

**Letter of Findings: 01-20170146**  
**Individual Income Tax**  
**For the Years 2010, 2011, and 2012**

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Indiana Restaurant Partner failed to establish that the Department's assessment of additional income tax on the flow-through restaurant income was "wrong;" the Department established that Restaurant Partner's restaurant income was underreported, and the assessment was not issued outside Indiana's statute of limitations.

### 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 § 6-8.1-5-2(b); *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 3.1-1-106](#); [45 IAC 15-5-7\(e\)](#).

Taxpayer argues that the Department of Revenue overstated the amount of income attributable to his shared ownership of an Indiana restaurant, and that the assessment of tax was outside the statute of limitations.

### STATEMENT OF FACTS

Taxpayer is a partner in an Indiana restaurant. The Indiana Department of Revenue ("Department") along with local law enforcement agencies conducted an audit investigation of the restaurant's books, records, and tax returns. The investigation resulted in the issuance of the Department's "Case Report" dated December 2104. The Case Report concluded that during 2010 through 2012, the restaurant failed to report the full amount of its sales. Accordingly, the Department issued the restaurant assessments of additional tax.

As a partner to the restaurant, the Department conducted an audit review of Taxpayer's own income tax returns and tax records resulting in the assessment of additional Indiana income tax.

Taxpayer protested the assessment of income tax. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

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

### DISCUSSION

Taxpayer objects to the assessment of additional income tax on the ground that the assessments are overstated, that the Department acted outside its authority in assessing the tax and that the assessments are barred by the statute of limitations.

As a threshold issue, it is the Taxpayer's 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 and investigative report, are entitled to deference.

Because the restaurant is operated as an S-corporation, IC § 6-3-4-11 imposes on the Taxpayer the responsibility for paying Indiana individual income tax on his share of the income earned from the restaurant. 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*); see also [45 IAC 3.1-1-106](#).

In the 2014 "Case Report" issued by the Department's "Special Investigation Division," the Department found that Taxpayer's restaurant underreported the amount of sales which occurred at the restaurant location.

The Department's investigation found that the restaurant failed to maintain "source documents" and that it was the restaurant's practice to destroy "guest check tickets" on a regular basis. In addition, the audit questioned the accuracy of the restaurant's daily summary register tapes ("z-tape") because the cash register daily tapes were not retained. The audit report also indicates that it was the practice of restaurant employees to "register a lesser amount than the actual sales price," use the "no sale" register button to ring up particular transactions, and routinely "left the cash register drawer open between customers." Further, the audit found that a review of the restaurant's bank accounts established "that there were no cash deposits for many months, and often there were no cash deposits for years."

In reviewing the restaurant's general ledgers, the Department found that restaurant "[r]evenues were increased and cash on hand was increased in order to balance [] accounting entries." According to the Department's investigative report, the restaurant's practice of adjusting the general ledger entries "indicates the business was not reporting all their sales" and that restaurant records were incomplete and unreliable.

The Department is unable to agree with Taxpayer that the assessment of additional tax was unfounded or that the Department had no basis upon which to issue the assessment. Instead, the Department acted reasonably in fulfilling the responsibility imposed upon it by IC § 6-8.1-5-1(b) which *mandates* that the Department issue proposed assessments when there is a reasonable belief a taxpayer has not reported the correct amount of tax due. As explained in the audit report, "The Department could not rely on the [T]axpayer's records . . ." Taxpayer has produced no substantive, contemporaneous documents which would directly - or even indirectly - refute the Department's conclusion that the restaurant's record keeping practices were questionable at best and the Taxpayer's income from the restaurant was under-reported. Taxpayer raises numerous objections but has proposed no reasonably well-documented alternative to the assessment. If there are records accurately detailing the restaurant's 2010 through 2012 sales and the corresponding income passing through to Taxpayer, Taxpayer has not produced them.

Taxpayer argues that the assessments were issued outside the three-year statute of limitations. Taxpayer is incorrect. IC § 6-8.1-5-2(b) provides as follows:

If a person files a return for the utility receipts tax ([IC 6-2.3](#)), adjusted gross income tax ([IC 6-3](#)), supplemental net income tax ([IC 6-3-8](#)) (repealed), county adjusted gross income tax ([IC 6-3.5-1.1](#)) (repealed), county option income tax ([IC 6-3.5-6](#)) (repealed), local income tax ([IC 6-3.6](#)), or financial institutions tax ([IC 6-5.5](#)) that understates the person's income, as that term is defined in the particular income tax law, by at least twenty-five percent (25[percent]), the proposed assessment limitation is six (6) years instead of the three (3) years provided in subsection (a).

See also [45 IAC 15-5-7\(e\)](#).

Since Taxpayer underreported his income by more than twenty-five percent, the six-year statute of limitations applies, and the assessments are not barred by the three-year limitation. IC § 6-8.1-5-2(a).

The Department is unable to agree that Taxpayer has made a coherent or quantifiably specific objection to the results of the audit. Rather than offering a specific alternative, Taxpayer has simply set forth a litany of complaints

and criticisms. The Department does not disagree with Taxpayer's suggestion that there *may* be alternative methods of determining the income from the restaurant locations but Taxpayer has done nothing to meet his burden of establishing that the assessments are "wrong" as required by IC § 6-8.1-5-1(c).

The Department acted well within its statutory mandate of issuing assessments when confronted with instances of underreported tax, and the issuance of the assessment did not take place outside the statute of limitations applicable under the circumstances.

### FINDING

Taxpayer's protest is denied.

*Posted: 11/29/2017 by Legislative Services Agency*  
An [html](#) version of this document.