

Letter of Findings: 02-20221002
Withholding Penalties
For the Years 2015, 2016, and 2017

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

The Department agreed that Indiana Manufacturer/Retailer met its burden of establishing that its failure to withhold tax on behalf of its non-resident partner was due to "reasonable cause" sufficient to warrant abatement of the resulting penalties.

ISSUE

I. Indiana Partnership Returns - Failure to Withhold Tax on Behalf of Non-Resident Partner.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; *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 15-11-2](#).

Taxpayer asks that the Department abate penalties attributable to Taxpayer's failure to withhold tax on behalf of its non-resident partner.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of selling and distributing consumer electronic products intended for use in commercial, marine, and recreational vehicles. The products are manufactured in China and then shipped to the Company's Indiana business location. Company sells its products over the internet.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's 2015, 2016, and 2017 IT-65 composite Indiana returns. In reviewing the returns, the Department noted that Taxpayer's 2015 return exercised its prerogative to "opt-out" of filing a composite return - which would have included all of Taxpayer's qualifying non-resident partners - by filing the IN-COMPA (Indiana Composite Filing Opt-out Affidavit). Although Taxpayer was entitled to "opt-out," it failed to submit the requisite IN-COMPA affidavit.

Moreover, the Department's audit noted that in filing Taxpayer's 2016 and 2017 returns, the election to "opt-out" was unavailable. As explained in the IT-65 instructions:

Effective January 1, 2015, [IC 6-3-4-12](#) now provides that all nonresident partners must be included in a composite return schedule, and the partnership must continue to withhold Indiana adjusted gross income tax for all nonresident partners. There is no provision for a partner to "opt out" of composite filing.

As a result, the Department assessed a 20 percent penalty for each year (2016 and 2017) Taxpayer failed to withhold on behalf of their non-resident partner along with a \$500 penalty for failure to file form IT-65 COMP composite returns.

The cumulative penalties totaled approximately \$150,000.

Taxpayer disagreed with the assessment and submitted a protest to that effect. This Letter of Findings is written in response to that protest.

ISSUE

I. Indiana Partnership Returns - Failure to Withhold Tax on Behalf of Non-Resident Partner.

DISCUSSION

The issue is whether Taxpayer has established that the Department erred in assessing the failure to withhold penalties.

The Department assessed the 20 percent penalty under authority of IC § 6-8.1-10-2.1(h) which provides:

A:

- (1) corporation which otherwise qualifies under [IC 6-3-2-2.8\(2\)](#);
- (2) partnership; or
- (3) trust;

that fails to withhold and pay any amount of tax required to be withheld under [IC 6-3-4-12](#), [IC 6-3-4-13](#), or [IC 6-3-4-15](#) shall pay a penalty equal to twenty percent (20[percent]) of the amount of tax required to be withheld under [IC 6-3-4-12](#), [IC 6-3-4-13](#), or [IC 6-3-4-15](#). This penalty shall be in addition to any penalty imposed by section 6 of this chapter. *Effective July 1, 2016, to June 30, 2019.*

The Department assessed the \$500 penalty under IC § 6-8.1-10-2.1(j) which provides:

If a partnership or an S corporation fails to include all nonresidential individual partners or nonresidential individual shareholders in a composite return as required by [IC 6-3-4-12\(i\)](#) or [IC 6-3-4-13\(j\)](#), a penalty of five hundred dollars (\$500) per partnership or S corporation is imposed on the partnership or S corporation.

The penalties were "assessed." As such, it is Taxpayer's responsibility to establish that the existing proposed 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*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation [45 IAC 15-11-2\(b\)](#) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id.*

Departmental regulation [45 IAC 15-11-2\(c\)](#) requires that 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"

IC § 6-8.1-5-1(c) requires that Taxpayer establish either that the 20 percent "failure to withhold" and \$500 "failure to file" penalties were wrongly assessed or that the circumstances justify abatement under the IC § 6-8.1-10-2.1(d) "reasonable cause" provisions.

Taxpayer cites to circumstances which purportedly tend to show that Taxpayer acted with "reasonable care as would be expected of an ordinary reasonable taxpayer."

Taxpayer explains that it all times "engaged and relied upon sophisticated tax representatives at [major accounting firm] and [family-owned accounting firm] to remain compliant with the tax laws of Indiana and other states." Taxpayer explains that these advisors stated that "it was not required to withhold tax on distributions to its non-resident corporation based on IAC 3.1-1-107" According to Taxpayer, a "'non-resident partner' does not include a foreign corporation qualified to do business in Indiana" and that its non-resident partner is indeed "a foreign corporation qualified to do business in Indiana." Moreover, such a distinction - foreign corporation and Indiana corporation - would not survive constitutional scrutiny. As explained by Taxpayer:

Tax laws cannot discriminate against in-state incorporated entities to the detriment of all other taxpayers. The law as written discriminates against all entities that were not formed under the laws of Indiana.

Taxpayer states that the Department's audit mislead - or failed to properly communicate - the possible imposition

of penalties. As explained by Taxpayer:

During the audit, the Department never put the Taxpayer on notice that a penalty would be assessed or why. In fact, the Taxpayer had no knowledge of the penalty even after it appeared on the last page of a lengthy assessment that included a statement that "the net tax assessment made in this report is \$0.00."

The Department is unable to agree that the penalty was unwarranted on its face, that the imposition of an otherwise routine penalty raises questions of constitutional-significance, or that the audit was at fault because the particular issue was not specifically communicated.

However, the Department concludes that Taxpayer acted in a manner consistent with advice provided by its financial and tax advisors. However, wrong that advice may have been, reliance on that advice was indicative of the "reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is sustained.

April 27, 2022

Posted: 06/29/2022 by Legislative Services Agency
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