

DEPARTMENT OF STATE REVENUE

01-20150387.LOF

**Letter of Findings Number: 01-20150387
Indiana Individual Income Tax
For Tax Years 2012 and 2013**

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. 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

Shareholder, an individual, had additional income and was liable for additional state individual income tax because the S Corporation was not allowed to deduct personal expenses incurred by Shareholder. To properly claim the deduction of its business expenses, the S Corporation was required to maintain adequate records.

ISSUE**I. Indiana Individual Income Tax - Imposition.**

Authority: I.R.C. § 1361; I.R.C. § 1362; IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3-2-2; IC § 6-3-2-2.8; IC § 6-8.1-5-1; IC § 6-8.1-5-4; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); [45 IAC 3.1-1-2](#); [45 IAC 3.1-1-3](#); [45 IAC 3.1-1-8](#); [45 IAC 3.1-1-9](#).

Taxpayer, the sole shareholder of an S Corporation, protests the Department's proposed assessments, claiming that the Department's audit erroneously disallowed certain legitimate expenses.

STATEMENT OF FACTS

Taxpayer is an individual and the sole shareholder of an Indiana S Corporation ("Corporation"). Corporation is in the residential and auto glass repair business. Corporation's income flows through to Taxpayer, the sole shareholder. Taxpayer is subsequently required to file his federal and Indiana individual income tax returns, reporting and remitting the income tax on the income received from Corporation.

The Indiana Department of Revenue ("Department") audited Corporation's business records for the 2012 and 2013 tax years. Pursuant to the audit, the Department found that Corporation claimed certain deductions on expenses which it classified as Corporation's business expenses, but disallowed personal expenses incurred by Taxpayer. Those personal expenses included, but not limited to, medical bills, veterinary bills, and child support payments. The audit disallowed those expenses. As a result, Corporation had additional taxable income, which subsequently passed through to Taxpayer. The Department thus assessed Taxpayer additional Indiana income tax.

Taxpayer protested the Department's assessment which stemmed from the audit's disallowance of certain Corporation's business expenses. A phone hearing was held during which Taxpayer's representatives explained the basis of the protest. This Letter of Findings results. Letter of Findings 04-20150145 (August 26, 2015), 20151028 Ind. Reg. 045150363NRA, addressed Corporation's protest of the Department's proposed assessments on sales/use tax separately. Additional facts will be provided as necessary.

I. Indiana Individual Income Tax - Imposition.**DISCUSSION**

Pursuant to the audit, the Department disallowed certain Corporation's business expenses, resulting in additional taxable income passed through to Taxpayer. Taxpayer, the sole shareholder, was assessed additional income tax as a result. Taxpayer protested the assessment which stemmed from the audit's disallowance of Corporation's business expenses.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012). Thus, a taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Additionally, IC § 6-8.1-5-4(a) specifically mandates "[e]very person subject to a listed tax must keep books and records so that the [D]epartment can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." The records referenced above "include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks." Id. The issue is whether Taxpayer meets the burden of proof demonstrating that the Department's proposed assessment was incorrect.

Indiana imposes a tax "on 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." IC § 6-3-2-1(a). With regard to corporations and nonresidents, IC § 6-3-2-2 specifically outlines what is income derived from Indiana sources and subject to Indiana income tax. For Indiana income tax purposes, the presumption is that taxpayers properly and correctly file their federal income tax returns as required pursuant to the Internal Revenue Code. Thus, to efficiently and effectively compute what is considered the taxpayers' Indiana income tax, the Indiana statute refers to the Internal Revenue Code.

An S Corporation is a small business corporation, which must meet certain statutory requirements and properly elect to be exempt from income tax for income tax purposes under I.R.C. §§ 1361 and 1362. An S Corporation generally does not pay taxes on its income. IC § 6-3-2-2.8; see also I.R.C. § 1361 et seq. Rather, the S Corporation's income subsequently passes through to its shareholders; its shareholders report and pay the income tax when they file their federal or state individual income tax returns. Id.

IC § 6-3-1-3.5(b) provides the starting point to determine the corporations' taxable income and to calculate what would be their Indiana income tax after applying certain additions and subtractions to that starting point. See also [45 IAC 3.1-1-8](#). Several deductions are allowed in determining Indiana Adjusted Gross Income under [45 IAC 3.1-1-9](#).

The expenses disallowed in this case were the expenses which Corporation deducted in its corporate income tax returns as business expenses. The audit noted that Corporation had been incurring certain expenses, including, but not limited to "medical bills, veterinary bills, child support payments, credit card payments for retail shopping stores, grocery store receipts, bed and breakfast expenses, utility expenses, and car payments for Taxpayer's daughter." The audit disallowed those expenses on the ground that the expenses were not ordinary, necessary, and reasonable in carrying out Corporation's business. Consequently, the audit disallowance resulted in additional unreported gross income which passed through to Taxpayer, the sole shareholder, who therefore had additional income tax pursuant to [45 IAC 3.1-1-2](#) and [45 IAC 3.1-1-3](#).

