DEPARTMENT OF STATE REVENUE

01-20170757.LOF

Letter of Findings Number: 01-20170757
Individual Income Tax
For Tax Years 2009-14

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Married couple did not establish that their gambling activities qualified as professional gambling. Casual gamblers are required to itemize deductions, but itemized deductions are not allowed on Indiana income tax returns. Indiana individual income tax was therefore properly assessed.

ISSUE

I. Individual Income Tax–Adjustments.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3-4-6; IC § 6-8.1-5-1; IC § 6-8.1-5-2; *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); *Chow v. C.I.R.* T.C. Memo 2010-48 (2010); 45 IAC 3.1-1-1; 45 IAC 3.1-1-4; 45 IAC 15-5-7; IRC § 62; IRC § 63; IRC § 165; Treas. Reg. § 1.183-2.

Taxpayers protest the imposition of Indiana individual income tax.

STATEMENT OF FACTS

Taxpayers ("Husband" and "Wife") are a married out-of-state couple. As the result of an investigation, the Indiana Department of Revenue ("Department") determined that Taxpayers had not properly reported their Indiana income tax for the tax years 2009, 2010, 2011, 2012, 2013, and 2014 ("Tax Years"). The Department therefore issued proposed assessments for Indiana income tax, penalties, and interest for those years. Also, Taxpayers had filed an Indiana income tax return for 2014 claiming a refund which the Department processed prior to the investigation. When the investigation determined that Taxpayers owed income tax for 2014 rather than being due a refund, the Department issued a proposed assessment to reclaim the previously issued refund. Taxpayers filed a lawsuit in the Indiana Tax Court in response to this proposed assessment. The Department argued that Taxpayers had not exhausted their administrative remedies yet and that a decision by the court would be premature. The court remanded the matter to the Department for administrative procedures. This Letter of Findings therefore includes the refund matter along with the protest of the proposed assessments. Taxpayers protest the proposed assessments resulting from the investigation and the proposed assessment resulting from the refund from 2014. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Individual Income Tax–Adjustments.

DISCUSSION

Taxpayers protest the proposed assessments for additional Indiana income tax for the tax years 2009-14, including a proposed assessment issued to recover a refund which the Department believed was issued in error. Specifically, Taxpayers protest the Department's determination that Taxpayers did not qualify to file as professional gamblers and that they were therefore ineligible to itemized deductions. The Department based its determination on the basis that its investigation evaluated Taxpayers' activities and the federal requirements to qualify as professional gamblers. Also, in the course of this investigation the Department discovered that the Internal Revenue Service ("IRS") had previously determined that Taxpayers did not qualify as professional gamblers. That discovery led to a separate investigation which resulted in proposed assessments for income tax for the years 2005-07. Taxpayers protested those assessments and the Department addressed that protest in a

separate Letter of Findings. Taxpayers protest that they did qualify as professional gamblers at all times and that they had reached a settlement with the IRS for the previous years. Additionally, Taxpayers protest that the Department misinterpreted and misapplied the federal requirements in the investigation report.

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 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.

There are several Indiana statutes and regulations which are relevant to this situation. First, IC § 6-3-2-1(a) states:

> Each taxable year, a tax at the rate of three and four-tenths percent (3.4 [percent]) of adjusted gross income is imposed upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person.

IC § 6-3-1-3.5 defines adjusted gross income in relevant part as:

> When used in this article, the term "adjusted gross income" shall mean the following:
> (a) *In the case of all individuals, "adjusted gross income" (as defined in Section 62 of the Internal Revenue Code)*, modified as follows:
> . . . .
> (*Emphasis added*).

45 IAC 3.1-1-1 further describes adjusted gross income:

> Adjusted Gross Income for Individuals Defined. For individuals, "Adjusted Gross Income" is "Adjusted Gross Income" as defined in Internal Revenue Code § 62 modified as follows:
> (1) Begin with gross income as defined in section 61 of the Internal Revenue Code.
> (2) Subtract any deductions allowed by section 62 of the Internal Revenue Code.
> (3) Make all modifications required by IC 6-3-1-3.5(a).

45 IAC 3.1-1-4 provides:

> Deductions under Internal Revenue Code Subchapter B, Parts VI and VII which are allowable in determining Federal taxable income (itemized deductions) are not allowable deductions in determining Indiana Adjusted Gross Income.

