

**Letter of Findings: 01-20140449
Individual Income Tax
For the Years 2011 and 2012**

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires the publication of this document in the Indiana Register. The 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 This document is effective on its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Individual shareholders of a Subchapter S Corporation that operated a gas station and convenience store failed to provide sufficient information to support their argument against the Department's income tax assessments. The shareholders bear the burden of proving that the Department's assessment is incorrect.

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).

Taxpayers argue that the Department of Revenue erred when it determined that Taxpayers owed additional individual income tax.

STATEMENT OF FACTS

Taxpayers own a Subchapter (or "Sub") S Corporation that operated an Indiana combination gas station and convenience store. The Department of Revenue ("Department") conducted sales and income tax audits of this business for the 2011 and 2012 tax years ("Tax Years"). The income tax audit found that the business made more sales than originally reported which "flowed through" to Taxpayers as the shareholders of the Sub S Corporation. The audit determined that Taxpayers owed additional individual income tax.

Taxpayers disagreed with the results of both the business and individual audit results and submitted separate protests to that effect. Administrative hearings were conducted in response to each protest, during which Taxpayers' representative explained the basis for the protests. The Department issued Letter of Findings 04-20140414 (February 25, 2015)("LOF") in response to Taxpayers' protest of the Department's sales tax assessment.

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

I. Individual Income Tax - Subchapter S Corporation Receipts.

DISCUSSION

Taxpayers maintain that they do not owe additional income tax because the Department's audit of Taxpayers' gas station/convenience store business contained errors.

In Taxpayers' protest, Taxpayers briefly asserted their disagreement with the Department's additional income tax assessments "based upon the pass-through entity adjustments."

The Department based its income tax assessments on Taxpayers' under-reporting of gasoline and diesel fuel sales, as well as convenience store retail sales subject to sales tax. The sales tax audit also showed Taxpayers had over-reported exempt gasoline and diesel fuel sales, as well as convenience store retail sales.

Taxpayers' 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 2011 and 2012. The examination revealed that Taxpayer had under-reported fuel sales, diesel fuel sales, and convenience store retail sales. During the audit, the Department requested additional documents from Taxpayers' representative. To attempt to respond to the Department's request, Taxpayers' representative requested source documents from representative's client multiple times. However, Taxpayers did not provide additional documents.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. IC § 6-8.1-5-1(c) provides that, "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, 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 generally apply to determine an individual shareholder's tax liability.

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

In the companion LOF 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. The Department based this finding on a comparison between the figures provided in Taxpayers' representative's income tax report to a total sales figure calculated after consulting the bizstats.com resource. This audit method yielded an increase in total sales, which affected the percentage of exempt sales claimed by Taxpayer. An increase in total sales, coupled with a reduction of sales qualified for an exemption, yielded a higher income to Taxpayers.

The Department notes that Taxpayers failed to produce source documentation establishing the amount of goods sold at its convenience store, source documentation establishing the number of items which were sold as "exempt," and source documentation establishing the number of items which were sold as "non-exempt." In addition, Taxpayers simply underreported to the Department the amount of gross sales sold in its convenience store.

The companion LOF, addressing the sales amount at Taxpayers' Sub S Corporation's combination gas station/convenience store, concluded as follows:

Given the fact that Taxpayer failed to retain or preserve source documentation of its day-to-day transactions, Taxpayer has not 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 Taxpayers failed to establish that they did not under report their convenience store sales, or that Taxpayers did not over-report their exempt sales. Therefore, the increase in total sales "flowed through" to Taxpayers as the shareholders of Taxpayers' Sub S Corporation and is properly categorized as additional income to its shareholders.

FINDING

Taxpayers' protest is respectfully denied.

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