

**Letter of Findings: 01-20232322**  
**Indiana Individual Income Tax For the Years 2014, 2015, and 2016**

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

S Corporation's Shareholders, in the business of operating combination gas station/convenience stores, were unable to meet their burden of establishing that the Department's proposed assessments of additional income tax were wrong.

### ISSUE

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

**Authority:** [IC 6-2.5-1-5](#); [IC 6-8.1-5-1](#); [IC 6-8.1-5-4](#); *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); Letter of Findings 04-20232323 (January 5, 2024).

Taxpayers argue that the Department of Revenue overstated the amount of income attributable to their ownership of two combination gas station/convenience stores.

### STATEMENT OF FACTS

Taxpayers are Indiana residents and shareholders of an S Corporation, which operates two combination gas station/convenience stores. The S Corporation's income flowed through to Taxpayers.

Taxpayers routinely file joint IT-40 Resident Individual Income Tax returns. On their 2014, 2015, and 2016 returns, Taxpayers reported income received from the S Corporation. Taxpayers were subject to individual income tax on their distributive shares of their S Corporation business.

The Indiana Department of Revenue ("Department") conducted an audit of the S Corporation's 2014, 2015, and 2016 income and sales tax returns. That audit resulted in an assessment of additional sales tax and consequently affected the amount of income determined to be 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 S Corporation received additional unreported income and because the S Corporation's original income tax return called for adjustments reflecting the results of the audit report.

Taxpayers disagreed with both the S Corporation'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.

The S Corporation's sales tax assessment is addressed in a separate Letter of Findings docketed as 04-20232323. 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 adjustments to their

income statements and tax returns were wrong.

### **A. Summary of Taxpayers' Arguments.**

In general, Taxpayers criticize the Department's reliance on "estimates" and that the estimates employed "are unreasonable and unacceptable, as well as being beyond industry standards." As explained by Taxpayers, "It is very unlikely for a typical gas station to make the kind of profits that the [audit] assessed." Taxpayers come to that conclusion because they "provided all of the required documents." Essentially, Taxpayers argue that if the Department had relied on the documentation provided, the adjustments made would not have been necessary.

### **B. Burden of Proof.**

In considering both the audit result and Taxpayers' contentions, the Department points out that it is Taxpayers' responsibility to establish that the income tax assessments are 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.

In assessing the audit report conclusion, the relevant Indiana law, and Taxpayers' arguments, the Department bears in mind that "when [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 original audit, are entitled to deference.

### **C. Record Keeping Responsibility.**

Indiana law requires that "[e]very person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." [IC 6-8.1-5-4\(a\)](#). In addition, [IC 6-8.1-5-4\(c\)](#) provides that, "A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times." *Id.*

In the absence of the required "books and records," [IC 6-8.1-5-4\(e\)](#) provides:

The failure of a person to keep books and records in the ordinary course of business shall be considered for purposes of determining the weight of the evidence as it relates to the person's liability for a listed tax, and not for purposes of the admissibility of the evidence.

[IC 6-8.1-5-1\(b\)](#) requires of the Department as follows:

If the department reasonably believes that a person has not reported the proper amount of tax due, the department *shall make* a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to [IC 6-8.1-10](#) concerning the imposition of penalties and interest. (*Emphasis added*).

### **D. S Corporation Audit.**

The Department's S Corporation's audit commenced October 2016, and was completed April 2021. During the course of the audit, Taxpayers were represented by two different spokespersons.

The Department's audit concluded that Taxpayers failed in their duty to keep and provide books and records. As explained in the audit report:

Due to the facts discovered by the auditor listed above, and the failure of the [T]axpayer's representative to answer the questions posed during the audit, the auditor determined that [T]axpayer's records were unreliable.

....

Due to the taxpayer's failure to demonstrate it kept accurate or reliable records, the auditor determined that it was necessary to complete the audit based on the best information available.

The audit was confronted with a series of issues which, according to the audit report, led to the conclusion that the S Corporation's books and records were incomplete. Instead, the audit determined that the best information available consisted of documents not kept by the S Corporation, but rather the documents kept by third party transaction processors and banks.

#### **E. Taxpayers/Shareholders.**

As noted above, the results of the S Corporation audit adjustments flowed through to the Taxpayers' own returns because, according to the audit report, Taxpayers "had not properly reported all income expenses reported on Federal Form 1120S for calendar years [ ] 2014, 2015, and 2016." The 1120S is the "U.S. Income Tax Return for an S Corporation."