IC § 6-3-4-6 provides:

> (a) Any taxpayer, upon request by the department, shall furnish to the department a true and correct copy of any tax return which the taxpayer has filed with the United States Internal Revenue Service which copy shall be certified to by the taxpayer under penalties of perjury.
> (b) *Each taxpayer shall notify the department of any modification as provided in subsection (c) of:*
> *(1) a federal income tax return filed by the taxpayer after January 1, 1978; or*
> *(2) the taxpayer's federal income tax liability for a taxable year which begins after December 31, 1977.*
> *The taxpayer shall file the notice on the form prescribed by the department within one hundred twenty (120) days after the modification is made if the modification was made before January 1, 2011, and one hundred eighty (180) days after the modification is made if the modification is made after December 31, 2010*.
> (c) *For purposes of subsection (b), a modification occurs on the date on which a:*
> *(1) taxpayer files an amended federal income tax return;*
> *(2) final determination is made concerning an assessment of deficiency;*
> *(3) final determination is made concerning a claim for a refund;*
> *(4) taxpayer waives the restrictions on assessment and collection of all, or any part, of an underpayment of*

federal income tax by signing a federal Form 870, or any other Form prescribed by the Internal Revenue Service for that purpose. For purposes of this subdivision:

(A) a final determination does not occur with respect to any part of the underpayment that is not covered by the waiver; and

(B) if the signature of an authorized representative of the Internal Revenue Service is required to execute a waiver, the date of the final determination is the date of signing by the authorized representative of the Internal Revenue Service;

(5) taxpayer enters into a closing agreement with the Internal Revenue Service concerning the taxpayer's tax liability under Section 7121 of the Internal Revenue Code that is a final determination. The date the taxpayer enters into a closing agreement under this subdivision is the date the closing agreement is signed by an authorized representative of the Internal Revenue Service; or

(6) modification or alteration in an amount of tax is otherwise made that is a final determination; for a taxable year, regardless of whether a modification results in an underpayment or overpayment of tax.

(d) For purposes of subsection (c)(2) through (c)(6), a final determination means an action or decision by a taxpayer, the Internal Revenue Service (including the Appeals Division), the United States Tax Court, or any other United States federal court concerning any disputed tax issue that:

(1) is final and conclusive; and

(2) cannot be reopened or appealed by a taxpayer or the Internal Revenue Service as a matter of law.

(e) If the federal modification results in a change in the taxpayer's federal or Indiana adjusted gross income, the taxpayer shall file an Indiana amended return within one hundred twenty (120) days after the modification is made if the modification was made before January 1, 2011, and one hundred eighty (180) days after the modification is made if the modification is made after December 31, 2010.

(*Emphasis added*).

IC § 6-8.1-5-2(i) states:

> If a taxpayer's federal taxable income, federal adjusted gross income, or federal income tax liability for a taxable year is modified due to a modification as provided under IC 6-3-4-6(c) and IC 6-3-4-6(d) (for the adjusted gross income tax), or a modification or alteration as provided under IC 6-5.5-6-6(c) and IC 6-5.5-6-6(e) (for the financial institutions tax), then the date by which the department must issue a proposed assessment under section 1 of this chapter for tax imposed under IC 6-3 is extended to six (6) months after the date on which the notice of modification is filed with the department by the taxpayer.

Since IC § 6-3-1-3.5 and 45 IAC 3.1-1-1 refer to the internal revenue code ("IRC") the Department also refers to IRC § 62, which provides in relevant part:

> (a) For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions:
>
> (1) Trade and business deductions
>
> The deductions allowed by this chapter (other than by part VII of this subchapter) which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee.
>
> . . . .

