

**Letter of Findings Number: 01-20170704
Individual Income Tax
For Tax Year 2016**

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires the publication of this document in the Indiana Register. The 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 This document is effective on its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.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 were properly assessed additional individual income tax because they had unreported capital gains from the sale of investment property and failed to adequately document claimed losses.

ISSUES

I. Individual Income Tax - Partnership Income.

Authority: 26 U.S.C. §1231; IC § 6-3-1-19; IC § 6-3-2-2; IC § 6-3-4-12; IC § 6-8.1-5-1; *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](#).

Taxpayers protest imposition of additional income tax on unreported Indiana source income.

II. Individual Income Tax - Partnership Losses - Documentation.

Authority: IC § 6-8.1-5; *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).

Taxpayers protest the disallowance of suspended losses.

STATEMENT OF FACTS

Taxpayers are Husband and Wife who reside in Illinois. Taxpayers filed an IT-40PNR for tax year 2016 reporting income from Husband's investment in an Indiana limited liability company that owned multi-family real estate in Indiana. The property was sold in 2016. Taxpayers reported Husband's pro rata distribution from the limited liability company on their Indiana individual non-resident tax return. The Indiana Department of Revenue ("Department") determined that Taxpayers had not reported all of their taxable Indiana source income, and issued Taxpayers a proposed assessment for additional tax due. Taxpayers protest this proposed assessment. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Individual Income Tax - Partnership Income.

DISCUSSION

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.

Taxpayers argue that the Department improperly assessed individual income tax on additional income that they did not receive from Indiana sources. Husband is a member of an Indiana limited liability company, which is taxed as a partnership for state and federal income tax purposes. IC § 6-3-1-19.

Pursuant to IC § 6-3-4-12(a):

Every partnership shall, at the time that the partnership pays or credits amounts to any of its nonresident partners on account of their distributive shares of partnership income, for a taxable year of the partnership, deduct and retain therefrom the amount prescribed in the withholding instructions referred to in section 8 of this chapter. . . .

Also, according to [45 IAC 3.1-1-106\(b\)\(2\)](#), "[t]he distributive share of a nonresident partner will be reported after apportionment to determine the partnership income derived from sources within Indiana. This determination will be accomplished by use of the apportionment formula described in [IC 6-3-2-2\(b\)](#)." Therefore, in accordance with IC § 6-3-2-2(b):

[I]f business income of a corporation or a nonresident person is derived from sources within the state of Indiana and from sources without the state of Indiana, the business income derived from sources within this state shall be determined by multiplying the business income derived from sources both within and without the state of Indiana

26 U.S.C. § 1231(a) provides:

(3) Section 1231 gains and losses.--For purposes of this subsection--

(A) Section 1231 gain.--The term "section 1231 gain" means--

- (i)** any recognized gain on the sale or exchange of property used in the trade or business, and
- (ii)** any recognized gain from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) into other property or money of--
 - (I)** property used in the trade or business, or
 - (II)** any capital asset which is held for more than 1 year and is held in connection with a trade or business or a transaction entered into for profit. (**Emphasis in original**).

During the protest, Taxpayers provided a copy of their 2016 federal tax return, including all relevant schedules. Based on this information, Taxpayers have affirmatively established that they reported the proper amount of gross income with regard to the limited liability company's activity.

FINDING

Taxpayers' protest with respect to the inclusion of additional taxable income is sustained.

II. Individual Income Tax - Partnership Losses - Documentation.

DISCUSSION

Taxpayers also reported passive activity losses that had been carried forward from 2015. Taxpayers assert that the Department erred by disallowing Husband's pro rata share of suspended losses of the limited liability company from prior years, totaling \$12,710. The Department adjusted Taxpayers' 2016 IT-40PNR to disallow the losses due to lack of adequate documentation. As previously stated, "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." IC § 6-8.1-5-1(c); *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.

Neither Taxpayers nor the Indiana limited liability company filed Indiana tax returns for tax year 2015 reporting the suspended losses that Taxpayers now seek to claim for tax year 2016. Taxpayers were presented with the opportunity to file these returns in order to substantiate the losses claimed in tax year 2016, but declined to do so. Because Taxpayers have not adequately documented the losses, they have not met their burden under IC § 6-8.1-5-1(c) of showing that the adjustments to their 2016 IT-40PNR and resulting assessment were wrong. In other words, Taxpayers did not establish that the loss carryover was an Indiana-source loss. Absent a federal Form 8582 from 2015 (or possibly earlier years) or such other evidence as would show the source of the loss, Taxpayers have not established that they were entitled to the passive loss deduction carryover from 2015.

FINDING

Taxpayers' protest with respect to disallowance of suspended losses is denied.

CONCLUSION

In summary, Taxpayers have established that their 2016 income was correctly reported with the sole exception of the passive activity loss. Taxpayers' protest is therefore sustained in part and denied in part.

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