

Letter of Findings: 02-20231624
Income Tax
For the Years 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Indiana Partnership was responsible for additional tax concerning guaranteed payments it made to its nonresident individual partners. Indiana Partnership demonstrated that penalty should be abated.

ISSUE

I. Payments Subject to Income Tax - Burden of Proof.

Authority: I.R.C. § 707; I.R.C. § 736; [IC 6-3-4-12](#); [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); *Miller Brewing Co. v. Indiana Dep't of State Revenue*, 903 N.E.2d 64 (Ind. 2009); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Treas. Reg. § 1.707-1; IT-65 Indiana Partnership Return Booklet (2019); IT-65 Indiana Partnership Return Booklet (2020).

Taxpayer protests the assessments of tax for 2019 and 2020.

II. Tax Administration - Penalty.

Authority: [IC 6-3-4-12](#); [IC 6-8.1-10-2.1](#); [45 IAC 15-11-2](#).

STATEMENT OF FACTS

Taxpayer is an Indiana limited liability partnership. Taxpayer files federal and Indiana income tax returns, Form 1065 and Form IT-65, respectively. Taxpayer's income flows through to its partners, including resident and nonresident partners. For the nonresident partners, Taxpayer files composite nonresident partner returns and withholds tax on the "flow-through" income, as statutorily required.

In 2022, the Indiana Department of Revenue ("Department") audited Taxpayer's tax filings and business records for 2019 and 2020 (the "Tax Years at Issue"). The audit noted that Taxpayer made guaranteed payments to individuals who were nonresident partners. The audit found that Taxpayer did not withhold and remit composite tax on guaranteed payments it made to several of its nonresident partners. The Department assessed Taxpayer additional tax, interest, and penalties accordingly.

Taxpayer protested the assessment. An administrative hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Payments Subject to Income Tax - Burden of Proof.

DISCUSSION

The Department assessed Taxpayer additional composite tax concerning guaranteed payments Taxpayer made to several individual partners, who were nonresidents, for the Tax Years at Issue. Taxpayer argued that it was not responsible for the additional composite tax assessed. Therefore, the issue is whether, for the Tax Years at Issue, Taxpayer provided verifiable documentation sufficiently demonstrating that it was not responsible for additional composite tax concerning guaranteed payments it made to its nonresident partners.

As a threshold issue, all tax assessments are *prima facie* evidence that the Department's claim for the unpaid tax

is valid; the taxpayer bears the burden of proving that any assessment is incorrect. [IC 6-8.1-5-1\(c\)](#); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). "[E]ach assessment and each tax year stands alone." *Miller Brewing Co. v. Indiana Dep't of State Revenue*, 903 N.E.2d 64, 69 (Ind. 2009). The taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010). "[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, interpretations of Indiana tax law contained within this decision, as well as the preceding audit reference, are entitled to deference.

Taxpayer in this case has elected to be treated as a partnership. Under [IC 6-3-4-12\(a\)](#) (as in effect during the Tax Years at Issue),

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 [] 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, the Department's 2019 IT-65 Indiana Partnership Return Booklet, available at <https://www.in.gov/dor/tax-forms/2019-corporatepartnership-income-tax-forms/> (last visited August 1, 2023), further provides, in pertinent part:

IC [§] 6-3-4-12 provides that all nonresident partners' distributive shares 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. Each nonresident partner's composite tax is calculated at the relevant tax rate. The department has streamlined the procedure for making withholding payments for nonresidents.

...

Individual Partners - A partnership ***must withhold state adjusted gross income (AGI) tax at the individual income tax rate on the apportioned distributive shares of partnership income*** (on current year earnings derived from Indiana sources) ***and any other guaranteed payments attributable to Indiana***. It must do this each time it pays or credits any of its nonresident partners and part-year resident individual partners.

(Emphasis in original) (Emphasis added). See also 2020 IT-65 Indiana Partnership Return Booklet, available at <https://www.in.gov/dor/tax-forms/2020-corporatepartnership-income-tax-forms/> (last visited August 1, 2023).

A payment "made in liquidation of the interest of a retiring partner" according to I.R.C. § 736(a) is considered:

- (1) as a distributive share to the recipient of partnership income if the amount thereof is determined with regard to the income of the partnership, or
- (2) as a guaranteed payment described in [I.R.C. §] 707(c) if the amount thereof is determined without regard to the income of the partnership.

Therefore, "[t]o the extent determined without regard to the income of the partnership, payments to a partner for services [] shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a) (relating to gross income) and, subject to section 263, for purposes of section 162(a) (relating to trade or business expenses)." I.R.C. § 707(c); Treas. Reg. § 1.707-1(c). Guaranteed payments thus are regarded as ordinary income to the partners, which are taxed as ordinary income or interest income to the partners. In other words, guaranteed payments are includable in every partners' income and those partners are required to report the guaranteed payments as though these payments were part of their distributive share of ordinary income. As such, for composite tax purposes, the partnership is required to withhold tax from these guaranteed payments

made to individual partners, who are nonresidents.