IRC § 63 provides in relevant part:

> (d) Itemized deductions. For purposes of this subtitle, the term "itemized deductions" means the deductions allowable under this chapter other than–
>
> (1) the deductions allowable in arriving at adjusted gross income, and
>
> (2) the deduction for personal exemptions provided by section 151.
>
> (e) Election to itemize
>
> (1) In general
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> Unless an individual makes an election under this subsection for the taxable year, no itemized deduction shall be allowed for the taxable year. For purposes of this subtitle, the determination of whether a deduction is allowable under this chapter shall be made without regard to the preceding sentence.
>
> (2) Time and manner of election
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> Any election under this subsection shall be made on the taxpayer's return, and the Secretary shall prescribe the manner of signifying such election on the return.
>
> (3) Change of election Under regulations prescribed by the Secretary, a change of election with respect to itemized deductions for any taxable year may be made after the filing of the return for such year. If the spouse of the taxpayer filed a separate return for any taxable year corresponding to the taxable year of the

taxpayer, the change shall not be allowed unless, in accordance with such regulations–

(A) the spouse makes a change of election with respect to itemized deductions, for the taxable year covered in such separate return, consistent with the change of treatment sought by the taxpayer, and

(B) the taxpayer and his spouse consent in writing to the assessment (within such period as may be agreed on with the Secretary) of any deficiency, to the extent attributable to such change of election, even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

This paragraph shall not apply if the tax liability of the taxpayer's spouse for the taxable year corresponding to the taxable year of the taxpayer has been compromised under section 7122.

. . . .

Also, IRC § 165(d) states:

Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

The Department's investigation report referred to Treas. Reg. 1.183-2, which provides in relevant part:

(a) *In general.* For purposes of section 183 and the regulations thereunder, the term *activity not engaged in for profit* means any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212. Deductions are allowable under section 162 for expenses of carrying on activities which constitute a trade or business of the taxpayer and under section 212 for expenses incurred in connection with activities engaged in for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income. Except as provided in section 183 and § 1.183-1, no deductions are allowable for expenses incurred in connection with activities which are not engaged in for profit. Thus, for example, deductions are not allowable under section 162 or 212 for activities which are carried on primarily as a sport, hobby, or for recreation. The determination whether an activity is engaged in for profit is to be made by reference to objective standards, taking into account all of the facts and circumstances of each case. Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into the activity, or continued the activity, with the objective of making a profit. In determining whether such an objective exists, it may be sufficient that there is a small chance of making a large profit. Thus it may be found that an investor in a wildcat oil well who incurs very substantial expenditures is in the venture for profit even though the expectation of a profit might be considered unreasonable. In determining whether an activity is engaged in for profit, greater weight is given to objective facts than to the taxpayer's mere statement of his intent.

(b) *Relevant factors.* In determining whether an activity is engaged in for profit, all facts and circumstances with respect to the activity are to be taken into account. No one factor is determinative in making this determination. In addition, it is not intended that only the factors described in this paragraph are to be taken into account in making the determination, or that a determination is to be made on the basis that the number of factors (whether or not listed in this paragraph) indicating a lack of profit objective exceeds the number of factors indicating a profit objective, or vice versa. Among the factors which should normally be taken into account are the following:

(1) *Manner in which the taxpayer carries on the activity.* The fact that the taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books and records may indicate that the activity is engaged in for profit. Similarly, where an activity is carried on in a manner substantially similar to other activities of the same nature which are profitable, a profit motive may be indicated. A change of operating methods, adoption of new techniques or abandonment of unprofitable methods in a manner consistent with an intent to improve profitability may also indicate a profit motive.

(2) *The expertise of the taxpayer or his advisors.* Preparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are expert therein, may indicate that the taxpayer has a profit motive where the taxpayer carries on the activity in accordance with such practices. Where a taxpayer has such preparation or procures such expert advice, but does not carry on the activity in accordance with such practices, a lack of intent to derive profit may be indicated unless it appears that the taxpayer is attempting to develop new or superior techniques which may result in profits from the activity.

(3) *The time and effort expended by the taxpayer in carrying on the activity.* The fact that the taxpayer devotes much of his personal time and effort to carrying on an activity, particularly if the activity does not have substantial personal or recreational aspects, may indicate an intention to derive a profit. A taxpayer's withdrawal from another occupation to devote most of his energies to the activity may also be evidence that the activity is engaged in for profit. The fact that the taxpayer devotes a limited amount of time to an activity does not necessarily indicate a lack of profit motive where the taxpayer employs competent and qualified persons to carry on such activity.

