DEPARTMENT OF STATE REVENUE

03-20160301.LOF

Letter of Findings: 03-20160301
Withholding Tax
For the Years 2011, 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

The Department was unable to agree with Indiana Employer's assertion that - in instances where it failed to obtain or maintain records of its employee's county of residence - it was required to withhold its employee's income tax at the non-residence rate.

ISSUES

I. Withholding Tax - Audit Calculations.

Authority: IC § 6-3-4-8(a); IC § 6-3-4-8(a)(1); IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); Indiana Dep't of State Rev. 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); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 3.1-1-97; Income Tax Information Bulletin 32 (July 2008); Departmental Notice 1 (October 1, 2013).

Taxpayer argues that the Department erred when it assessed Taxpayer additional withholding tax at the Marion County resident withholding rate.

II. Withholding Tax - Negligence Penalty.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(2); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer maintains that it is entitled to an abatement of the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana business that conducts research and manufacturing activities. Taxpayer's facilities are located in Marion County, Indiana. The Indiana Department of Revenue ("Department") conducted a withholding tax audit. After reviewing Taxpayer's business records and withholding tax returns, the Department assessed additional withholding tax.

Taxpayer disagreed with the assessment arguing that the assessment overstated the amount of Taxpayer's tax liability. An administrative review was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Withholding Tax - Audit Calculations.

DISCUSSION

The issue is whether the Department correctly calculated the amount of Taxpayer's additional withholding tax liability. Taxpayer argues that the audit erred in calculating the amount of additional tax due for two reasons. Taxpayer states that three employees did not work for Taxpayer during the entire three-year audit span and that the remaining assessment should be calculated at the Marion County non-resident rate.

The Department's audit report explains the reasons for the assessment:

> During calendar years 2011, 2012, and 2013 there were found instances when the [T]axpayer failed to withhold county income taxes for a number of employees, therefore an adjustment has been made to the [T]axpayer's withholding tax liability. The [T]axpayer was given numerous opportunities to provide information that would prove why withholding tax should not be due on these employees and no information was supplied.

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, the 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). When an agency is charged with enforcing a statute, the courts defer to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." Indiana Dep't of State Rev. v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014).

Every employer is required to withhold taxes on payments of wages it pays to its employees pursuant to IC § 6-3-4-8(a) which states in part as follows:

> Except as provided in subsection (d), every employer making payments of wages subject to tax under this article, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, **shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department.** The department shall base its withholding instructions on the adjusted gross income tax rate for persons, on the total rates of any income taxes that the taxpayer is subject to under IC 6-3.5, and on the total amount of exclusions the taxpayer is entitled to under IC 6-3-1-3.5(a)(3) and IC 6-3-1-3.5(a)(4). However, the withholding instructions on the adjusted gross income of a nonresident alien (as defined in Section 7701 of the Internal Revenue Code) are to be based on applying not more than one (1) withholding exclusion, regardless of the total number of exclusions that IC 6-3-1-3.5(a)(3) and IC 6-3-1-3.5(a)(4) permit the taxpayer to apply on the taxpayer's final return for the taxable year. Such employer making payments of any wages:
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> (1) **shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld under this section** and shall not be liable to any individual for the amount deducted from the individual's wages and paid over in compliance or intended compliance with this section; and
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> (2) shall make return of and payment to the department monthly of the amount of tax which under this article and IC 6-3.5 the employer is required to withhold.

Accordingly, IC § 6-3-4-8(a) requires an employer to "withhold, collect, and pay over income tax on wages paid by such employer to such employee . . . [in] the amount prescribed in withholding instructions issued by the department." IC § 6-3-4-8(a)(1) provides that the employer is "liable to the state of Indiana for the payment of the tax required to be deducted and withheld." (Emphasis added). IC § 6-3-4-8 specifically provides that the employer is liable for the amount that it was required to withhold.

45 IAC 3.1-1-97 further explains in relevant part:

> Employers who make payments of wages subject to the Adjusted Gross Income Tax Act, and who are required to withhold Federal taxes pursuant to the Internal Revenue Code (USC Title 26), **are required to withhold from employees' wages Adjusted Gross and County Adjusted Gross Income Tax**. (**Emphasis added**).