Throughout the protest process, referencing [IC 6-3-4-12](#) and the Department's IT-65 Indiana Partnership Return Booklet, Taxpayer stated the following:

The partnership filed the composite tax schedule for both years and disclosed on page 1 of form IT-65 the complete number of nonresident partnerships. Along with the composite tax schedule a footnote was included with each years *[sic]* filing explaining why there are non-resident partners listed on the composite schedule without a composite tax being calculated for them. . . .

The partners on the schedule which did not have tax calculated for them is because those members are non-residents in which the income reported on their K-1 is not a distributive share of partnership income for the year.

(Emphasis in original).

Taxpayer, however, declined to provide additional documents requested. The footnote of Taxpayer's tax filings stated:

THERE ARE [SEVERAL] NONRESIDENTS NOT INCLUDED IN THE CALCULATION ON THE COMPOSITE RETURN. THE REASON FOR THEIR EXCLUSION IS THE INCOME REPORTED ON THEIR K-1 FROM THE FIRM IS RETIREMENT INCOME AND NOT A DISTRIBUTIVE SHARE OF INCOME FROM THE PARTNERSHIP.

(EMPHASIS IN ORIGINAL).

Upon review, Taxpayer's reliance of its explanation is misplaced. Undisputedly, Taxpayer made guaranteed payments - namely, payments "made in liquidation of the interest of a retiring partner" - to its individual nonresident partners. The payments are partners' income and are required to be reported as though the payments are part of their distributive share of ordinary income. The guaranteed payments to nonresident partners were thus subject to composite tax. Taxpayer did not withhold tax on those guaranteed payments. The audit noted, in part:

In the review of the K-1s for each of the nonresident shareholders where no composite tax was assessed, the taxpayer listed the income as Guaranteed Payments. As per the [] IT-65 return booklet, "A partnership must withhold state adjusted gross income (AGI) tax at the individual income tax rate on the apportioned distributive shares of partnership income and any other guaranteed payments attributable to Indiana. It must do this each time it pays or credits any of its nonresident partners and part-year resident individual partners." As a result of the review, the auditor determined the guaranteed payments are subject to composite tax.

To conclude, given the totality of the circumstances, the Department is not able to agree that Taxpayer met its burden of proof as required under [IC 6-8.1-5-1\(c\)](#). The guaranteed payments made to individual partners are regarded as ordinary income under I.R.C. § 736(a) and are required to be reported as though these payments are part of their distributive share of ordinary income. Since those individual partners were nonresident partners, Taxpayer was required to withhold tax on those guaranteed payments made to them.

FINDING

Taxpayer's protest of tax assessment is respectfully denied.

II. Tax Administration - Penalty.

DISCUSSION

Taxpayer requested that the penalty be abated.

[IC 6-3-4-12](#) provides, in relevant part:

(h) If a partnership fails to withhold and pay any amount of tax required to be withheld under this section and thereafter the tax is paid by the partners, the amounts of tax as paid by the partners shall not be collected from the partnership but it may not be relieved from liability for interest or penalty otherwise due in respect to

the failure to withhold under [IC 6-8.1-10](#).

...

(j) If a partnership does not include all nonresident partners in the composite return, the partnership is subject to the penalty imposed under [IC 6-8.1-10-2.1\(j\)](#).

...

(m) Notwithstanding subsection (k), a partnership is subject to a late payment penalty for the failure to file a return, pay the full amount of the tax shown on the partnership's return, or pay the deficiency of the withholding taxes due under this section for any amounts of withholding tax, including any interest under [IC 6-8.1-10-1](#), reported or paid after the due date of the return, as adjusted by any extension under [IC 6-8.1-6-1](#).

The Department may waive a penalty as provided in [45 IAC 15-11-2\(c\)](#), which states, in part:

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 argued that it "did include and assess the non-resident composite tax for any partners whose income was a distributive share of current year income." Therefore, Taxpayer believed that it was "diligent in following the requirements when they applied to the non-residents" because "[t]he non-resident partners were all listed on the composite tax schedule (even those that did not have withholding calculated) to present a complete schedule so that the number of non-residents listed on the schedule matched the number of non-resident partners listed on page 1 of IT-65." Taxpayer maintained that it generally has a good compliance record.

Given the totality of the circumstances, the Department is prepared to agree that the penalty should be abated.

FINDING

Taxpayer's protest of penalty is sustained.

SUMMARY

Taxpayer's protest of penalty is sustained. However, Taxpayer's protest of composite tax is respectfully denied.

August 17, 2023

Finding Replaces: New

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