(4) *Expectation that assets used in activity may appreciate in value.* The term *profit* encompasses appreciation in the value of assets, such as land, used in the activity. Thus, the taxpayer may intend to derive a profit from the operation of the activity, and may also intend that, even if no profit from current operations is derived, an overall profit will result when appreciation in the value of land used in the activity is realized since income from the activity together with the appreciation of land will exceed expenses of operation. See, however, paragraph (d) of § 1.183-1 for definition of an activity in this connection.
(5) *The success of the taxpayer in carrying on other similar or dissimilar activities.* The fact that the taxpayer has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises may indicate that he is engaged in the present activity for profit, even though the activity is presently unprofitable.
(6) *The taxpayer's history of income or losses with respect to the activity.* A series of losses during the initial or start-up stage of an activity may not necessarily be an indication that the activity is not engaged in for profit. However, where losses continue to be sustained beyond the period which customarily is necessary to bring the operation to profitable status such continued losses, if not explainable, as due to customary business risks or reverses, may be indicative that the activity is not being engaged in for profit. If losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damages, other involuntary conversions, or depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit. A series of years in which net income was realized would of course be strong evidence that the activity is engaged in for profit.
(7) *The amount of occasional profits, if any, which are earned.* The amount of profits in relation to the amount of losses incurred, and in relation to the amount of the taxpayer's investment and the value of the assets used in the activity, may provide useful criteria in determining the taxpayer's intent. An occasional small profit from an activity generating large losses, or from an activity in which the taxpayer has made a large investment, would not generally be determinative that the activity is engaged in for profit. However, substantial profit, though only occasional, would generally be indicative that an activity is engaged in for profit, where the investment or losses are comparatively small. Moreover, an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or only occasional small profits are actually generated.
(8) *The financial status of the taxpayer.* The fact that the taxpayer does not have substantial income or capital from sources other than the activity may indicate that an activity is engaged in for profit. Substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved.
(9) *Elements of personal pleasure or recreation.* The presence of personal motives in carrying on of an activity may indicate that the activity is not engaged in for profit, especially where there are recreational or personal elements involved. On the other hand, a profit motivation may be indicated where an activity lacks any appeal other than profit. It is not, however, necessary that an activity be engaged in with the exclusive intention of deriving a profit or with the intention of maximizing profits. For example, the availability of other investments which would yield a higher return, or which would be more likely to be profitable, is not evidence that an activity is not engaged in for profit. An activity will not be treated as not engaged in for profit merely because the taxpayer has purposes or motivations other than solely to make a profit. Also, the fact that the taxpayer derives personal pleasure from engaging in the activity is not sufficient to cause the activity to be classified as not engaged in for profit if the activity is in fact engaged in for profit as evidenced by other factors whether or not listed in this paragraph.

. . . .

The Department's investigation came to the conclusion that, based on its own evaluation of Treas. Reg. 1.183-2, Taxpayers were not able to make itemized deductions pursuant to IRC § 63(d)-(e). Also, under 45 IAC 3.1-1-4 itemized deductions are not allowable in determining Indiana adjusted gross income. The Department therefore adjusted Taxpayers' 2009-14 Indiana returns to reflect Taxpayers' status as casual gamblers and remove itemized deductions. The investigation discussed all nine factors listed under Treas. Reg. 1.183-2(b) for both Husband and Wife. The Department's conclusion after that discussion was that Taxpayers did not meet the requirements of Treas. Reg. 1.183-2(b).

Regarding the nine factors listed under Treas. Reg. § 1.183-2(b), the United States Tax Court's opinion in *Chow v. C.I.R.* T.C. Memo 2010-48 (2010) explained:

> Section 1.183-2(b), Income Tax Regs., provides a nonexclusive list of relevant factors to be weighed when considering whether a taxpayer is engaged in an activity for profit. The relevant factors are: (1) The manner in which the taxpayer carried on the activity; (2) the expertise of the taxpayer or his advisers; (3) the time and

effort expended by the taxpayer in carrying on the activity; (4) the expectation that the assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other activities for profit; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, that are earned from the activity; (8) the financial status of the taxpayer; and (9) whether elements of personal pleasure or recreation are involved in the activity. No one factor is determinative of whether an activity is engaged in for profit. *Brannen v. Commissioner,* 722 F.2d 695, 704 (11th Cir.1984), affg. 78 T.C. 471, 1982 WL 11168 (1982); *Golanty v. Commissioner, supra* at 426; sec. 1.183-2(b), Income Tax Regs. Some of the factors do not apply or are neutral here.