Taxpayer protested the disallowance, claiming that the disallowance of the expenses was overstated. Specifically, Taxpayer explained that (1) Corporation did not claim deduction on certain expenses noted as "personal draw"; (2) certain expenses were listed twice (i.e., duplicate) in the audit report; (3) although Taxpayer had been living in the same building that Corporation is located, Corporation was entitled to deduct some expenses associated with building, such as utility, repair and maintenance, and property tax. Taxpayer further proposed that Corporation should be allowed to deduct fifty percent of those expenses. This Letter of Findings addresses those issues as follows:

A. Personal Draw

Taxpayer stated that the audit erroneously disallowed certain expenses because Corporation did not deduct those expenses as business expenses in its corporate income tax returns for the tax years at issue ("IT-20S Returns"). Taxpayer explained that Corporation did pay those personal expenses, including medical bills and veterinary bills, during the tax years at issue, but it did not deduct those expenses as Corporation's business expenses. Referencing its IT-20S Returns and "Profit Loss" statements for the tax years at issue, Taxpayer explained that when Corporation filed its corporate income tax returns, it added those expenses back and never deducted those expenses. Taxpayer maintained that the audit erroneously disallowed the expenses which were not claimed in Corporation's IT-20S Returns.

Upon review, Taxpayer's documentation showed several manual calculations to compute Corporation's taxable income. Taxpayer, however, did not provide any supporting documentation concerning his basis in Corporation; nor did Taxpayer demonstrate that he had reimbursed Corporation. Both Corporation and Taxpayer are on notice that, in the absence of the supporting documentation, those payments made from Corporation's checking account to pay for Taxpayer's personal expenses generally were distributions to Taxpayer.

Nonetheless, the Department is mindful that, in this instance, Taxpayer is the sole shareholder to Corporation (an S Corporation). The audit disallowance eventually reached similar results as discussed above. Thus, the Audit Division is requested to review the items noted under "personal draw" in a supplemental audit review and determine whether those expenses were properly disallowed.

Given the totality of the circumstances, Taxpayer is sustained to the extent that the supplemental audit verifies the expenses not claimed and deducted by Corporation.

B. Duplicate Disallowance

Taxpayer pointed to the audit "additional income" list in the audit report, claiming that the audit erroneously disallowed certain expenses twice. To illustrate, Taxpayer explained that the audit listed "AT&T in the amount of \$2,990.23" and "AT & T Mobility in the amount of \$2,990.23" for the same tax year. Thus, Taxpayer asserted that audit disallowed the same expenses twice, overstating Corporation's income as a result.

Upon review, the Audit Division is requested to review the items listed in the audit report, if any, in a supplemental audit review and remove the duplicate assessments, if appropriate. Taxpayer is sustained to the extent that the supplemental audit verifies the duplicate assessments.

C. Non-Personal Use Percentage

Taxpayer stated that Corporation is located in a building and that Taxpayer has been living "in a 10 x 10 room of [that] building." Additionally, Taxpayer claimed that Corporation, including shop and office, occupies 50 percent of the building. Taxpayer thus contended that Corporation also incurred certain expenses, including utilities, repair and maintenance, and property tax, at 50 percent with respect to its use of that building and therefore was entitled to deduct 50 percent of the expenses incurred during the tax years at issue. Taxpayer thus asserted that the audit erroneously disallowed certain expenses, including utilities, repair and maintenance, and taxes, at 50 percent. To support its protest, Taxpayer offered copies of receipts and billing statements. Taxpayer also provided a copy of hand-drawn map to illustrate the use of the building, personal or otherwise.

Upon review, however, Taxpayer's reliance on its argument and supporting documentation is misplaced. Specifically, in this instance, Taxpayer's hand-drawn map cannot be verified regarding the percentage of use, personal or otherwise. Taxpayer had the opportunity to work with the Department's auditor, who would have had the first-hand knowledge and has been in better position to verify the use of the building, personal or otherwise, and the percentage of use. However, both Taxpayer and Corporation failed to do so during the audit review. Thus, the Department is not able to agree that Taxpayer met its burden to demonstrate that the audit assessment is wrong.

In short, Taxpayer's protest is sustained in part and denied in part. Taxpayer is sustained to the extent that the audit verifies Subpart A and Subpart B in a supplemental audit review and removes the assessments as deemed appropriate. Taxpayer's protest of Subpart C, the disallowance of expenses with respect to the use of the building, is denied.

FINDING

Taxpayer's protest is sustained, in part, subject to results of the Department's supplemental audit review. Taxpayer's protest of the disallowance of expenses with respect to the use of the building is respectfully denied.

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