DEPARTMENT OF STATE REVENUE

01-20181971.LOF

Letter of Findings: 01-20181971
Individual Income Tax
For the Year 2017

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Married couple were unable to prove that the Department's adjustment to their 2017 income tax return was incorrect. Therefore, the assessment remains as initially issued.

ISSUES

I. Individual Income Tax–Taxable Income.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-3-3-3; IC § 6-8.1-5-1; *Indiana Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014); *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*, 897 N.E.2d 289 (Ind. Tax Ct. 2007); 26 IRC § 1341; State Form 56317.

Taxpayers protest the imposition of Indiana income tax income earned in another state.

II. Tax Administration–Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayers protest the imposition of the negligence penalty.

STATEMENT OF FACTS

Taxpayers ("Husband" and "Wife") are a married couple living in Indiana. After review of Taxpayers' 2017 Indiana income tax return, the Indiana Department of Revenue ("Department") determined that Taxpayers had claimed a deduction to which they were not entitled. The Department therefore issued a proposed assessment for Indiana adjusted gross income tax ("AGIT"), penalty, and interest. Taxpayers filed a protest, arguing that the income was earned in another state, had already been taxed by that state, and was not taxable income in Indiana. Taxpayers filed their protest with the Protest Submission Form (State Form 56317) and selected the option to have their protest determined without an administrative hearing. This Letter of Findings is therefore written based on the information in the protest file. Further facts will be supplied as required.

I. Individual Income Tax–Taxable Income.

DISCUSSION

Taxpayers protest the imposition of Indiana AGIT for the tax year 2017. The Department imposed income tax based on Taxpayers' 2017 Indiana income tax return, in which Taxpayers listed over 94.6 percent of their income as a deduction under Code 630. Code 630 is used when a taxpayer is deducting income from that year's return which was previously included as taxable income for a preceding year, but which was repaid by the taxpayer in the year for which the return was being filed. The Department determined that the amount claimed by Taxpayers exceeded the threshold for that deduction. Taxpayers argue that Husband had been employed in Illinois and state that Illinois state income tax was already paid on the income earned in Illinois. Taxpayers also state that they sent supporting documentation in the form of a W-2 from Husband's Illinois employer along with their 2017 Indiana AGIT return. Therefore, Taxpayers argue, Indiana has no claim for income tax on that income.

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 [D]epartment'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,* 897 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.

IC § 6-3-2-1(a) states:

> (a) Each taxable year, a tax at the following rate 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:
> (1) For taxable years beginning before January 1, 2015, three and four-tenths percent (3.4[percent]).
> (2) For taxable years beginning after December 31, 2014, and before January 1, 2017, three and three-tenths percent (3.3[percent]).
> (3) For taxable years beginning after December 31, 2016, three and twenty-three hundredths percent (3.23[percent]).

IC § 6-3-1-3.5 provides:

> 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:
> . . .
> (22) *Subtract an amount as described in Section 1341(a)(2) of the Internal Revenue Code to the extent, if any, that the amount was previously included in the taxpayer's adjusted gross income for a prior taxable year*.
> (*Emphasis added*).

Also, 26 IRC § 1341(a) provides:

> General rule. If–
> (1) an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item;
> (2) *a deduction is allowable for the taxable year because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item or to a portion of such item*; and
> (3) the amount of such deduction exceeds $3,000, then the tax imposed by this chapter for the taxable year shall be the lesser of the following:
> (4) the tax for the taxable year computed with such deduction; or
> (5) an amount equal to–
> (A) the tax for the taxable year computed without such deduction, minus
> (B) the decrease in tax under this chapter (or the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the exclusion of such item (or portion thereof) from gross income for such prior taxable year (or years).
>
> For purposes of paragraph (5)(B), the corresponding provisions of the Internal Revenue Code of 1939 shall be chapter 1 of such code (other than subchapter E, relating to self-employment income) and subchapter E of chapter 2 of such code.
> (*Emphasis added*).

