

**Letter of Findings Number: 01-20160758; 01-20160759**  
**Individual Income Tax**  
**For Tax Years 2013 & 2014**

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Individual Shareholders proved that the Department's calculations of individual income tax were incorrect because the income tax liability was miscalculated. Individual Shareholders were not entitled to abatement of penalties because they did not demonstrate that they exercised ordinary business care, and interest may not be abated under Indiana law.

### ISSUES

#### I. Income Tax—Individual Income.

**Authority:** IC § 6-3-2-1; IC § 6-8.1-5-1; Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayers protest proposed assessments for additional income tax.

#### II. Tax Administration—Penalties and Interest.

**Authority:** IC § 6-8.1-5-4; IC § 6-8.1-10-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayers protest the imposition of penalties and interest.

### STATEMENT OF FACTS

Taxpayers are shareholders in an S-corporation operating a convenience store with an attached gas station ("S-corp"). As the result of an audit, the Indiana Department of Revenue ("Department") determined that S-corp did not accurately report total sales and taxable sales for the tax years 2013 and 2014 ("Tax Years") which resulted in proposed sales tax assessments for those years being issued to S-corp. Also, the increase in calculated sales resulted in additional income from those increased sales. Since S-corp was operated as a pass-through entity, the Department issued proposed assessments to the shareholders of S-corp for individual income tax for the Tax Years. S-corp protested the proposed income tax assessments issued to it. Taxpayers also protest the proposed assessments for individual income tax, penalties, and interest. An administrative hearing was held to address the income tax protest for S-corp. A separate Letter of Findings 04-20160581 addresses S-Corp's protest of the income tax audit. Further facts will be supplied as required.

#### I. Income Tax—Individual Income.

### DISCUSSION

Taxpayers protest that the Department erred in its calculations of taxable sales at S-corp which in turn led to erroneous calculations in the Department's determination of individual income tax due from Taxpayers as shareholders of S-corp. The Department based its calculations of total sales and taxable sales tax on its determination that S-corp had failed to keep documentation which it was statutorily required to keep which would verify its reported sales figures for the Tax Years. The Department reviewed what business documents were available and combined that information with statistical averages from BizStats.com and used those numbers to determine the amount of S-corp's sales and taxable sales. The Department then issued proposed assessments

for sales tax, penalties, and interest to S-corp. The Department's calculations also resulted in the determination that S-corp had additional income from the additional sales, which in turn resulted in income flowing through to Taxpayers as shareholders in a disregarded entity. The Department issued proposed assessments for individual income tax, penalties, and interest to Taxpayers for the Tax Years at issue.

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 Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. 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, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

IC § 6-3-2-1(a) provides for the imposition of individual income tax. Taxpayers protest the proposed assessments for individual income tax based on S-corp's protest of the Department's calculations of S-corp's total sales, taxable sales, and income. Specifically, S-corp protested that the Department used the incorrect statistical averages to determine fuel sales and that a different, presumably correct, calculation of fuel sales would result in significantly reduced amounts of sales and income for S-corp. Those reduced amounts of income for S-corp would then result in reduced income flow-through to Taxpayers.

In a separate Letter of Findings, the Department denied S-corp's protest of the calculations of additional sales which gave rise to the additional income for S-corp. The Department found that it used the correct calculation of fuel sales in the audit and also determined that S-corp's alternate calculation was not accurate because it was based upon incomplete business records. The Department did find, however, that the income tax audit did not accurately account for the S-corp's change in inventory and total expense amounts reported for 2014. Since Taxpayers' protest in the instant case is wholly dependent on the outcome of S-corp's protest of the calculations of additional sales and the change in inventory and total expense amounts, Taxpayers' protest is also denied in part and sustained in part. Taxpayers' income tax liability will be recalculated based upon the results of a supplemental audit of S-corp.

## FINDING

Taxpayers' protest is denied in part and sustained in part, subject to supplemental audit.

## II. Tax Administration—Penalties and Interest.

### DISCUSSION

Taxpayers protest the imposition of penalties pursuant to IC § 6-8.1-10-2.1 and the imposition of interest pursuant to IC § 6-8.1-10-1. The Department notes that waiver of interest is not permitted under IC § 6-8.1-10-1(e). Penalty waiver is permitted if the taxpayers show that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. [45 IAC 15-11-2\(b\)](#) clarifies the standard for the imposition of the negligence penalty as follows:

"Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2\(c\)](#) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. 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 this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayers protest the Department's assessment of penalties and interest. After review of the documentation and analysis provided in the protest process, the Department may not waive interest, as provided by IC § 6-8.1-10-1(e). Also, Taxpayers were the owners and operators of S-corp. As explained in the Letter of Findings for S-corp's protest of income tax assessments, Taxpayers failed in their duty as the owners/operators of S-corp to keep sales records as required under IC § 6-8.1-5-4(a). That failure as the owners/operators of S-corp, along with the Department's audit conclusion that S-corp owed additional sales tax, directly led to the imposition of the income tax assessments at issue in this protest. Taxpayers have not affirmatively established that they exercised ordinary business care in this case. Therefore, waiver of penalties is not warranted under [45 IAC 15-11-2\(c\)](#). However, since Taxpayers were sustained in part in Issue I above, base tax may be reduced in a supplemental audit. Penalties will be correspondingly recalculated based upon any adjustments of base tax.

#### **FINDING**

Taxpayers' protest to the imposition of penalties and interest is denied.

#### **SUMMARY**

Taxpayers' Issue I protest regarding the imposition of adjusted gross income tax is denied in part and granted in part. Taxpayers' Issue II protest regarding the imposition of penalties and interest is denied.

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