

**Letter of Findings Number: 01-20120523  
Individual Income Tax  
For The Tax Years 2007-09**

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## ISSUES

### **I. Individual Income Tax - Imposition.**

**Authority:** IC § 6-3-1-3.5; IC § 6-8.1-3-2.2; IC § 6-8.1-3-1; IC § 6-8.1-5-1; IC § 6-8.1-5-4.

Taxpayer protests the Department's imposition of individual income tax.

### **II. Tax Administration—Fraud Penalty.**

**Authority:** IC § 6-8.1-10-1; IC § 6-8.1-10-4.

Taxpayer protests the imposition of a one hundred percent fraud penalty.

## STATEMENT OF FACTS

Taxpayer is an Indiana resident. The Indiana Department of Revenue ("Department") determined that Taxpayer had not reported the proper amount of income on her Indiana individual income tax returns for the tax years 2007, 2008, and 2009. The Department issued proposed assessments for individual income tax, interest, and penalty for each of these years. Those proposed assessments advanced to Demand Notices for payment, but they are still the same liabilities as they were at the proposed assessment stage. This Letter of Findings addresses those proposed assessments. Taxpayer protested the Department's calculations of income tax and the imposition of fraud penalty for these years. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

### **I. Individual Income Tax - Imposition.**

## DISCUSSION

Taxpayer protests the Department's imposition of individual income tax for the tax years 2007, 2008, and 2009. In the course of an investigation of Taxpayer's compliance with sales and use taxes with regards to sales of dogs and puppies during the tax years, the Department determined that Taxpayer had unreported sales which in turn resulted in additional income from those sales. The Department based its calculations on the best information available to it at the time. Taxpayer argues that the Department over-stated the volume and value of the sales. 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).

Indiana individual income tax is imposed under IC § 6-3-1-3.5. Also, IC § 6-8.1-3-1(a) states:

The department has the primary responsibility for the administration, collection, and enforcement of the listed taxes. In carrying out that responsibility, the department may exercise all the powers conferred on it under this article in respect to any of those taxes.

Also, IC § 6-8.1-3-2.2 provides:

- (a) This section does not:
  - (1) apply to an otherwise lawful investigation concerning organized crime activities; or
  - (2) prohibit, restrict, or prevent the exchange of information if a person is being investigated for multiple violations of [IC 6-2.5](#) (state gross retail and use taxes).
- (b) As used in this section, "investigation" means an oral or written inquiry directed to a person, organization,

or governmental entity.

(c) As used in this section, "surveillance" means the monitoring of a person, place, or event by:

- (1) electronic interception;
- (2) overt or covert observations;
- (3) photography; or
- (4) the use of informants.

(d) The commissioner or an employee of the department may not knowingly authorize, require, or conduct:

- (1) an investigation; or
- (2) a surveillance;

unless the purpose of the investigation or surveillance is reasonably related to the administration of a listed tax.

(Emphasis added).

Another relevant statute is IC § 6-8.1-5-1(b), which provides:

If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to [IC 6-8.1-10](#) concerning the imposition of penalties and interest. The department shall send the person a notice of the proposed assessment through the United States mail. (Emphasis added).

Next, IC § 6-8.1-5-4 states:

(a) Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

(b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person has filed:

- (1) for an unlimited period, if the person fails to file a return or receives notice from the department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return; or
- (2) in all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the department consents to earlier destruction.

In addition, if the limitation on assessments provided in section 2 of this chapter is extended beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.

Therefore, IC § 6-8.1-3-2.2 explains that the Department may conduct an investigation if it is reasonably related to the administration of a listed tax. In this case, the Department conducted an investigation which was reasonably related to the administration of sales tax and individual income tax, which in turn resulted in the individual income tax assessments at issue in this protest.

As a result of the investigation, the Department determined that Taxpayer had not included the income from the sales of the dogs and puppies in her Indiana individual income tax calculations for the tax years in question, as required under IC § 6-3-1-3.5. Since Taxpayer did not keep books and records available for the Department to review, as required by IC § 6-8.1-5-4, the Department based the proposed assessments on the best information available to it at the time it issued the liabilities in question, as provided by IC § 6-8.1-5-1(b).

In the course of the protest and hearing process, Taxpayer provided documentation previously unavailable to the Department in support of her position that she did not owe Indiana individual income tax on the profits from the sales at issue. Primarily, Taxpayer provided documentation establishing that Taxpayer's mother, not Taxpayer, owned the farm where the sales took place. Taxpayer argues that, similarly to the fact that she did not own the real property where the dogs/puppies were sold, she did not own the tangible personal property (dogs/puppies) which was sold thereupon.

The information provided in the administrative protest and hearing process establishes that Taxpayer's mother

has claimed full ownership of the dogs and the associated tax responsibilities and liabilities which flowed from their sale. Taxpayer appears to have been acting as an employee of the dog and puppy business. While Taxpayer might have received compensation for such employment, the income at issue in this protest stems from the profits of selling the dogs and puppies. The Department agrees with Taxpayer's protest. Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c).

### **FINDING**

Taxpayer's protest is sustained.

## **II. Tax Administration–Fraud Penalty.**

### **DISCUSSION**

The Department imposed one hundred percent fraud penalties under IC § 6-8.1-10-4 and interest for each tax year at issue. Under IC § 6-8.1-10-2(e), the Department may not waive interest. Taxpayer protests the imposition of a one hundred percent fraud penalty. Since Taxpayer has been sustained in whole regarding base tax in Issue I above and since penalty is based on a percentage of base tax, the imposition of penalty is moot. Taxpayer does not owe any penalty or interest regarding the liabilities at issue in this case.

### **FINDING**

Taxpayer's protest of the fraud penalty is sustained.

### **CONCLUSION**

Taxpayer is sustained on Issue I regarding Indiana individual income for the tax years 2007, 2008, and 2009. Taxpayer is sustained on Issue II regarding the imposition of penalty.

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