

**Letter of Findings: 01-20160660  
Individual Income Tax  
For the Years 2008 through 2015**

**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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 rejected in large part Individuals' arguments that an audit assessment of additional individual income tax should be adjusted; Individuals failed to file returns for seven tax years; their arguments to adjust the assessment were speculative and lacked the documentation necessary to establish the assessment was wrong.

### ISSUE

#### **I. Indiana Individual Income Tax - Business Income.**

**Authority:** 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 and individual ownership of various Indiana businesses.

### STATEMENT OF FACTS

Taxpayers are husband and wife shareholders, employees, responsible officers, and owners of Indiana businesses.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayers' business records.

Taxpayers did not file Indiana income tax returns for the years 2008 through 2015. Taxpayers are "shareholder-employees" of an Indiana construction business. According to the audit report, Taxpayers "were receiving compensation from that company in the form of payments for their personal expenses which included debit card transactions and checks written for "food, medicine, and other personal items." Taxpayers took "cash withdrawals" from the construction business bank accounts. In addition, Taxpayers received payments from the company for "auto and truck expenses" and for "fuel."

Prior to 2010, Taxpayer/husband worked for a family corporation. The audit found that family corporation did not issue W-2s or 1099-MISC forms to Taxpayer/husband.

Taxpayer/wife was the sole owner of a retail business.

The Department's audit requested information and records for Taxpayers' construction business. That information was not provided.

In the absence of financial records, business records, state income tax returns, or federal tax returns, the Department's audit issued assessments based on "U.S. Bureau of Labor Statistics" in order to determine the "average median wage for operating engineers and other construction equipment operators in [] Indiana."

The audit determined that Taxpayer/wife received income attributed to the retail business. Because there were no financial records for the retail business, the Department calculated Taxpayer/wife's income based on the last year in which retail business reported sales tax.

The Department's audit calculated Taxpayers' total income "from wages, ordinary business from the [construction company] s-corporation, and net business income from the [Taxpayer/wife's] sold proprietorship." In arriving at an amount of taxable income, the audit allowed a deduction for "self-employment taxes," allowed Taxpayers one standard exemption for each tax year, and allowed credit for state and county taxes withheld by the construction company.

The audit assessed local income tax for the county in which Taxpayers resided.

Taxpayers disagreed with the assessment and submitted a protest to that effect. The Department conducted two administrative hearings during which Taxpayers' representative explained the basis for the protest. This Letter of Findings results.

## **I. Indiana Individual Income Tax - Business Income.**

### **DISCUSSION**

The issue is whether Taxpayers have established that the Department's assessment of individual income tax is erroneous because the assessment overstates the amount of income Taxpayers received during 2008 through 2014.

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 business 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 - for the retail business - 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](#).

Taxpayers' representative admits that the construction business's records "became disorganized and tax filings were missing" but argues that the Department audit relied on "various assumptions and estimations and conclusions that are not accurate." Taxpayers' representative explained that Taxpayer/wife's retail business ceased activity in 2013 and that Taxpayer/husband did not receive formal wages from the construction business. According to Taxpayers' representative the actual amount of "reasonable compensation" Taxpayer/husband received from the construction business during 2010 was \$0 and that any remaining assessment "needs to be adjusted down by [25 percent] to reflect that he did not receive any income during the [s]pring of 2011."

Taxpayers also disagree with the assessment because the Department failed to allow a reasonable depreciation on the construction company's equipment.

Taxpayers argue that the audit report "has not provided any detail of her calculations to the taxpayer, and the taxpayer believes that part of the income that the auditor has included is actually a capital contribution . . . ."

In a separate but related protest, the Department agreed that Taxpayer/wife's retail business ceased business in August 2013. See Letter of Findings 04-20160661 (June 16, 2017). As a result, the Letter of Findings requested

the Department's audit division "review the original assessment and to make whatever adjustments are needed to reflect the determination that [retail business] ceased business August 2013." Since the retail business adjustment is related to the Taxpayers' income tax assessment, the retail business adjustment will "flow-through" to the Taxpayers' income tax assessment.

However, in all other respects, Taxpayers' protest is denied. Taxpayers' objections are incomplete, speculative, unsupported and do not justify any specific adjustment to the remaining income tax assessment. Taxpayers have failed to meet their statutory obligation under IC § 6-8.1-5-1(c) of establishing that the assessment is wrong.

### **FINDING**

Taxpayers' protest is sustained in part and denied in part. The Department's adjustment to the amount of income attributable to the Taxpayer/wife's retail business will affect in part the Taxpayers' income tax assessment.

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