Therefore, Code 630 is used on an Indiana AGIT return when a taxpayer is claiming a deduction for income that was included in taxable income for a previous year, but which was paid back in the current filing year, as provided by IC § 6-3-1-3.5(a)(22). This is not what happened in the instant case.

The relevant statute for Taxpayers' argument that Husband's income was taxed in Illinois, where Husband was employed, is IC § 6-3-3-3, which provides:

> (a) *Whenever a resident person has become liable for tax to another state upon all or any part of his income for a taxable year derived from sources without this state and subject to taxation under IC 6-3-2, the amount of tax paid by him to the other state shall be credited against the amount of the tax payable by him. Such credit shall be allowed upon the production to the department of satisfactory evidence of the fact of such payment, except that such application for credit shall not operate to reduce the tax payable under IC 6-3-2 to an amount less than would have been payable were the income from the other state ignored.* The credit provided for by this subsection shall not be granted to a taxpayer when the laws of the other state, under which the adjusted gross income in question is subject to taxation, provides for a credit to the taxpayer substantially similar to that granted by subsection (b).
> (b) Whenever a nonresident person has become liable for tax to the state where he resides upon his income for the taxable year derived from sources within this state and subject to taxation under IC 6-3-2, the proportion of tax paid by him to the state where he resides that his income subject to taxation under IC 6-3-2 bears to his income upon which the tax so payable to the other state was imposed shall be credited against the tax payable by him under IC 6-3-2, but only if the laws of the other state grant a substantially similar credit to residents of this state subject to income tax under the laws of such other state, or impose a tax upon the income of its residents derived from sources in this state and exempt from taxation the income of residents of this state. No credit shall be allowed against the amount of the tax on any adjusted gross income taxable under IC 6-3-2 that is exempt from taxation under the laws of the other state.

Therefore, Taxpayers' argument that Husband's income is not subject to Indiana AGIT could be correct. However, as provided by IC § 6-3-3-3(a), such credit shall be allowed upon the production to the Department of satisfactory evidence of the fact of such payment. While Taxpayers state that, at the time they filed their 2017 Indiana income tax return, they provided a W-2 substantiating that Illinois state tax was withheld by Husband's employer, the protest file does not have a copy of that W-2. The only documentation in the protest file is the Department's explanation that Taxpayers' claim of the deduction established under IC § 6-3-1-3.5(a)(22) by using Code 630 on their return was incorrect. As explained above, IC § 6-8.1-5-1(c) requires that a taxpayer prove that a proposed assessment is wrong. In this case, Taxpayers have not met that burden.

FINDING

Taxpayers' protest is denied.

II. Tax Administration–Penalty.

DISCUSSION

Taxpayers requested that the Department abate the negligence penalty. Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a negligence penalty if the taxpayer:

> (1) fails to file a return for any of the listed taxes;
> (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
> *(3) incurs, upon examination by the department, a deficiency that is due to negligence*;
> (4) fails to timely remit any tax held in trust for the state; or
> (5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.
>
> (*Emphasis added*).

45 IAC 15-11-2(b) further 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.

The Department may waive a negligence penalty when a taxpayer establishes that its failure to pay a tax was due to reasonable cause and not due to negligence. 45 IAC 15-11-2(c). The taxpayer must demonstrate that it exercised ordinary business care in carrying out or failing to carry out a duty giving rise to the penalty. Reasonable cause is fact sensitive and will vary based on the facts of each individual case.

In this instance, Taxpayers have not demonstrated that their actions were reasonable as described in 45 IAC 15-11-2(c). By the terms of their own protest letter, Taxpayers listed the wrong deduction code on their 2017 income tax return. Further, while Taxpayers have given a plausible explanation of how their return should have been filed, they have not yet provided documentation to establish that their position is correct. Therefore, the Department cannot agree that waiver of penalty is warranted.

FINDING

Taxpayer's protest of the negligence penalty is denied.

SUMMARY

Taxpayer is denied on Issue I regarding the imposition of income tax. Taxpayer is denied on Issue II regarding the imposition of penalty.

November 28, 2018

Posted: 01/30/2019 by Legislative Services Agency
An html version of this document.