

**Letter of Findings: 03-20170093
Withholding Tax
For the Years 2013 - 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Indiana S Corporation was required to include the company-paid health insurance premiums in the shareholder-employees' W-2 (Wage and Tax Statement) forms because the payments on behalf of the shareholder-employees who owned greater than two-percent share were not excludable from income tax. Since company-paid health insurance premiums for the two-percent shareholder-employees were required to be included in the shareholder-employees' W-2s subject to income tax, Indiana S Corporation was required by statutes to withhold tax (a trust tax) on those payments.

ISSUE

I. Withholding Tax - Imposition.

Authority: I.R.C. § 106; I.R.C. § 1372; IC § 6-3-4-8; IC § 6-8.1-5-1; *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *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); *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. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); [45 IAC 3.1-1-97](#); IRS Notice 2008-1, *Special Rules for Health Ins. Costs of 2-Percent S'holder-Employees*, 2008-1 C.B. 251 (2007); Income Tax Information Bulletin 32 (July 2008).

Taxpayer protests the audit's adjustment of State and County withholding tax.

STATEMENT OF FACTS

Taxpayer is an Indiana S Corporation doing business in Indiana. Taxpayer has various shareholder-employees who reside and work in Indiana.

In 2016, the Indiana Department of Revenue ("Department") audited Taxpayer's business records and withholding tax returns for the 2013, 2014, and 2015 tax years ("Tax Years at Issue"). Pursuant to the audit, the Department found that Taxpayer paid "health insurance premiums" on behalf of four (4) shareholder-employees; each owned shares greater than two (2) percent and the payments of the "health insurance premiums" were included in the W-2s of these shareholder-employees for those years. The audit further found that Taxpayer did not withhold Indiana and county income taxes on those payments. As a result, the Department assessed additional withholding taxes, interest, and penalty.

Taxpayer timely protested the assessment. An administrative phone hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results. Additional facts will be provided as necessary.

I. Withholding Tax - Imposition.

DISCUSSION

Pursuant to the audit, the Department found that Taxpayer failed to properly withhold State and County income taxes on W-2 payments paid to four (4) shareholder-employees who resided and worked in Indiana during the Tax Years at Issue. Specifically, those shareholder-employees owned shares greater than two (2) percent during the Tax Years at Issue. The audit found that Taxpayer paid the "health insurance premiums" for those

shareholder-employees and was required to include those payments in the shareholder-employees' W-2s for the Tax Years at Issue. The audit further found that Taxpayer included those payments at issue in the shareholder-employees' W-2s without withholding Indiana and county income taxes on the payments. The audit thus assessed additional withholding taxes and explained in relevant part, as follows:

IC [§] 6-3-4-8 and [45 IAC 3.1-1-97](#) provide that employers who make payments of wages subject to the Adjusted Gross Income Tax Act are required to withhold federal taxes pursuant to the Internal Revenue Code (USC Title 26) and withhold state and county income taxes from wages of its employees. Furthermore, [45 IAC 3.1-3-1](#) provides that a county income tax be imposed on individuals who are residents of adopting counties. The tax is to be withheld from the wages of these individuals.

According to IRS S Corporation compensation, health and accident insurance premiums paid on behalf of a greater than 2-percent S Corporation shareholder-employee are deductible by the S Corporation, reportable as wages on the shareholder-employee's Form W-2 and subject to income tax withholding (IRS S Corporation and Medical Issues).

The review of Form W-2s revealed that the S Corporation [i.e., Taxpayer] paid health insurance premiums for the four shareholder-employees and reported those premiums as wages. Such additional wages are subject to income tax withholding, however the taxpayer failed to withhold State and County income taxes

Taxpayer disagreed with the audit adjustments, arguing that it was not responsible for the additional withholding tax on the payments in question.

As a threshold issue, all tax assessments are *prima facie* evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment 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). When an agency is charged with enforcing a statute, the courts defer to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

Every employer is required to withhold taxes on payments of wages it pays to its employees pursuant to IC § 6-3-4-8(a) (as in effect during the Tax Years at Issue), which states in part as follows:

Except as provided in subsection (d), every employer making payments of wages subject to tax under this article, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, **shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department.** The department shall base its withholding instructions on the adjusted gross income tax rate for persons, on the total rates of any income taxes that the taxpayer is subject to under [IC 6-3.5](#), and on the total amount of exclusions the taxpayer is entitled to under [IC 6-3-1-3.5\(a\)\(3\)](#) and [IC 6-3-1-3.5\(a\)\(4\)](#). However, the withholding instructions on the adjusted gross income of a nonresident alien (as defined in Section 7701 of the Internal Revenue Code) are to be based on applying not more than one (1) withholding exclusion, regardless of the total number of exclusions that [IC 6-3-1-3.5\(a\)\(3\)](#) and [IC 6-3-1-3.5\(a\)\(4\)](#) permit the taxpayer to apply on the taxpayer's final return for the taxable year. Such employer making payments of any wages:

(1) **shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld under this section** and shall not be liable to any individual for the amount deducted from the individual's wages and paid over in compliance or intended compliance with this section; and

(2) shall make return of and payment to the department monthly of the amount of tax which under this article and [IC 6-3.5](#) the employer is required to withhold.

(Emphasis added).

Accordingly, IC § 6-3-4-8(a) requires an employer to "withhold, collect, and pay over income tax on wages paid by such employer to such employee . . . [in] the amount prescribed in withholding instructions issued by the

department." IC § 6-3-4-8(a)(1) provides that the employer is "liable to the state of Indiana for the payment of the tax *required* to be deducted and withheld." (*Emphasis added*). IC § 6-3-4-8 specifically provides that the employer is liable for the amount that it was *required* to withhold.

[45 IAC 3.1-1-97](#) further explains in relevant part:

Employers who make payments of wages subject to the Adjusted Gross Income Tax Act, and who are required to withhold Federal taxes pursuant to the Internal Revenue Code (USC Title 26), **are required to withhold from employees' wages Adjusted Gross and County Adjusted Gross Income Tax.** (*Emphasis added*).

The employers are "withholding agents . . . shall make return of and payment to the Department . . . tax due, for either County and State." *Id.* "All amounts deducted and withheld by an employer shall immediately upon deduction become the money of the State." *Id.* The regulation further states, "In the case of delinquency or nonpayment of withholding tax, the employer is liable for such tax, penalties, and interest." *Id.*

To state it differently, unless specifically exempted by statutes, an Indiana employer is required to withhold state and county income tax from payments it paid to individual employees who reside and/or work in Indiana. The employer is responsible for the tax when it fails to do so as required by the above mentioned Indiana law.

Throughout its protest, Taxpayer argued that its payments for shareholder health insurance premiums were not subject to withholding tax although the payments in question were included in the shareholder-employees' W-2s. Taxpayer in its January 27, 2017, letter stated in part, as follows:

When the W-2s are prepared each year, the shareholder health insurance premiums are calculated and recorded as an add-back on the shareholder-employee Form W-2s. Since this takes place after the final paycheck run of the calendar year, there is not an opportunity to withhold taxes.

If the premiums were reported throughout the year, the shareholder-employees would choose not to withhold tax (by increasing the number of their exemptions) because they each receive a self-employed health insurance deduction on their individual tax returns. Therefore, there is no tax obligation on these fringe benefits. . . .

Nonetheless, Taxpayer did not refer to any statutory authority other than the Department's Income Tax Information Bulletin 32 (July 2008), 20080827 Ind. Reg. 045080659NRA ("Information Bulletin 32"). Taxpayer argued that "we don't believe that the W-2 income related to shareholder health insurance premiums should be subject to withholding" because "[t]he self-employed health insurance deduction is listed as one such deduction" under Section "III. Income Subject to County Income Tax."

Upon review, however, Taxpayer's reliance is misplaced. Specifically, in this instance, Taxpayer is an S Corporation that paid the "health insurance premiums" on behalf of its four shareholder-employees. The Department's audit found, and Taxpayer did not dispute, that each shareholder-employee owned greater than two percent share of Taxpayer - an S Corporation -and that they were "2-percent shareholders" under I.R.C. § 1372 during the Tax Years at Issue.