Respondent asserts that petitioner had no business plan, did not seek or follow expert advice, and did not adhere to her alleged pattern of strategic times to gamble. Thus respondent argues that petitioner did not carry on her activities in a businesslike manner and did not use the skills involved in her prior successful activity of managing Dr. Chow's medical practice.

Petitioner testified that she had "on the job" training as a professional gambler beginning in 1987; that she read a couple of books about slot machine strategy; and that she had reasons for gambling on particular days and during particular hours. **The nature of gambling or other high-risk activities makes comparison to businesslike conduct of more traditional businesses difficult. There seem to be no recognizable standards for a businesslike approach to slot machine gambling. Therefore these factors are not conclusive**.

The record contains information about petitioner's history of profits and losses only for the 2 years in issue. Petitioner received substantial jackpots, but she continued to play until the overall results, whether on a session-by-session basis or an annual basis, were substantial losses. Her gambling and her losses increased from 2004 to 2005, when the substantial proceeds of the sale of the Del Mar Avenue property permitted her to increase the "capital" she claims to have invested in the gambling activity. Petitioners, however, were retired, and the record suggests that sale of the Del Mar Avenue property eliminated a substantial source of rental income. Petitioners' other income would not permit petitioner to sustain such losses indefinitely in the future. Petitioners' situation is distinguishable from cases respondent cites in which other sources of income allowed a taxpayer to pursue an activity as a hobby, without expectation of profit.

The parties dispute whether petitioner maintained appropriate records of her gambling activities. Petitioners claim that respondent's agents are responsible for loss of certain records and that, therefore, respondent cannot show that they did not maintain adequate records. Petitioner did not maintain a logbook, but the casino records of her activities allowed the parties to reconstruct the stipulated amounts of winnings and losses. Cf. *Estate of Espinoza v. Commissioner,* T.C. Memo.2005-239. The schedules and Forms W-2G attached to petitioners' returns were detailed as to dates and amounts. While petitioners' calculations of deductible losses were erroneous, they appear to be attributable to a misunderstanding of the law rather than to insufficient records.

Respondent acknowledges that petitioner engaged in gambling during 2004 and 2005 with continuity and regularity. It is unclear from her testimony whether she derived pleasure from it, but that factor is generally neutral. See, e. g., *Strickland v. Commissioner,* T.C. Memo.2000-309. Petitioner strongly disputes a suggestion by respondent's agent that her gambling was "compulsive" or "addictive". Her activities appear similar to those in other cases not involving professional gamblers, but there is no evidence from either party sufficient to draw a conclusion about psychological factors. Cf. *Gagliardi v. Commissioner,* T.C. Memo.2008-10.

Bearing in mind that the expectation of profit is a matter of subjective intent and need not be reasonable, see sec. 1.183-2(a), Income Tax Regs., we believe that the preponderance of the evidence favors petitioner's claim that during 2004 and 2005 she pursued gambling with a profit objective. This is a close case, and petitioners would be prudent to abandon gambling as a potential source of income. We conclude, however, that petitioner was a professional gambler during 2004 and 2005 and may deduct her gambling losses to the extent of her gambling winnings on Schedule C. Of course, she may not deduct any excess losses from petitioners' adjusted gross income from other sources.
Id. at 5-7.
(**Emphasis added**.)

As the court explained in *Chow*, the nature of gambling or other high-risk activities makes comparison to businesslike conduct of more traditional businesses difficult. There seem to be no recognizable standards for a businesslike approach to slot machine gambling, which is the sole gambling activity at issue in the instant protest.

Taxpayers state that they did qualify as professional gamblers under the IRC. In support of this position, Taxpayers provided analysis prepared for this protest as well as analysis provided to the IRS in Taxpayers' appeal of the federal adjustments. The various sets of analysis echo each other in reference to the IRC, treasury regulations, and federal tax court cases. For the years 2005-07, the IRS evaluated these arguments and did not change its determination that Taxpayers were casual gamblers. However, Taxpayers and the IRS did reach a settlement agreement for those years which resulted in Taxpayers paying less than initially determined to be due by the IRS. The IRS' reasons for settling with Taxpayers are unknown to the Department, but without written confirmation that the IRS has reclassified Taxpayers' status from casual gamblers to professional gamblers, the Department cannot agree with Taxpayers' position. A settlement agreement between these two parties does not change the amount due on the adjusted returns, as determined by the IRS based on the IRC.

