

Letter of Findings: 01-20241104
Indiana Individual Income Tax For the Years 2019, 2020, and 2021

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Individual, an S Corporation Shareholder, who operated an Indiana business which underreported its taxable sales, was unable to meet his burden of proof necessary to establish that the Department's proposed assessments of additional individual income tax were wrong.

ISSUE

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

Authority: [IC 6-2.5-8-8](#); [IC 6-2.5-9-3](#); [IC 6-3-4-11](#); [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); [45 IAC 2.2-8-12](#); Letter of Findings 04-20241026 (February 20, 2024).

Taxpayer argues that the Department of Revenue overstated the amount of income attributable to his interest in a C Corporation which subsequently reorganized as an S Corporation during the years at issue.

STATEMENT OF FACTS

Taxpayer is an Indiana resident who routinely files Indiana individual income tax returns. Taxpayer's income derives from his ownership interest in an Indiana business ("Business") which sells plants and gardening accessories.

The Indiana Department of Revenue ("Department") initiated an audit review of the Business's financial records and tax returns for the years 2019, 2020, and 2021.

As a result, and based on the "best information available," the Department assessed the Business approximately \$14,000 in additional sales tax in addition to penalty and interest charges.

The Department also reviewed Taxpayer's individual income tax returns because, as an S Corporation, income from the store "flowed through" to Taxpayer. As explained in the audit report, "[The Business audit] revealed additional income due to sales being higher on the sales tax returns and general ledgers when compared to the income tax returns." As a result, the Department assessed Taxpayer approximately \$4,600 in additional individual income tax.

Taxpayer and Business disagreed with the Department's assessments and submitted protests to that effect. The Business's sales tax protest is addressed in a separate decision designated as Letter of Findings 04-20241026 (February 20, 2024).

An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings, addressing the individual income tax assessment, results.

This Letter of Findings interchangeably refers to Taxpayer's Indiana plant and gardening supply store as "Business," "S Corporation," or "C Corporation."

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

DISCUSSION

The issue is whether Taxpayer has met the burden of proof necessary to establish that the Department's adjustments to his income statements and tax returns were wrong.

A. Summary of Taxpayer and Business's Arguments.

In general, Taxpayer argues that the Department misunderstood - or failed to account for - the Business's reorganization from C Corporation to S Corporation in 2019 and then compounded that error by failing to recognize that the Business had "changed its accounting method from accrual to cash basis."

B. Burden of Proof.

In considering both the Business audit results and Taxpayer's own individual contentions, the Department points out that it is Taxpayer's 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, 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." *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 each of Taxpayer and the Business's 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 both original audits, are entitled to deference.

C. Taxpayer's Record Keeping Responsibility.

Both the sales and income tax assessments are predicated on the Department's conclusion that Taxpayer - and his Business - were unable to document and correctly report purportedly exempt sales.

Indiana law requires that "[e]very person subject to a listed tax must keep books and records so that the [D]epartment 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.

D. The Department's Responsibility.

In instances in which the Department believes that an individual or business has not reported the correct amount of tax, [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*).

E. S Corporation Audit Objections.

As mentioned, the S Corporation argued that the Department failed to consider the Business's reorganization in 2019. During that time, the Business changed from reporting its sales as a C Corporation to reporting its sales as

an S Corporation. In addition, the S Corporation changed from reporting its sales income on an accrual basis to reporting on cash basis.

The Department's Letter of Findings 04-20241026 (February 20, 2024) addressed these objections as follows:

[S Corporation] has failed to reconcile its arguments - that [S Corporation] was reorganized as an S Corporation or that [S Corporation] changed its accounting methodology - with the Department's finding that [S Corporation] was responsible for sales tax on undocumented retail transactions. By whatever means [S Corporation] accounted for or documented its customers' purchases, the Department is unable to agree that [S Corporation] has met its statutory burden under [IC 6-8.1-5-1](#)(c) of establishing that the assessment was wrong.

The Department concluded that that S Corporation's argument - while factually correct - simply missed the mark. While the Business was reorganized and its accounting method was changed, the assessment was based on the S Corporation's failure to account for purportedly exempt sales because the S Corporation failed to provide its customers' exemption certificates. That failure runs afoul of the requirements found in [IC 6-2.5-8-8](#)(b). The statute provides, in part, that "[a] seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase." When the vendor fails to accept a "proper exemption certificate," the vendor "has a duty to remit state gross retail or use taxes" because the vendor "holds those taxes in trust for the state and is personally liable for the payment for these taxes....." [IC 6-2.5-9-3](#)(a).

[45 IAC 2.2-8-12](#)(c) summarizes the dilemma the S Corporation faced.

All retail sales of tangible personal property for delivery in the state of Indiana shall be presumed to be subject to sales or use tax until the contrary is established. The burden of proof is on the buyer and also on the seller unless the seller receives an exemption certificate.

F. The Basis for the Individual Income Tax Assessment.

Because the Business operated as an S Corporation during a portion of 2019 and all of 2021 and 2021, [IC 6-3-4-11](#) imposes on the Taxpayer the responsibility for paying Indiana individual income tax on his share of the income earned from his plant and gardening store. 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*).

G. Summary and Conclusion.

Taxpayer - as an owner/shareholder of the S Corporation - maintains that the sales income was either fully reported as flowing through to Taxpayer or fully accounted for when the Business was reporting these sales as a C Corporation.

In this instance, Taxpayer's argument runs counter to the evidence. The audit determined that certain sales amounts were not accounted for on either the Taxpayer's individual returns or the returns filed during the time the Business was reporting as a C Corporation. That being so, the Department is bound by its obligation under [IC 6-8.1-5-1](#)(b) to issue an assessment based on the "best information available." In making that determination, the Department is entitled to consider both the information available and the information either not available or simply not provided. In this case, the missing exemption certificates, and the determination that "[the S Corporation audit] revealed additional income due to sales being higher on the sales tax returns and general ledgers when compared to the income tax returns" justified both the S Corporation's sales tax assessment and Taxpayer's own income tax assessment.

Neither the audit or this administrative review was able to fully account for the entirety of the S Corporation's sales or the Taxpayer's income. As such, the Department is obliged to conclude that Taxpayer has not met his statutory burden under [IC 6-8.1-5-1](#)(c) of establishing that the assessments were wrong.

FINDING

Taxpayer's protest is respectfully denied.

February 20, 2024

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