

Letter of Findings: 01-20160107; 01-20160108; 01-20160109
Individual Indiana Income Tax
For the Year 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Shareholders of S Corporations operating combination gas station / convenience stores, were unable to meet their burden of establishing that the Department's proposed assessments of additional income tax were wrong; Shareholders failed to maintain complete, contemporaneous, accurate records of fuel and convenience store items sales.

ISSUE

I. Indiana Individual Income Tax - Flow-Through Business Income.

Authority: IC § 6-3-4-11; IC § 6-3-4-11(a); IC § 6-8.1-5-1(b); IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); 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); [45 IAC 15-5-1](#).

Taxpayers argue that the Department of Revenue overstated the amount of income attributable to their shared ownership of four combination gas station / convenience stores business locations.

STATEMENT OF FACTS

Taxpayers are equal shareholders of Indiana combination gas station / convenience stores organized as two separate S Corporations. The S Corporations operate four different retail locations which sell fuel and convenience store items. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of the business locations. That audit resulted in an assessment of additional tax based on the audit's determination that the two businesses earned previously unreported additional income. The additional income eventually "flowed-through" to the S corporations' shareholders.

As a result, the Department issued Taxpayers an assessment of additional individual income tax. Taxpayers disagreed with the assessment of income tax and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayers' representatives explained the basis for the protest. This Letter of Findings addresses the assessments of individual income tax.

I. Indiana Individual Income Tax - Flow-Through Business Income.

DISCUSSION

The issue is whether Taxpayers have established that the assessments of Indiana income tax are unwarranted on the ground that the Department's audit overstated the amount of convenience store and fuel sales.

A. Audit Results.

The Department's audit requested copies of complete business records in order to determine if sales tax had been properly collected and remitted. The audit requested "z-tapes, sales invoices, sales journals, and bank statements." Taxpayers' representatives explained that these records were not retained because "that would be a lot of paper." Taxpayers' representatives did provide copies of bank statements.

The Department's audit reviewed records of fuel sales. The audit noted "large variances" in the amount of fuel purchased and the amount of fuel sold. In one location, those "variances" exceeded one million dollars.

In the absence of convenience store sales records, the audit considered records of store purchases and used those amounts to determine an amount of store sales. However, the audit excluded "lottery and other non-retail sales . . ." from the amount of taxable sales.

The audit also reviewed business purchases. In the absence of more direct information, the audit was unable to determine if tax was paid on the purchase of capital and other items. Based on the bank records, the audit determined that the businesses paid for "repair and maintenance supplies, store expenses and miscellaneous supplies" along with expenses for the "payment of leased equipment." The audit assessed use tax on these transactions.

B. Taxpayers' Response.

Taxpayers' representatives object to the assessment of flow-through income on the ground that the audit's assessment constituted a mere "guestimate." In its response to the audit's conclusion that the stores under-reported their fuel sales, Taxpayers state that the audit was without factual foundation in determining the purported price of the fuel sold at the various locations. In particular, Taxpayers' representatives criticize the audit's reliance on information available from the United States Energy Information Administration (www.eia.gov) to determine the price of fuel sold at the four business locations. Taxpayers repeat their assertion that reliance on this information constitutes "ONLY A GUESTIMATE OF SALES."

According to the Taxpayers' representatives, the Department should have relied on more "traditional audit procedures" to determine the fuel and store sales. According to the representatives, the audit should have relied on the "reconciliation of bank deposits, T-Method Cash Accounting, etc." to determine the store and fuel sales.

Taxpayers' representatives state that the audit results are further flawed by the failure to consider income as reported on the Taxpayers' state and federal income tax returns, the failure to account for transfers of money between business bank accounts, the failure to account for deposits made by the various business owners for additional working capital needs, and the failure to properly account for deposits from [the] business owners "other business interests."

C. Hearing Analysis.

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). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

As individuals operating multiple locations conducting retail transactions and collecting sales tax on behalf of the state, Taxpayers were required to maintain complete, contemporaneous, and accurate financial records including cash register receipts. "Every 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." IC § 6-8.1-5-4(a). The "records" referenced "include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks." *Id.*

In the absence of accurate or complete records, Indiana law requires that the Department issue a proposed assessment based on the best information the Department can obtain. "If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(b). See also [45 IAC 15-5-1](#).

Because they are operated as S-corporation, IC § 6-3-4-11 imposes on the Taxpayers the responsibility for paying Indiana individual income tax on their share of the income earned from their multiple gas station / convenience stores. The statute provides in part:

A partnership as such shall not be subject to the adjusted gross income tax imposed by [IC 6-3-1](#) through [IC 6-3-7](#). Persons or corporations carrying on business as partners shall be liable for the adjusted gross income tax only in their separate or individual capacities. In determining each partner's adjusted gross income, such partner shall take into account his or its distributive share of the adjustments provided for in [IC 6-3-1-3.5](#).

IC § 6-3-4-11(a) (Emphasis added).

The Department is unable to agree that Taxpayers have made any coherent or quantifiably specific objection to the results of the audit. Rather than offering a specific alternative, Taxpayers have simply set forth a litany of complaints and criticisms. The Department does not disagree with Taxpayers suggestion that there may be alternative methods of determining the income from these four locations, but Taxpayers have done nothing to meet their burden establishing that the assessments are "wrong" as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayers' protests are denied.

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