

**Letter of Findings: 01-20140066**  
**Individual Income Tax**  
**For the Years 2010 and 2011**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

**ISSUE**

**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 (9th ed. 2009).

Taxpayers argue that the Department erroneously assessed them additional income tax.

**STATEMENT OF FACTS**

Taxpayers are part owners of an Indiana business which operates a combination gas station, convenience store, and fast-food restaurant.

Taxpayers' business entered into an agreement with a national petroleum company to sell gasoline at its location. Taxpayers' business receives 50 percent of the gross profits received from gasoline sales.

Taxpayers operate a nationally branded fast-food restaurant at their business location.

Taxpayers' convenience store sells tobacco products, groceries, snack foods, beverages, coffee, and general merchandise. The convenience store also sells lottery tickets, money orders along with accepting payments for utility bills.

The Indiana Department of Revenue ("Department") conducted an audit of Taxpayers' business records and tax returns. The audit resulted in the assessment of additional sales, withholding, individual income, and wireless prepaid card tax.

That audit found that the business made more sales than originally reported which "flowed through" to Taxpayers as the owners of the S Corporation. The audit determined that Taxpayers owed additional individual income tax.

The Department's audit began in February 2013. Taxpayers were informed on February 18, 2013, that the audit would require an opportunity to review Taxpayers' books and records.

On February 26, 2013, Taxpayers were again notified that the audit needed to review Taxpayers' records. During the course of the eight month audit, Taxpayers were repeatedly asked to produce business records and missing tax returns. During the four-hour September 5, 2013, "closing conference" with Taxpayers' representative and one of the Taxpayers, the Taxpayers were asked to produce the missing documentation no later than September 6, 2013. Taxpayers failed to provide the requested information by that date.

In the absence of the requested records, the Department issued proposed assessments of additional income tax based the best information available to the Department. Taxpayers disagreed with the assessments and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayers' representative explained the basis for the protest. This Letter of Findings results.

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

**DISCUSSION**

Taxpayers state that they do not owe additional income tax because the related audit overstated the amount of sales which occurred at its gas station, convenience store, and fast-food restaurant.

As a threshold issue, it is the Taxpayers' 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 Taxpayers' combination gas station/convenience store/fast-food restaurant – is "[a] corporation whose income is taxed through its shareholders rather than through the corporation itself." Black's Law Dictionary 394 (9th ed. 2009). 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 Taxpayers are subject to potential income tax based on their ownership of the combination gas station, convenience store, fast-food restaurant; the issue is whether or not the audit correctly found that the S Corporation under-reported its store sales.

In the companion Letter of Findings (04-20130693) addressing the assessment of additional sales and use

tax for Taxpayers' business, the Department found that Taxpayers had understated the amount of the business's income.

That conclusion was reached because the audit found that the business failed to retain original source documentation establishing the amount of sales which occurred at its business. Taxpayers' representative "provided a limited number of monthly summary statements but admits that it has no records of sales which occurred at its restaurant." As stated in the companion Letter of Findings:

Based on the documentation available, it is not possible to agree that Taxpayer established that the audit assessment was "wrong" as required under IC § 6-8.1-5-1(c). The Department's audit requested repeatedly for records sufficient to establish the amount of sales which occurred at its business location. As stated by the audit, "[Taxpayer] did not provide any accounting records for audit and claims it does not keep records and books . . . ." In addition, the audit noted that "[Taxpayer's] shareholders were informed in a prior audit of a different entity to retain all source documents and [Taxpayer] did not do so. [Taxpayer] did not retain z-tapes and could not present any sales source documents for audit." In addition, "[Taxpayer] did not present a material portion of purchase records, stating that it did not retain invoices/receipts."

Taxpayers were unable to produce source documentation establishing the amount of goods sold at its convenience store, gas station, and restaurant, were unable to produce source documentation establishing the number of items which were sold as "exempt," and were unable to produce source documentation establishing the number of items which were sold as "non-exempt."

Taxpayers' representative maintains it recently discovered sales tax records which establish that Taxpayer owes less sales and use tax than originally assessed. To that end, Taxpayer has provided a limited number of summaries in the form of monthly z-tapes but admits that it has no records of sales which occurred at its restaurant.

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

Taxpayers have failed to meet their burden of establishing that the assessment of additional income tax was "wrong" as required by IC § 6-8.1-5-1(c). However, the Department agrees that the Audit Division should revisit the original audit, review Taxpayers' newly discovered z-tapes and make whatever adjustments to the original assessment as may be warranted.

#### **FINDING**

Taxpayers' protest is sustained subject to the result of the supplemental audit review of the newly submitted z-tapes.

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