

Letter of Findings: 01-20231625
Individual Indiana Income Tax
For the Year 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Department was bound by an IRS decision disallowing certain business expenses claimed on Individual's 2017 federal and Indiana tax returns because the calculation of Indiana income tax began with federal adjusted gross income.

ISSUE

I. Indiana Individual Income Tax - Business Expenses and IRS Adjustment.

Authority: [IC 6-3-1-3.5](#); [IC 6-3-2-1](#); [IC 6-3-4-6](#); [IC 6-8.1-5-1](#); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer argues that the Department's assessment of additional income tax was wrong because the assessment was based on an erroneous IRS decision disallowing business expenses.

STATEMENT OF FACTS

Taxpayer is an Indiana resident who routinely files federal and Indiana income tax returns.

In a letter dated December 2019, the Internal Revenue Service ("IRS") informed Taxpayer that it was "examining your [2017] return and need a response from you." The IRS asked Taxpayer to explain the Schedule 5, line 17, "Legal and professional services." On Schedule 5, Taxpayer had originally claimed approximately \$30,000 in "Legal and Professional Expenses."

The IRS proceeded to disallow the claimed expenses. The IRS explained, "You can usually deduct expenses that you incur in attempting to produce taxable income." However, "[B]ased on the information you provided; your business was not established until June of 2018."

The IRS provided a second reason it was disallowing the expenses.

[F]or the 2017 tax year you can claim business start-up costs up to \$10,000.00 that was incurred. In order to claim these deductions you must have declared these expenses as startup/organizational costs when you filed your tax return.

....

You had up to six months after the filing date for 2017 tax year to declare these costs Since we can find no record of you declaring these costs, we cannot allow any of the [\$30,000] Legal and Professional Expenses you claimed.

The IRS decision affected the federal adjusted gross income reported on Taxpayer's 2017 return. That amount increased from approximately \$48,000 to approximately \$78,000. The Indiana Department of Revenue ("Department") followed suit on the ground that Indiana income begins with the adjusted gross income reported on the federal return.

In a letter dated June 2023, the Department explained as follows:

A review of your Indiana Individual Income tax for the tax period ending December 31, 2017, indicates you owe an additional [\$1,700]. This amount represents the full liability due including all assessed penalties and interest to date.

....

[The liability is] a result of an audit conducted by the Internal Revenue Service that affected your Indiana tax return. The Indiana return begins the computation of taxable income with federal adjusted gross income.

Taxpayer disagreed with the Department's decision and submitted a protest to that effect. This Letter of Findings is based on Taxpayer's explanation and the information and documentation available to the Department.

I. Indiana Individual Income Tax - Business Expenses and IRS Adjustment.

DISCUSSION

The issue raised by Taxpayer is whether the IRS made a mistake when it denied Taxpayer's business expenses and the Department compounded that mistake when it adjusted the 2017 Indiana return to reflect the IRS's decision.

Taxpayer explained why the Department made a mistake assessing additional Indiana income tax.

The IRS has not provided due process in this matter which boils down to categorizing some legitimate deductions and wrongly stating I was a start-up [because] I opened my company in December 2015 and was actively engaged with a customer to develop a custom product.

....

I provided proof I was working with a customer and also requested to amend my return and recategorize the expenses that they said should be capitalized.

Taxpayer concluded "I should owe nothing to the IRS or the DOR [because] [t]he IRS is a broken agency and how they have handled my case violates their own procedure."

Indiana imposes a tax "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." [IC 6-3-2-1\(b\)](#). [IC 6-3-1-3.5\(a\)](#) provides the starting point in determining the taxpayer's taxable income and calculates what would be their Indiana income tax after applying any particular additions and subtractions. The statute provides in small part that Indiana adjusted gross income starts with "'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code) . . ."

As with any assessment of Indiana listed taxes, it is Taxpayer's responsibility here to establish that the proposed assessments of tax, interest, and penalty are 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, including during an action appealed to the tax court under this chapter. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." The Department will treat a poorly developed or non-cogent argument as having been waived. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

The Department is in no position to second-guess the IRS on this matter. Publicly available information confirms that Taxpayer was in the process of developing an "an eco-friendly food tray that . . . increase[s] the use of environmentally-friendly products." Taxpayer may very well have spent \$30,000 to develop the food tray, but that is an issue between the IRS and Taxpayer. What is clear is that Indiana law specifies that the calculation of Indiana's tax begins with "'adjusted gross income' (as defined in Section 62 of the Internal Revenue Code) . . ." When and if the IRS revokes its original decision and adjusts the adjusted gross income from \$78,000 back to \$48,000, Indiana law would then allow Taxpayer to file an amended Indiana return reporting that change. [IC 6-3-4-6\(c\)](#). The Department would then be required to refund any excess tax.

As to this protest, Taxpayer's protest is denied because the Department is bound by the IRS decision disallowing the expenses and because Taxpayer has not met his statutory burden under [IC 6-8.1-5-1](#)(c) of establishing that the Department's decision was wrong. Of course, if the IRS does make any change to that decision after this decision is issued, Taxpayer will have the opportunity to report that change to the Department subject to the applicable statutes of limitations.

FINDING

Taxpayer's protest is respectfully denied.

August 23, 2023

Finding Replaces: New

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An [html](#) version of this document.