The audit report indicated that the S Corporation "failed to correctly report its Gross Receipts, Other Income, Loans to Shareholders, Additional Paid-in Capital, and Retained Earnings." In addition, the S Corporation "made [ ] undisclosed distributions in excess of the [Taxpayers'] basis."

"Gross Receipts" was adjusted to reflect the additional S Corporation's sales. The increase was approximately \$5,000,000. That adjustment was made pursuant to [IC 6-2.5-1-5](#), which defines "gross retail income" as the "total amount of consideration, including cash, credit, property, and services, for which tangible personal property is sold, leased, or rented, valued in money, whether received in money or otherwise"

"Other Income" was adjusted to reflect "the amounts earned by the [S Corporation] commissions on lottery sales and ATM withdrawals." The amount of additional "other income" was approximately \$84,000 as defined in [IC 6-2.5-1-5](#).

"Loans to Shareholders" was adjusted to mirror the amount of loans made to or held by Taxpayers. The audit report notes that neither the S Corporation nor Taxpayers "provided sufficient documentation substantiating the validity of the existing loans." Instead, the audit treated the "loans" simply as "additional distributions to the [Taxpayers]."

"Additional Paid In Capital" was originally reported as \$300,000 in 2014. However, Taxpayers' representative explained that the "amount of the additional paid-in capital was and had been since the beginning . . . zero." The \$300,000 was adjusted to zero. This particular adjustment "[did] not flow through as a distribution to the [Taxpayers]."

"Retained Earnings" was originally reported by Taxpayers as approximately \$470,000. However, the audit report noted that neither the S Corporation nor Taxpayers "provided sufficient documentation substantiating the validity of any retained earnings." As a result, the audit adjusted "the amount reported as the beginning balance of retained earnings in 2014 [and was] adjusted to zero." Again, this particular adjustment "[did] not flow through as a distribution to the [Taxpayers]."

"Distributions" was adjusted to reflect the audit's conclusion that "no documentation was discovered or provided demonstrating the additional income was not distributed." Instead, the additional income amount determined in the S Corporation's audit "will be treated as a deemed distribution."

Details concerning the S Corporation's purported failure to provide sufficient and verifiable documentation are addressed in Letter of Findings 04-20232323 (January 5, 2025) and are incorporated here. In general, the audit concluded that the S Corporation "failed in its responsibility to provide all requested books and records and that the documentation that was provided was unreliable."

#### **F. Analysis and Conclusion.**

Taxpayers argue that they provided all the documentation sufficient to establish that both they and S Corporation properly and fully reported all the income and retail sales on their original returns, that the Department's reliance on perceived "estimates" was both unreasonable and unacceptable, and that the Department deployed audit personnel who were unfamiliar with the operation and finances of combination gas station/convenience stores.

The Department here notes that Taxpayers have not specifically addressed any of the audit's findings concerning "Gross Receipts, Other Income, Loans to Shareholders, Addition Paid-in Capital, and Retained Earnings." As a result, this Letter of Findings accepts those adjustments as unchallenged.

As to the remainder of Taxpayers' arguments, the Department is unable to agree that Taxpayers have met their statutory burden under [IC 6-8.1-5-1\(c\)](#) of establishing that the assessment was wrong. The cumulative effect of the two audit reports - and consideration of Taxpayers' and S Corporation's arguments - does not lead to a conclusion that that the assessments should be either abated or reduced. Without minimizing any of the numerous issues raised, this decision quotes from Letter of Findings 04-20232323 (January 5, 2024) as emblematic of the audit's sales and income findings:

That conclusion [denying the S Corporation's protest] is amply reinforced by pointing out a single conclusion in the audit report. "Almost double the amount of cash was circulating through the [S Corporation's] bank accounts and ATM than could be accounted for."

Since Taxpayer has not provided sufficient documentation or analysis to establish that the Department's conclusions were wrong, Taxpayers' protest is denied.

### FINDING

Taxpayers' protest is denied with the result that the assessments remain as originally issued.

January 5, 2024

*Replaces Finding Document at: New*

*Posted: 03/27/2024 by Legislative Services Agency*  
An [html](#) version of this document.