

Letter of Findings Number: 01-20170271
Individual Income Tax
For Tax Years 2012-13

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Individuals provided sufficient documentation and explanation to establish that waiver of penalties is warranted. Base tax and interest are still due.

ISSUE

I. Tax Administration–Penalties.

Authority: IC § 6-3-4-4.1; IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; *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); [45 IAC 3.1-1-76](#); [45 IAC 15-11-2](#).

Taxpayers protest the imposition of penalties.

STATEMENT OF FACTS

Taxpayers are a married couple ("Husband" and "Wife") residing in Indiana. The Indiana Department of Revenue ("Department") determined that Taxpayers had not filed Indiana income tax returns for the tax years 2012 and 2013. The Department therefore issued proposed assessments for individual income tax, negligence penalties, underpayment penalty, and interest for those years. Taxpayers protested the imposition of the proposed assessments. In between the filing of the protest and the administrative hearing, Taxpayers conducted additional research and came to the conclusion that Indiana income tax was due, but continued to protest the imposition of penalties. The administrative hearing was conducted and this Letter of Findings results. Further facts will be supplied as required.

I. Tax Administration–Penalties.

Taxpayers protest the imposition of penalties for the tax years 2012 and 2013. The Department based its determination that penalties were appropriate based on the fact that Taxpayers did not file Indiana income tax returns for those years. Taxpayers protest that they did in fact file state income taxes, but that it was to the wrong state. For the years at issue, Husband worked in a state that had a reciprocal agreement with Indiana. Husband misunderstood how reciprocity worked and remitted state income taxes to that state rather than to Indiana. During the administrative hearing, Husband explained that he relied on his employer, who had several employees in similar circumstances to Husband. Husband also explained that he now understands the mechanics of state income reciprocity and has begun filing Indiana state income tax returns. This, Taxpayers feel, demonstrates that they acted reasonably in attempting to fulfill their Indiana income tax duties.

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 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.

Taxpayers' income resulted from Husband's employment in one of the states with which Indiana has a reciprocal income tax agreement. The relevant regulation is [45 IAC 3.1-1-76\(a\)](#), which provides:

Residents who have income consisting of salaries, wages, and commissions from states with which Indiana has a reciprocal tax agreement must report all such income as if it were from Indiana. These states include:

Illinois Michigan Pennsylvania
Kentucky Ohio Wisconsin

Credit cannot be taken for any taxes withheld by or paid to any of these states in connection with salaries, wages, or commissions received from such states. If tax has been withheld by any of these states, a claim for refund should be filed with the state which withheld the taxes.

Therefore, if any state income tax is paid to one of the states listed under [45 IAC 3.1-1-76\(a\)](#) by a resident of Indiana, that resident should file a claim for refund with the other state, since the income tax should have been paid to Indiana in the first place.

Next, The Department refers to IC § 6-8.1-10-2.1, which states in relevant parts:

...

(b) Except as provided in subsection (g), the penalty described in subsection (a) is ten percent (10 [percent]) of:

- (1) the full amount of the tax due if the person failed to file the return;
- (2) the amount of the tax not paid, if the person filed the return but failed to pay the full amount of the tax shown on the return;
- (3) the amount of the tax held in trust that is not timely remitted;
- (4) the amount of deficiency as finally determined by the department; or
- (5) the amount of tax due if a person failed to make payment by electronic funds transfer, overnight courier, or personal delivery by the due date.

...

(d) If a person subject to the penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

(e) A person who wishes to avoid the penalty imposed under this section must make an affirmative showing of all facts alleged as a reasonable cause for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust, in a written statement containing a declaration that the statement is made under penalty of perjury. The statement must be filed with the return or payment within the time prescribed for protesting departmental assessments. A taxpayer may also avoid the penalty imposed under this section by obtaining a ruling from the department before the end of a particular tax period on the amount of tax due for that tax period.

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Next, the Department refers to [45 IAC 15-11-2\(b\)](#), which states:

"Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Also, [45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause,

the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

Also, IC § 6-3-4-4.1 states in relevant part:

(a) Any individual required by the Internal Revenue Code to file estimated tax returns and to make payments on account of such estimated tax shall file estimated tax returns and make payments of the tax imposed by this article to the department at the time or times and in the installments as provided by Section 6654 of the Internal Revenue Code. However, the following apply to estimated tax returns filed and payments made under this subsection:

(1) In applying Section 6654 of the Internal Revenue Code for the purposes of this article, "estimated tax" means the amount which the individual estimates as the amount of the adjusted gross income tax imposed by this article for the taxable year, minus the amount which the individual estimates as the sum of any credits against the tax provided by [IC 6-3-3](#).

(2) Estimated tax for a nonresident alien (as defined in Section 7701 of the Internal Revenue Code) must be computed by applying not more than one (1) exclusion under [IC 6-3-1-3.5\(a\)\(3\)](#) and [IC 6-3-1-3.5\(a\)\(4\)](#), 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.

(b) Every individual who has adjusted gross income subject to the tax imposed by this article and from which tax is not withheld under the requirements of section 8 of this chapter shall make a declaration of estimated tax for the taxable year. However, no such declaration shall be required if the estimated tax can reasonably be expected to be less than one thousand dollars (\$1,000). *In the case of an underpayment of the estimated tax as provided in Section 6654 of the Internal Revenue Code, there shall be added to the tax a penalty in an amount prescribed by [IC 6-8.1-10-2.1\(b\)](#).*

....
(*Emphasis added*).

In this case, Taxpayers incurred a deficiency for both 2012 and for 2013 which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(b). Also, Taxpayers did not file a quarterly estimated tax payment for 2013 which resulted in a penalty as provided by IC § 6-3-4-4.1(b). Both the negligence penalty and the failure to file quarterly estimated tax payment penalties are allowed to be waived if a taxpayer is able to show that they had reasonable cause for their actions. Taxpayers have affirmatively established that their failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#). Therefore, base income tax and interest are still due, but penalties will be waived.

FINDING

Taxpayers' protest is sustained.

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