

DEPARTMENT OF STATE REVENUE

02-20181391.LOF

Letter of Findings Number: 02-20181391
Income Tax
For Tax Years 2013-15

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Retail business is sustained to the extent it is sustained in a related sales tax protest. The adjustment in the sales tax protest will directly result in an adjustment to this income tax protest.

ISSUES

I. Income Tax—Additional Sales.

Authority: IC § 6-8.1-5-1; IC § 6-3-2-2; *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).

Taxpayer protests proposed assessments for additional income tax.

II. Tax Administration—Penalties.

Authority: IC § 6-8.1-5-4; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of penalties.

STATEMENT OF FACTS

Taxpayer is a retail business in Indiana. As the result of a sales tax audit for tax years 2014, 2015, and 2016, the Indiana Department of Revenue ("Department") determined that Taxpayer had underreported total sales at its business for those tax years. The Department therefore used the best information available to determine total sales for those tax years and applied the results to Taxpayer's income tax audit for the tax years 2013, 2014, and 2015. In a separate protest of proposed assessments of sales tax, Taxpayer was partially sustained and the Letter of Findings for that protest required a supplemental audit to recalculate total sales. Since income from the additional sales formed the basis for the imposition of additional income tax, the supplemental audit resulting from that protest will impact the Department's calculations of additional income upon which to impose income tax.

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.

Indiana income tax is established under IC § 6-3-2-2(a), which states:

With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

- (1) income from real or tangible personal property located in this state;
- (2) *income from doing business in this state*;
- (3) income from a trade or profession conducted in this state;
- (4) compensation for labor or services rendered within this state; and
- (5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property to the extent that the income is apportioned to Indiana under this section or if the income is allocated to Indiana or considered to be derived from sources within Indiana under this section.

Income from a pass through entity shall be characterized in a manner consistent with the income's characterization for federal income tax purposes and shall be considered Indiana source income as if the person, corporation, or pass through entity that received the income had directly engaged in the income producing activity. Income that is derived from one (1) pass through entity and is considered to pass through to another pass through entity does not change these characteristics or attribution provisions. In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana. In the case of compensation of a team member (as defined in section 2.7 of this chapter), only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (r) is considered derived from sources within Indiana.

(Emphasis added).

In this case, Taxpayer was doing business in Indiana and so was subject to adjusted gross income tax as provided by IC § 6-3-2-2(a). The Department's calculations of additional sales at the retail location resulted in the determination that Taxpayer also had additional income from those sales.

In the course of its protest of additional sales at the retail location, Taxpayer was able to provide sufficient documentation to establish that a portion of the Department's calculations of additional income were overstated. Therefore, the Letter of Findings in the related sales tax protest determined that a supplemental audit would be required to apply the new information and recalculate the amount of additional sales at the retail business. Since the income tax at issue in the instant protest was based on the determination of additional sales as determined in the related sales tax audit, and since that amount will now be recalculated pursuant to the determinations of the Letter of Findings in that protest, the amount of additional income at issue will need to be redetermined as well.

FINDING

Taxpayer's protest of the imposition of income tax is sustained to the extent total sales are redetermined in the related sales tax protest.

II. Tax Administration—Penalties.

DISCUSSION

Taxpayer protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Penalty waiver is permitted if a taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. [45 IAC 15-11-2\(b\)](#) clarifies the standard for the imposition of the negligence penalty as follows:

"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 standard for waiving the negligence penalty is given at [45 IAC 15-11-2\(c\)](#) as follows:

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. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer protests the Department's assessment of penalties. After review of the documentation and analysis provided in the protest process, the Department does not agree that waiver of penalties is warranted. Taxpayer failed in its duty to keep sales records as required under IC § 6-8.1-5-4(a). While Taxpayer was sustained in part due to the results of the related sales tax protest, Taxpayer was not wholly sustained and some income tax does remain due. Taxpayer has not affirmatively established that it exercised ordinary business care in this case. Therefore, waiver of penalties is not warranted under [45 IAC 15-11-2\(c\)](#). However, since base tax is being recalculated, penalties will also be recalculated to reflect the new amount of base tax.

FINDING

Taxpayer's protest to the imposition of penalties is denied.

SUMMARY

Taxpayer's Issue I protest regarding the imposition of adjusted gross income tax is sustained, to the extent required by the supplemental audit in the related sales tax protest. Taxpayer's Issue II protest regarding the imposition of penalties is denied.

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