The Internal Revenue Service ("IRS"), in its Notice 2008-1, specifically explains that, pursuant to I.R.C. § 1372, a "2-percent shareholder is not an employee for purposes of [I.R.C.] § 106" even though I.R.C. § 106 "provides an exclusion from the gross income of an employee for employer-provided coverage under an accident and health plan." IRS Notice 2008-1, *Special Rules for Health Ins. Costs of 2-Percent S'holder-Employees*, 2008-1 C.B. 251 (2007) (explaining further that "[a]ccident and health insurance premiums paid or furnished by an S corporation on behalf of its 2-percent shareholders . . . are included in wages for income tax withholding purposes on the shareholder-employee's Form W-2, Wage and Tax Statement . . .")(internal citation omitted). Notice 2008-1 further states that "[t]he 2-percent shareholder is required to include the amount of the accident and health insurance premiums in gross income under § 61(a)." *Id.* That is, the S Corporation-paid "health insurance premiums" on behalf of its 2-percent shareholder-employee are required to be included in the shareholder-employee's gross income subject to income tax withholding. *Id.* Taxpayer here was an S Corporation and its shareholder-employees in this instance were undisputedly 2-percent shareholders of Taxpayer's. Taxpayer paid the "health insurance premiums" on behalf of its shareholder-employees for the Tax Years at Issue. Therefore, Taxpayer is required by federal law to include the payments in those shareholder-employees' gross income on their W-2s subject to income tax withholding. In turn, Taxpayer is statutorily required to withhold the Indiana and county income taxes on the payments pursuant to IC § 6-3-4-8 and [45 IAC 3.1-1-97](#). In the

absence of any statutory exception, the fact that Taxpayer chose to add back those payments to its shareholder-employees' W-2s "after the final paycheck run" does not lessen its statutory responsibility to withhold taxes.

In addition, Taxpayer asserted that it should not have been responsible for the withholding tax because the shareholder-employees could have been able to claim certain exemption or deduction (namely, "increasing the number of their exemptions" or claiming "self-employed health insurance deduction on their individual tax returns"). Taxpayer referencing Information Bulletin 32 to support its position that shareholder-employees could have excluded the payments from "principal work activity income." The Department's Information Bulletin 32, addressing "General Information on County Income Taxes," explains as follows:

I. County of Residence and County of Work

The taxpayer's county of residence is determined as of January 1 each year. For purposes of county tax, an individual's county of residence is determined by the county where the taxpayer maintains his home.

The taxpayer's county of principal work activity is also determined as of January 1 each year. An individual's county of principal work activity is that county where the taxpayer receives the greatest percentage of his gross income from salaries, wages, commissions, fees or other income of this type. . . .

III. Income Subject to County Income Tax

If an individual is a resident of a county that adopts the county tax, his entire adjusted gross income will be subject to the county tax at the tax rate imposed by that county. The adjusted gross income for county tax purposes will be the Indiana adjusted gross income, plus any adjustment taken for the non-Indiana locality earnings deduction.

If an individual resides in a non-adopting county, but his principal place of business or employment is in an adopting county, only the adjusted gross income derived from his principal place of business or employment is subject to the county tax at the nonresident rate.

The only deductions allowed from principal work activity income are those that directly apply to the production of income from one's principal work activity. They do not include Indiana deductions that are not related to the production of income.

The following deductions are considered directly related to the production of principal work activity income:

- Self-employed health insurance deduction

Taxpayer, however, is mistaken. Information Bulletin 32 provides guidance on county income tax concerning individuals who reside and/or work, in the adopting counties or otherwise, in the State of Indiana. While individuals who reside and/or work in Indiana may claim certain deductions on their individual income tax returns pursuant to the Information Bulletin 32, it does not provide any exceptions regarding an employer's withholding responsibility. Thus, the Information Bulletin 32 is beyond the scope of Taxpayer's protest. In other words, whether its 2-percent shareholder-employees could have claimed certain deductions or exemptions on their individual income tax returns does not negate Taxpayer's statutory responsibility as an employer to withhold tax on the W-2 payments at issue. Taxpayer's argument essentially shifts its statutory burden and requests that the Department consider individual income tax audits of each of its shareholder-employees to determine if the withholding tax that it was required to pay was exempt from individual income tax to relieve Taxpayer of its responsibility for withholding tax (a trust tax). Without any statutory authority to do so, the Department must respectfully decline Taxpayer's invitation to do so.

In short, as mentioned earlier, Taxpayer was required by statute to withhold taxes on the W-2 payments to its employees. Additionally, Taxpayer, as an S Corporation, is required to include the "health insurance premiums" it paid on behalf of its 2-percent shareholder-employees in their W-2s. Taxpayer referenced no statutory or regulatory authority to support its position that there is a statutory exception, which relieves its responsibility for the withholding tax even if its shareholder-employees had paid the income tax when they filed their individual income tax returns. Nor did Taxpayer offer any documents to show that it did withhold as statutorily required and that the Department's assessment is wrong. Given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden.

FINDING

Taxpayer's protest is respectfully denied.

Posted: 01/31/2018 by Legislative Services Agency
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