

Letter of Findings: 01-20231277
Indiana Individual Income Tax
For the Years 2018, 2019, and 2020

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Shareholders of S corporation operating a combination restaurant/convenience store, were unable to meet their burden of establishing that the Department's proposed assessments of additional income tax were wrong. Shareholders were not entitled to deduct rental payments paid on an apartment that was not their principal residence.

ISSUE

I. Indiana Individual Income Tax - Flow-Through Business Income.

Authority: [IC 6-3-2-6](#); [IC 6-3-4-11](#); [IC 6-8.1-5-1](#); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *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).

Taxpayers argue that the Department of Revenue overstated the amount of income attributable to their shared ownership of a combination gas station/convenience store and fast-food restaurant.

STATEMENT OF FACTS

Taxpayers are Indiana residents who routinely file joint IT-40 Resident Individual Income Tax returns. On their 2018, 2019, and 2020 returns, Taxpayers reported income received from a combination convenience store and restaurant. The business is organized as an S corporation and the business's income flowed through to Taxpayers. Taxpayers were subject to income tax on their distributive shares of their S corporation business.

The Indiana Department of Revenue conducted an audit of the business's 2018, 2019, and 2020 sales tax returns. That audit resulted in an assessment of additional sales tax and consequently affected the amount of income flowing through to Taxpayers. The Department's sales tax audit was conducted in parallel with the Department's review of Taxpayers' own individual returns.

The Department assessed Taxpayers additional income tax for the years under review. The Department did so on the grounds that the business received additional unreported income and because the Department concluded that Taxpayers were not entitled to claim a "renter's deduction" on their individual returns.

Taxpayers disagreed with both the business's sales tax assessment and the assessment of additional individual income tax. Taxpayers submitted protests challenging both the results of the sales tax audit and the income tax audit. An administrative hearing was conducted in order to permit Taxpayers' representative to explain the basis for their protests.

Taxpayers' sales tax assessment is addressed in a separate Letter of Findings docketed as 04-20231276. This Letter of Findings addresses Taxpayers' income tax assessment.

I. Indiana Individual Income Tax - Flow-Through Business Income.

DISCUSSION

The issue is whether Taxpayers have met their burden of establishing that the Department's assessment of additional income tax was wrong.

A. Taxpayer's Burden of Proof.

As a threshold issue, it is the Taxpayer's responsibility to establish that the sales 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. The Department points out that, "[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.'" *Dep't. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this Letter of Findings, as well as the two preceding audits, are entitled to deference.

B. S Corporation Flow Through Income.

[IC 6-3-4-11](#) imposes on the Taxpayers the responsibility for paying Indiana individual income tax on their share of the income earned from their convenience store and restaurant. The statute provides in part:

A partnership as such shall not be subject to the adjusted gross income tax imposed by [IC 6-3-1](#) through [IC 6-3-7](#). *Persons or corporations carrying on business as partners shall be liable for the adjusted gross income tax only in their separate or individual capacities.* In determining each partner's adjusted gross income, such partner shall take into account his or its distributive share of the adjustments provided for in [IC 6-3-1-3.5](#).

[IC 6-3-4-11\(a\)](#) (*Emphasis added*).

The Department agrees that Taxpayers' income tax assessment - right or wrong - depends primarily on any adjustments made as a result of the convenience store's parallel sales tax audit. As to Taxpayers' direct protest of the income tax assessment, Taxpayers have not met their statutory burden under [IC 6-8.1-5-1\(c\)](#) of establishing that the income tax assessment was wrong. However, any decision arrived at concerning the business's sales tax assessment should and will "flow through" to the Taxpayers' income tax liability. Any challenge raised here by Taxpayers is essentially premature and must, under Indiana law, await resolution of the sales tax issue.

C. Renter's Deduction.

Entirely unrelated to Taxpayers' business income is an issue directly related to Taxpayers' claim to a renter's deduction. The Department denied the exemption because, as explained in the audit report, Taxpayers' claim to the deduction on their 2018 and 2019 individual returns was disallowed because the location cited "was not [T]axpayers' principal place of residence." As explained in the report, "Taxpayer paid rent to an apartment in [municipality], Indiana for [their] dependent child."

The disallowance of the credit increased Taxpayers' adjusted gross income because [IC 6-3-1-3.5\(a\)](#) provides that "(a) In the case of all individuals, "adjusted gross income" (as defined in Section 62 of the Internal Revenue Code), modified as follows[s]ubtract any other amounts the taxpayer is entitled to deduct under [IC 6-3-2](#)."

Indiana does allow a Title 6 deduction pursuant to [IC 6-3-2-6](#) which provides in part:

- (a) Each taxable year, an individual who rents a dwelling for use as the individual's principal place of residence may deduct from the individual's adjusted gross income (as defined in [IC 6-3-1-3.5\(a\)](#)), the lesser of:
- (1) the amount of rent paid by the individual with respect to the dwelling during the taxable year;
 - (2) or three thousand dollars (\$3,000).
- (b) Notwithstanding subsection (a), a husband and wife filing a joint adjusted gross income tax return for a particular taxable year may not claim a deduction under this section of more than three thousand dollars (\$3,000).

Taxpayers have provided nothing which refutes the Department's decision disallowing the deduction. Taxpayers paid rent but not rent for their "principal place of residence."

FINDING

To the extent that Taxpayers claimed the renter's deduction, Taxpayers' protest is denied. To the extent that Taxpayers disagreed with the increase in flow through business income, Taxpayers' protest is sustained to the extent that any subsequent modification to the results of the sales tax audit will flow through to the income tax assessment addressed here.

August 23, 2023

Finding Replaces: New

Posted: 11/01/2023 by Legislative Services Agency
An [html](#) version of this document.