

**Supplemental Letter of Findings: 02-20200395**  
**Partnership Income Tax**  
**For Tax Years 2015, 2016, 2017 and 2018**

**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 Indiana Department of Revenue's (the "Department") 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Partnership erred by failing to include a nonresident partner on the composite return and is subject to the related penalties. Partnership was not required to withhold taxes on nonresident partner's behalf because nonresident partner is a captive insurer not subject to adjusted gross income tax.

### ISSUE

#### I. Partnership Income Tax - Filing Requirements.

**Authority:** [IC 6-3-1-3.5](#); [IC 6-3-2-2.8](#); [IC 6-3-4-10](#); [IC 6-3-4-11](#); [IC 6-3-4-12](#); [IC 6-8.1-5-1](#); [IC 6-8.1-10-2.1](#); [IC 27-1-2-2.3](#); [IC 27-1-18-2](#); *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); *Scopelite v. Indiana Dept. of Local Gov't Finance*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dept. of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); [45 IAC 3.1-1-105](#); [45 IAC 3.1-1-107](#); 26 U.S.C.A § 704.

Taxpayer protests the assessment of additional taxes and penalties.

### STATEMENT OF FACTS

Taxpayer is an Indiana partnership consisting of five partners. Four partners are in Indiana, and one partner ("Partner") is a corporation organized under the laws of another nation. Taxpayer was subject to an audit related to tax years 2015, 2016, 2017, and 2018. As a result of the audit, the Indiana Department of Revenue ("Department") determined Taxpayer failed to comply with the requirements of IC § 6-3-4-12(a) and (i) related to withholding amounts and filing a composite return for a nonresident partner. The Department issued assessments for unpaid taxes and associated penalties.

Taxpayer protested the assessments of additional tax and penalties. An administrative hearing was scheduled, but Taxpayer's representative failed to appear. Representative then requested a rehearing, which was granted. At the rehearing, Representative explained the basis for the protest. This Supplemental Letter of Findings results. Additional facts will be provided as necessary.

#### I. Partnership Income Tax - Filing Requirements.

### DISCUSSION

The Department audited Taxpayer for tax years 2015, 2016, 2017, and 2018, and determined Taxpayer failed to withhold taxes on behalf of Partner and failed to include Partner on its composite return. As a result, the Department assessed additional taxes and penalties to Taxpayer related to each audited tax year.

Taxpayer protests the Department's decision to assess additional tax and impose penalties. Taxpayer argues that it was not required to include Partner on a composite return because Partner was exempt from Indiana adjusted gross income tax. Additionally, Taxpayer states that because Partner is exempt from adjusted gross income tax and has no requirement to file an Indiana income tax return, Taxpayer was not required to withhold Indiana income tax from Partner's distributive share.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. A proposed assessment is prima facie evidence that DOR's claim for the unpaid tax is valid. [IC 6-8.1-5-1\(c\)](#). The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed

assessment is made. *Id.*; See e.g. *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). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dept. of Local Gov't Finance*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dept. of State Revenue*, 977 N.E.2d 480, 486, fn. 9 (Ind. Tax Ct. 2012).

In general, "every partnership doing business in this state, every partnership any partner of which is a resident, and every partnership which has gross income derived from sources within this state, shall make a return for each taxable year. . ." [IC 6-3-4-10\(a\)](#). However, partnerships are not subject to Indiana's adjusted gross income tax because the partners, whether individual persons or corporations, are liable for the tax on their separate or individual returns. [IC 6-3-4-11\(a\)](#). In determining each partner's adjusted gross income, each partner shall take into account the distributive share of the adjustments provided in [IC 6-3-1-3.5](#). *Id.*

A partnership must file an annual return with the Department disclosing each partner's distributive share of the partnership income. [45 IAC 3.1-1-105\(a\)](#). "Partner's distributive share" is the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations before any modifications under Indiana statutes. [45 IAC 3.1-1-105\(b\)](#). A partner's distributive share of "income, gain, loss, deduction, or credit" is determined by the partnership agreement. 26 U.S.C.A. § 704.

Pursuant to [IC 6-3-4-12\(h\)](#), a partnership is required to file a composite adjusted gross income tax return on behalf of all nonresident partners. Failure to include all nonresident partners in the composite return subjects the partnership to a penalty prescribed under [IC 6-8.1-10-2.1\(j\)](#).