Therefore, while Taxpayers have provided arguments and documentation in support of their protest of the Department's proposed assessments of proposed Indiana adjusted gross income tax, those arguments were already evaluated by the IRS and did not result in a reclassification of Taxpayers' casual gambler status by the IRS. Since Indiana adjusted gross income tax is calculated by starting with federally-determined income under IC § 6-3-1-3.5 and 45 IAC 3.1-1-1, and since the IRS is the federal authority charged with determining federal income amounts, the Department is not convinced that departure from the IRS' determination of Taxpayers' status as casual gamblers is warranted. While there was a settlement agreement between Taxpayers and the IRS to pay less federal income tax than initially determined to be due for the years 2005-07, Taxpayers have referred to no statute, regulation, or court case which would compel the Department to adhere to the terms of such a settlement in which it was not a party. Also, the federal settlement forms do not discuss Taxpayers' gambler status.

Next, IC § 6-8.1-5-2 allows the Department to reclaim refunds that were erroneously given by the Department. IC § 6-8.1-5-2(g) states:

> If any part of a listed tax has been erroneously refunded by the department, the erroneous refund may be recovered through the assessment procedures established in this chapter. An assessment issued for an erroneous refund must be issued:
> (1) within two (2) years after making the refund; or
> (2) within five (5) years after making the refund if the refund was induced by fraud or misrepresentation.

Therefore, the Department is authorized to issue an assessment to recover a refund which it believes was issued in error, providing that it meets the deadlines listed in IC § 6-8.1-5-2(g). In this case, the Department issued an assessment within two years of issuing a refund which it believed was in error, thus satisfying the requirements of IC § 6-8.1-5-2(g).

Taxpayers also argue that the Department was barred by the statute of limitations from issuing assessments for the tax years 2009, 2010, 2011, and 2012. Specifically, 45 IAC 15-5-7 provides:

> (a) Except as otherwise provided in IC 6-8.1-5-2, the statute of limitations for the assessment of a listed tax liability is three (3) years from the due date of the annual return (including extensions of time granted by the department) or the date on which the annual return is filed for the tax year, whichever is later. If an extension of time is granted by the department, the statute of limitations shall begin to run on the day after the last day of the extension period.
> (b) In the case where returns are filed monthly, quarterly, or semi-annually such as returns filed for the state gross retail or use tax, the gasoline tax, the special fuel tax, the motor carrier fuel tax, the oil inspection fee, or the petroleum severance tax, the statute of limitations for an assessment is three years from the date the return was filed, or the end of the calendar year which contains the taxable period for which the return was filed, whichever is later.
> (c) "Date of filing" is defined in IC 6-8.1-6-3. The due date of any listed tax is defined in IC 6-8.1-1-4.
> (d) If a taxpayer files an amended return which corrects, updates or in any way changes the amount and/or method of reporting, the statute of limitations for assessment will be three (3) years from the date on which the amended return is filed. However, once the statute of limitations for the original return (the return being amended) has run, the amount the department may assess due to the amended return is limited to any amount claimed as a refund on the amended return.
>
> EXAMPLE
>
> Corporation Y files its 19X2 Indiana return on April 15, 19X3. However, Corporation Y does not pay the tax due until May 1, 19X3. On April 30, 19X6, Corporation Y files an amended return for 19X2 claiming a refund for certain sales in interstate commerce for gross income tax purposes. The three (3) year statute of limitations for the original 19X2 return ended on April 15, 19X6. However, the amended return extends the

assessment period until April 30, 19X9. Any assessment levied after April 15, 19X6 will be limited to the amount resulting in a refund.

(e) *If a taxpayer files an adjusted gross income tax, supplemental net income tax, or county adjusted gross income tax return that understates its income by at least twenty-five percent (25[percent]), the statute of limitations for proposed assessments is increased from three (3) years to six (6) years. "Income," as used in 45 IAC 15-5-7(e), shall be defined to mean adjusted gross income for the adjusted gross income tax, supplemental net income for the supplemental net income tax and county adjusted gross income for the county adjusted gross income tax*.

(f) The running of the statute of limitations for purposes of assessing unpaid taxes will not start if the taxpayer fails to file a return which is required by any listed tax provision. Also, a substantially blank, unsigned or fraudulent return will not start the running of the statute of limitations.

