rather than through the corporation itself." Black's Law Dictionary 344 (7th ed. 1999). 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 an individual shareholder's tax liability.

However, the issue is not whether the Taxpayer is subject to potential income tax based on Taxpayer's ownership of the combination gas station and convenience store; the issue is whether or not the Taxpayer correctly found that the S Corporation under-reported its convenience store sales.

In the companion Letter of Findings (04-20130623) addressing the assessment of additional sales and use tax for Taxpayer's business, the Department found that Taxpayer had understated the amount of the business's income. That conclusion was reached because the audit found that the claimed mark-up on the items sold in Taxpayer's convenience store was unrealistic. As stated in the companion LOF:

Taxpayer asks the Department to agree that Taxpayer reported the proper amount of gross sales, that the cost-of-goods-sold for its convenience items was between 90 and 93 percent, and that it therefore marked up its convenience store items between approximately 8 to 11 percent.

It should be noted that Taxpayer was unable to produce source documentation establishing the amount of goods sold at its convenience store, was unable to produce source documentation establishing the number of items which were sold as "exempt," and was unable to produce source documentation establishing the number of items which were sold as "non-exempt." In addition, Taxpayer simply underreported to the Department the amount of gross sales sold in its convenience store.

The companion LOF – addressing the sales amount at Taxpayer's combination gas station/delicatessen/convenience store – concluded as follows:

Especially given the fact that Taxpayer failed to retain or preserve source documentation of its day-to-day transactions, it is not possible to conclude that Taxpayer has met its burden of demonstrating that the audit's conclusions were wrong as required under [IC 6-8.1-5-1\(c\)](#).

The companion LOF concluded that Taxpayer failed to establish that it did not under report its convenience store sales. Therefore, those unreported sales "flowed through" to Taxpayer as the sole shareholder of Taxpayer's S Corporation and are properly categorized as additional income to its sole shareholder.

**FINDING**

Taxpayer's protest is respectfully denied.

*Posted: 03/26/2014 by Legislative Services Agency*  
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