Under [IC 6-3-4-12\(n\)](#), a "nonresident partner" is:

- (1) an individual who does not reside in Indiana;
- . . .
- (4) a partnership not domiciled in Indiana;
- (5) a C corporation not domiciled in Indiana; or
- (6) an S corporation not domiciled in Indiana.

The Department notes that [IC 6-3-4-12](#) consisted of two different versions in effect during the audit years related to the protest. The 2015-2016 version defined a nonresident partner under subsection (m). The statute was subsequently amended, and effective April 2017 to present, the nonresident partner definition is found under subsection (n). The definition of a nonresident partner did not change when the statute was amended. The Department refers to the updated statute and subsection (n) in this Memorandum of Decision.

Certain organizations are exempt from tax on adjusted gross income. [IC 6-3-2-2.8](#). This includes insurance companies which pay a gross premium privilege tax pursuant to [IC 27-1-18-2](#) and captive insurers. [IC 6-3-2-2.8\(4\)\(A\)](#) and (B). A captive insurer is defined under [IC 27-1-2-2.3](#) and is subject to the following specific tax requirements:

- (a) As used in this section, "captive insurer" means a foreign company or an alien company:
  - (1) that is supervised in the foreign or alien jurisdiction;
  - (2) that is owned by a person that conducts business in Indiana;
  - (3) whose exclusive purpose is to insure property and casualty risks of:
    - (A) the parent entity described in subdivision (2);
    - (B) affiliates of the parent entity; or
    - (C) a controlled unaffiliated business;which may include reinsuring (through risk-sharing arrangements) property and casualty risks insured by other foreign companies or alien companies described in subdivision (1); and (4) that
    - (A) is owned or controlled by a state educational institution (as defined by [IC 21-7-13-32](#)) or
    - (B) has made an election under Section 831(b) of the Internal Revenue Code if that election is in effect.
- (b) As used in this section, "controlled unaffiliated business" means a business:
  - (1) that:
    - (A) is not an affiliate of; and
    - (B) has a contractual relationship with;a parent entity described in subsection (a)(2) or an affiliate of the parent entity; and
  - (2) the risks of which are managed by a captive insurer.
- (c) Except as provided in this section, this article does not apply to a captive insurer.

(d) A captive insurer that is doing business in Indiana:

- (1) is not required to obtain a certificate of authority in Indiana under [IC 27-1-6](#) for domestic formation or under [IC 27-1-17](#) for foreign company admission;
- (2) shall register with the commissioner; and
- (3) shall, for each calendar year after 2012 in which the captive insurer is doing business in Indiana, pay into the treasury of this state a tax of two thousand five hundred dollars (\$2,500).

(f) The state and a political subdivision of the state shall not impose a license fee or privilege or other tax on a captive insurer, except for the following:

- (1) The tax described in subsection (d)(3).
- (2) An applicable tax on real and tangible personal property of the captive insurer.

An insurance company not organized under Indiana laws, but doing business in the state, is required to report to the Indiana Department of Insurance, the gross amount of all premiums received by it on policies of insurance covering risks within the State. [IC 27-1-18-2\(a\)](#). Additionally, taxes paid under [IC 27-1-18-2](#) are "in lieu of all license fees or privilege or other tax levied or assessed by this state or by any municipality, county, or other political subdivision of this state." [IC 27-1-18-2\(h\)](#). All insurance companies, foreign or domestic, paying the premiums tax "shall have the same rights and privileges from further taxation and shall be given the same credits wherever applicable, as those set out for those companies paying only a tax on premiums as set out in this section." *Id.*

Taxpayer argues that Partner was not required to be included on a composite return because Partner was not subject to adjusted gross income tax in Indiana. It is clear that Partner is a nonresident partner under the definition provided in [IC 6-3-4-12\(n\)](#). Partner is an out-of-state corporation organized under the laws of another nation. [IC 6-3-4-12\(i\)](#) requires a partnership to file a composite adjusted gross income tax return on behalf of all nonresident partners, regardless of whether the nonresident partner has Indiana sourced income. *Id.* Thus, Taxpayer was required to file a composite return pursuant to [IC 6-3-4-12](#) and include Partner as a nonresident partner, even if Partner had no Indiana sourced income and was not subject to tax on adjusted gross income. Failure to do so was error and subjects Taxpayer to the assessed penalties.

Taxpayer also argues that it was not required to withhold taxes on behalf of Partner because any income of Partner's was already subject to the gross premium privilege tax. Taxpayer's explanation is based on an arrangement between a third entity and the ceding of monies from the third entity to Partner.