(1) A substantially blank return is one which does not furnish all the information necessary to determine a taxpayer's liability for the tax in question. In order for a return to be complete enough to determine the taxpayer's liability, the information does not have to be correct. Any denotion by the taxpayer which clearly indicates a positive denial of liability for any tax listed on the tax form shall constitute a completed return. Thus, a return which has "zero," or "-0-" or "none" written on a given line is not substantially blank. Also, if a taxpayer makes a positive indication of liability on a line which constitutes a total of one or more taxes, a return is deemed to be completed for all such taxes even if the particular line for the tax(es) is left blank.

(2) An unsigned return is one which does not have the original hand written signature of the individual taxpayer or corporate officer or their authorized designee. The return also must be dated.

(3) A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements to fraud.

(A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.

(B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.

(C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.

(D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.

(E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the department is required to prove all of the above elements are present. This must be shown by clear and convincing evidence.

(*Emphasis added*).

Taxpayers argue that they did not understate their Indiana income by twenty-five percent or more and that the extension to six years for issuing an assessment provided by 45 IAC 15-5-7(e) is not applicable. Also, Taxpayers state that the Department erroneously used its "net" redetermination of income to justify the extension of the statute of limitations to six years when it should have used "gross" income as the basis for whether or not the difference in reported and actual income was twenty-five percent or greater. A review of 45 IAC 15-5-7(e) reveals no reference to "net" income or "gross" income, but rather simply states "understates its income" as the appropriate level. Therefore, the Department is not convinced by Taxpayers' argument regarding "net" or "gross" income.

Regarding the statute of limitations extension to six years, in its investigation report the Department explained that Taxpayers filed a federal form 4868 for an automatic extension for filing their 2009 federal income tax return and that this extension pushed the filing date for Taxpayers' 2009 Indiana return to November 15, 2010. After adding the six-year assessment extension provided by 45 IAC 15-5-7(e), the Department determined its deadline for issuing an assessment for 2009 Indiana adjusted gross income tax ("AGIT") to be November 15, 2016. The Department's proposed assessment for 2009 Indiana AGIT was issued on October 18, 2016. The remaining proposed assessments at issue in this protest were also issued on October 18, 2016. Therefore, if the AGIT returns filed by Taxpayers understated their income by at least twenty-five (25) percent, the statute of limitations for proposed assessments is increased from three (3) years to six (6) years and the Department's assessments

were timely issued.

As provided above, Taxpayers filed their 2009-14 Indiana adjusted gross income tax returns in the manner of professional gamblers. In the course of the Department's investigations for this tax period and of the prior tax period of 2005-07, the Department learned of Taxpayers' reclassification from professional gamblers to casual gamblers by the IRS. Thus, Taxpayers were ineligible to itemize their deductions and the Department adjusted Taxpayers' 2009-14 Indiana AGIT returns to reflect their federally-redetermined status. These adjustments resulted in Taxpayers' originally-filed 2009-14 Indiana AGIT returns under-reporting Taxpayers' income for those years by more than twenty-five percent. As provided by 45 IAC 15-5-7(e), the criteria for extending the statute of limitations for issuing a proposed assessment were met and the Department's proposed assessments were correctly issued.

In conclusion, Taxpayers have not provided sufficient documentation to establish that they met the federal definition of "professional gambler." Both the Department's investigation report and Taxpayers' protest letters discuss the factors to be considered in determining professional gambler status. Most of the documentation supplied in the hearing process was available to and evaluated by the IRS at the federal level regarding Taxpayers' 2005-07 income tax filings. The IRS did not reclassify Taxpayers as professional gamblers and there is no evidence that the IRS has changed this position. The Department therefore defers to the federal taxing authority's judgement on determining whether or not Taxpayers meet the criteria of a federal treasury regulation's definition of "professional gambler." The statute of limitations for issuing proposed assessments did not prohibit the Department in this case. The adjustments to Taxpayers' 2009-14 AGIT resulted in differences of greater than twenty-five percent from what was originally reported on Taxpayers' Indiana AGIT returns for those years. Finally, the Department is authorized to issue proposed assessments to recover erroneously issued refund amounts. Since Taxpayers have been denied on their protest of the Department's determination of their status as causal gamblers and the resulting adjustments, the Department's assessment to recover the erroneous refund was correct. Taxpayers have not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayers' protest is denied.

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