

## DEPARTMENT OF STATE REVENUE

01-20130664.LOF

**Letter of Findings Number: 01-20130664  
Individual Income Tax  
For Tax Years 2009-2011**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require 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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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. Income Tax—Research Credit.**

**Authority:** IC § 6-8.1-5-1; IC § 6-3.1-4-3; IC § 6-3.1-4-4; IC § 6-3.1-4-7; I.R.C. § 41.

Taxpayers protest the denial of a claimed credit.

**STATEMENT OF FACTS**

Taxpayers are husband and wife who file a joint tax return. The husband is a shareholder in an S-Corporation (hereinafter "Company Y"). The Indiana Department of Revenue ("Department") audited Company Y. As a result, an adjustment was made to the "amount of credit used on the taxpayer's individual income tax return." Taxpayers filed a protest. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Income Tax –Research Credit.**

**DISCUSSION**

At the outset the Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

In a protest letter to the Department, Taxpayers' representative states:

The Indiana Department of Revenue (IDR) audited tax years 2009, 2010, and 2011. The audit resulted in an adjustment of the amount of the Indiana Research Credit the Taxpayers could take on their individual IT-40s. The 2009, 2010 and 2011 Indiana Research Credits were respectively reduced . . . and their amount of tax due for the years were increased by the same amounts.

Taxpayers' representative also states that the "notices assessed additional interest and penalties . . ." The protest letter states:

The Taxpayers are shareholders in an Indiana S corporation, [Company Y], which has research expenses that qualified for the Indiana Research Credit. These credits were passed-through to the Taxpayers, which they took on their individual Indiana tax return for the three years in question.

At issue is an adjustment the auditor made "to the amount of the credit the Taxpayers could take on their individual Indiana tax returns for all three years in question." The auditor, as Taxpayers note, cites to Section 41 of the Internal Revenue Code. The audit report specifically quotes I.R.C. § 41(g), which states:

In the case of an individual who--

- (1) owns an interest in an unincorporated trade or business,
- (2) is a partner in a partnership,
- (3) is a beneficiary of an estate or trust, or
- (4) is a shareholder in an S corporation,

the amount determined under subsection (a) for any taxable year shall not exceed an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade or business or entity. If the amount determined under subsection (a) for any taxable

year exceeds the limitation of the preceding sentence, such amount may be carried to other taxable years under the rules of section 39; except that the limitation of the preceding sentence shall be taken into account in lieu of the limitation of section 38(c) in applying section 39. (Emphasis added).

Taxpayers state that the "sole issue under contention is that the Indiana Research Credit can only be used to offset taxes that are attributed to the business income of the pass-through entity that produces the Indiana Research Credit." Taxpayers state that "[t]his is how the research credit is treated for federal purposes under IRC Section 41(g)." Taxpayers, however, argue that "for Indiana purposes," the Indiana Code limits the research credit "to the Taxpayers' total Indiana state tax liability and not just the portion of the liability produced by the pass-through entity that generated the research credits."

Taxpayers rely on IC § 6-3.1-4-3, which states:

(a) The amount of the credit provided by this chapter that a taxpayer uses during a particular taxable year may not exceed the sum of the taxes imposed by [IC 6-3](#) for the taxable year after the application of all credits that under [IC 6-3.1-1-2](#) are to be applied before the credit provided by this chapter. If the credit provided by this chapter exceeds that sum for the taxable year for which the credit is first claimed, then the excess may be carried over to succeeding taxable years and used as a credit against the tax otherwise due and payable by the taxpayer under [IC 6-3](#) during those taxable years. Each time that the credit is carried over to a succeeding taxable year, it is to be reduced by the amount which was used as a credit during the immediately preceding taxable year. The credit provided by this chapter may be carried forward and applied to succeeding taxable years for ten (10) taxable years following the unused credit year.

(b) A credit earned by a taxpayer in a particular taxable year shall be applied against the taxpayer's tax liability for that taxable year before any credit carryover is applied against that liability under subsection (a).

(c) A taxpayer is not entitled to any carryback or refund of any unused credit.

Taxpayers argue that I.R.C. § 41(g) places a limit on how much credit can be claimed for federal income tax, and that IC § 6-3.1-4-3 provides a limitation based upon the taxpayer's tax liability—without a further limitation regarding whether the income was from a pass-through entity. Again, quoting the Taxpayers:

This Indiana Code Section . . . is simply stating any taxes created by Indiana Code 6-3, the code for the Indiana adjusted gross income tax, can be offset by the Indiana Research Credit. There is no mention of the credit being limited to the portion of the tax generated under Indiana Code 6-3 relating to the entity generating the tax credits.

IC § 6-3.1-4-4 authorizes the auditor to consider I.R.C. § 41(g):

The provisions of Section 41 of the Internal Revenue Code as in effect on January 1, 2001, and the regulations promulgated in respect to those provisions and in effect on January 1, 2001, are applicable to the interpretation and administration by the department of the credit provided by this chapter, including the allocation and pass through of the credit to various taxpayers and the transitional rules for determination of the base period.

The auditor also cites to IC § 6-3.1-4-7, which states:

(a) If a pass through entity does not have state income tax liability against which the research expense tax credit may be applied, a shareholder, partner, or member of the pass through entity is entitled to a research expense tax credit equal to:

(1) the research expense tax credit determined for the pass through entity for the taxable year; multiplied by

(2) the percentage of the pass through entity's distributive income to which the shareholder, partner, or member is entitled.

(b) The credit provided under subsection (a) is in addition to a research expense tax credit to which a shareholder, partner, or member of a pass through entity is otherwise entitled under this chapter. However, a pass through entity and a shareholder, partner, or member of the pass through entity may not claim a credit under this chapter for the same qualified research expenses.

Taxpayer cites to the Department's Schedule IT-20REC. The 2009 version of that form (State Form 49184

(R4/8-09)) states in relevant part that:

**Carryover of Unused Credits**

A taxpayer is not entitled to any carryback or refund of any unused credit. However, it is not limited, unlike the federal credit, to just the taxes imposed on income attributed to a particular business which generated the expense credit.

The current version of the form (State Form 49184 (R7/8-12)), states:

**Carryover of Unused Credits**

A taxpayer is not entitled to any carryback or refund of any unused credit. It is not limited, unlike the federal credit, to just the taxes imposed on income attributed to a particular business which generated the expense credit.

Taxpayers argue: "IT-20REC explicitly state the credit is not limited to the taxes imposed on income attributed to a particular business that generated the Indiana Research Credit." Taxpayer therefore requests that the Department "remove the limitations of the credit against only tax generated by the pass-through entity generating the credits . . ."

Based upon the arguments provided and a review of IC § 6-3.1-4-3, the Department finds that Taxpayers have met their burden of proof for their protest of the years at issue. As Taxpayers correctly noted, the Department's instructions state that unlike the federal credit, the Indiana credit is not limited "to just the taxes imposed on income attributed to a particular business which generated the expense credit." Taxpayers' protest is sustained.

**FINDING**

Taxpayers' protest is sustained.

*Posted: 03/25/2015 by Legislative Services Agency*  
An [html](#) version of this document.