The employers are "[W]ithholding agent who are required to withhold Indiana Adjusted Gross Income Tax and County Adjusted Gross Income Tax . . . ." Id. "All amounts deducted and withheld by an employer shall immediately upon deduction become the money of the State." Id. The regulation further states, "In the case of delinquency or nonpayment of withholding tax, the employer is liable for such tax, penalties, and interest." Id.

However, Taxpayer argues that the Department's assessment is overstated because three of its employees were not employed by Taxpayer for the entire three-year audit period.

For the county income tax withholding, the Department's Income Tax Information Bulletin 32 (July 2008), 20080827 Ind. Reg. 045080659NRA, generally explains as follows:

> **I. County of Residence and County of Work**
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> The taxpayer's county of residence is determined as of January 1 each year. For purposes of county tax, an individual's county of residence is determined by the county where the taxpayer maintains his home.
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> The taxpayer's county of principal work activity is also determined as of January 1 each year. An individual's county of principal work activity is that county where the taxpayer receives the greatest percentage of his gross income from salaries, wages, commissions, fees or other income of this type. . . .

The Departmental Notice 1 (current version is available at http://www.in.gov/dor/reference/files/dn01.pdf, last visited August 5, 2016) provides relevant information to compute the state and county taxes, as follows:

> Both the county of residence and the county of principal employment of an individual are determined on January 1 of the calendar year in which the individual's taxable year commences. An individual cannot be subject to both a resident rate and a nonresident rate at the same time. If a person resides in an adopting county on January 1, he or she is subject to that county's resident rate. If a person resides out-of-state on January 1, but works in an Indiana county as of January 1, he or she is subject to the nonresident rate corresponding to his or her Indiana county of principal employment . . . .

The Department agrees that the assessment related to the three employees at issue should be revisited. To the extent that the three individuals' employment did not span the three audit years, the assessment should be adjusted.

Taxpayer makes a secondary argument. Taxpayer admits that it "failed to secure properly completed Indiana Form WH-4 that detailed a certain employee's county of residence" and that the Department assessed withholding tax at the Marion County resident rate. However, Taxpayer states that there is "limited guidance on what taxpayers should do if they are unaware of an employee's county of residence." Taxpayer concludes that when an employer "has no evidence of the employee's county of residence . . . a fair assessment would be to calculate the withholding tax liability using the Marion County non-resident rate . . . ." (Emphasis added). Taxpayer asserts that assessing at the non-resident rate avoids "unjustly enriching the State since it is very likely most or not all taxes have been paid by the employees."

The Department does not agree that the default assessment should be determined at the non-resident rate because doing so glosses over a taxpayer's responsibility to obtain and retain records sufficient to determine any tax liability. As stated in IC § 6-8.1-5-4(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 tax by reviewing those books and records." In this instance, the Department is unable to agree with Taxpayer's analysis and its underlying assertion that it has met its burden of establishing that this portion of the assessment was "wrong." IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied in part and sustained in part.

II. Withholding Tax - Negligence Penalty.

DISCUSSION

Taxpayer objects to the imposition of a ten percent "negligence penalty" arguing that it acted reasonably and with due diligence in fulfilling its responsibility to pay the full amount of withholding tax that was due the state.

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if a tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment - including the negligence penalty - is presumptively valid.

In addressing the issue of whether Taxpayer exercised "ordinary business care," Taxpayer argues that it "has a long history of compliance and any additional tax, that may be ultimately due, is not the result of willful neglect."

The Department is unable to agree that Taxpayer exercised the "reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer" when it failed to meet its responsibility of withholding county withholding tax on behalf of all its employees or of obtaining and maintaining the records necessary to calculate the correct amount of tax due for each of these employees." Based on a "case-by-case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department does not agree that the ten-percent negligence penalty should be abated.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

To the extent that three of Taxpayer's employees were not employed during all three of the years under audit, Taxpayer is entitled to an adjustment of the withholding tax assessment. In all other respects, Taxpayer's protest was denied.

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