

Letter of Findings: 01-20160725
Individual Income Tax
For the Year 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Individual was not subject to Indiana income tax on money withdrawn from his 401K plan because the withdrawal was in the form of a loan, he had made arrangements with his employer to repay the loan, and that the Individual had made regular payments on the amount borrowed from the plan.

ISSUE

I. Individual Income Tax - 401K Withdrawal.

Authority: IC § 6-3-1-3.5(a); IC § 6-3-1-8; IC § 6-8.1-5-1(c); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); 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); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); I.R.C. § 61; I.R.C. § 62; I.R.C. § 72(p); I.R.C. § 401(k).

Taxpayer argues he is not subject to individual income tax on an amount of money borrowed from a retirement account.

STATEMENT OF FACTS

Taxpayer is an Indiana resident who filed a 2013 individual income tax return. The Indiana Department of Revenue ("Department") assessed Taxpayer additional income tax based upon information obtained from the Internal Revenue Service.

Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer explained the basis for the protest. This Letter of Findings results.

I. Individual Income Tax - 401K Withdrawal.

DISCUSSION

The issue is whether Taxpayer is subject to Indiana income tax on money withdrawn from Taxpayer's retirement fund.

The proposed assessment constitutes evidence that the Department's claim for the unpaid tax is valid, and each taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); 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). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position 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). In reviewing a taxpayer's argument, the Indiana Supreme Court has held, that when it examines a statute that an agency is "charged with enforcing . . . we 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).

Indiana imposes on individuals an income tax based on each individual's "adjusted gross income." Indiana

borrowers the definition of "adjusted gross income" from I.R.C. § 62 with certain modifications specific to Indiana. IC § 6-3-1-3.5(a). Thus "adjusted gross income" is, "in the case of an individual, gross income minus . . . [certain] deductions." I.R.C. § 62. Similarly, the Act incorporates the definition of "gross income" as found in I.R.C. § 61(a). IC § 6-3-1-8. Therefore, "gross income" consists of "all income from whatever source derived . . ." I.R.C. § 61(a).

Taxpayer withdrew \$16,000 from his 401K retirement account. Upon doing so, the IRS adjusted his adjusted gross income to reflect the amount of the withdrawal. That adjustment "flowed through" to the amount of adjusted gross income indicated on his 2013 Indiana return. That "flow through" resulted in the assessment of which Taxpayer now objects.

Taxpayer argues that the withdrawal proceeds are not subject to tax because the money came to him in the form of a loan and that he has made regular repayments on that loan.

A 401K plan is a tax-qualified, pension plan as defined at I.R.C. § 401(k). Each plan is funded by payments deducted from an employee's paycheck before taxes are calculated. In general, loans are treated as taxable distributions under I.R.C. § 72(p) and therefore treated as income for federal and state purposes. However, if a loan meets certain criteria set forth under I.R.C. § 72(p)(2), the loan may be partially or totally excluded from a taxpayer's federal gross income. Individuals may borrow from the plan without penalty as long as the amount is repaid in accordance with I.R.C. § 72(p). However, the amount borrowed becomes a deemed distribution of income subject to individual tax when the individual borrower fails to meet certain statutory requirements. Id.

Taxpayer has documented that: (1) he made the withdrawal in the form of a loan; (2) that the loan amount met the exception under I.R.C. § 72(p)(2)(A); (3) that he arranged to have the loan repaid over 60 months; (4) that he currently is in the process of repaying the loan; (5) that the monthly payments are being regularly withheld by his employer; and (6) that, as of the date of this Letter of Findings, he has substantially repaid the amount borrowed from the 401K plan.

Taxpayer has met his burden under IC § 6-8.1-5-1(c) of establishing that the assessment of additional tax on money borrowed from his 401K plan was incorrect.

FINDING

To the extent that the Department assessed additional income tax on money withdrawn from his 401K retirement account, Taxpayer's protest is sustained.

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