Taxpayer explained that as part of its business, it sells gap insurance and extended warranties to customers. Customers pay the premiums for the policies directly to Taxpayer during the transaction. Taxpayer then remits the premiums to an out-of-state company ("Company"). Company is a risk management company that serves as a reinsurer for Taxpayer. In essence, Company assumes the financial risk for the gap insurance and extended warranty policies up to a certain dollar amount. Company retains an administrative fee, money for actual claims made, and a reserve percentage for claims from the premiums it receives from Taxpayer. Company also pays the gross premium privilege tax on the premiums collected as required under [IC 27-1-18-2](#).

After retaining the portion of the premiums described above, Company cedes the remaining premium monies to Partner. Partner then assumes any remaining outstanding financial risk stemming from the gap insurance and extended warranties. If a claim for either type of policy exceeds the reserve amounts collected by Company, the remaining claim amount is paid by Partner. If no additional claim is made on either the gap insurance policy or extended warranty, then Partner retains the remainder of the premium.

Taxpayer believes that because the gross premium privilege tax was paid by Company and the premiums are ceded to Partner after payment of that tax that those monies are no longer subject to tax. Essentially, Taxpayer argues that once the gross premium privilege tax is paid by Company, Partner receives "credit" for Company's payment of the tax.

Taxpayer collects the insurance premiums from its customers, and the premiums are then remitted to Company. It is Company that pays the gross premium privilege tax on the premiums - not Partner. Taxpayer is asking the Department to recognize that Company has paid the gross premium privilege tax and then transfer the credit for the gross premium privilege tax payment over to Partner. Under [IC 27-1-18-2](#), the insurance company paying the premium tax is not subject to income tax on income from gross premiums. The language of the statute does not state that ceding monies from one insurance company to another insurance company results in a "credit" for the second company. Taxpayer's understanding of how the gross premium tax is implemented is incorrect.

The premiums that Partner receives from Company are presumptively subject to tax because the premiums are Indiana sourced income. However, Taxpayer asserts that Partner is a captive insurer and because of this recognition, Partner is not subject to tax, so Taxpayer would not be subject to withhold on Partner's behalf.

Indiana requires partnerships to withhold on distributive shares of partnership income allocated to nonresident partners. [IC 6-3-4-12](#)(a) provides:

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. Such partnership so paying or crediting any nonresident partner:

- (1) shall be liable to the state of Indiana for the payment of the tax required to be deducted and retained under this section and shall not be liable to such partner for the amount deducted from such payment or credit and paid over in compliance or intended compliance with this section; and
- (2) shall make return of and payment to the department monthly whenever the amount of tax due under [IC 6-3](#) and [IC 6-3.5](#) exceeds an aggregate amount of fifty dollars (\$50) per month with such payment due on the thirtieth day of the following month, unless an earlier date is specified by section 8.1 of this chapter.

Additionally, [45 IAC 3.1-1-107](#)(a)(2) states:

*For a partner other than an individual partner, the income tax withheld may be calculated using any reasonable method designed to reflect the ultimate tax liability due Indiana because of the partnership's activities. As used in this section, "nonresident corporate partner" does not include a foreign corporation qualified to do business in Indiana. (Emphasis added.)*

Partner meets the requirements under [IC 27-1-2-2.3](#) to qualify as a captive insurer. Because of this designation, Partner is only subject to taxes prescribed by the Indiana Department of Insurance; Partner is not subject to any other licensing fees, privilege taxes, or other taxes. [IC 27-1-2-2.3](#)(f). Thus, Partner is not subject to tax on its adjusted gross income.

The Department notes that Taxpayer is not required to withhold taxes simply because Partner is a nonresident partner. It is only because Partner is a captive insurer under [IC 27-1-2-2.3](#) and is subject to very specific tax requirements under this statute that Taxpayer is not required to collect withholding on Partner's behalf. As noted previously, Taxpayer is still required to include Partner on a composite return as a nonresident partner. The decision set forth in this Supplemental Letter of Findings is limited to the narrow circumstances in which Partner is effectively exempt from income tax, and Taxpayer had provided an explanation and documentation supporting such conclusion.

To summarize, Taxpayer is required to file a composite return and include its nonresident partner. Taxpayer must pay the penalties associated with failing to file a composite return. Because Partner is a captive insurer and not subject to tax on adjusted gross income, Taxpayer was not required to withhold taxes on Partner's behalf.

## FINDING

Taxpayer's protest is partially sustained and partially denied.

May 18, 2023

Posted: 07/26/2023 by Legislative Services Agency  
An [html](#) version of this document.