DEPARTMENT OF STATE REVENUE

02-20210071.LOF
02-20210072.LOF

**Letter of Findings 02-20210071 and 02-20210072
Corporate Income Tax Penalty
For the Tax Year Ending August 30, 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

The Department agreed with Retailers that the Department's assessment of underpayment and late penalties was incorrect; a review of the Department's records and the Retailers' tax returns indicated that Retailers correctly reported their "annualized" income and timely made the estimated quarterly payments as required.

ISSUE

I. Indiana Corporate Income Tax - Underpayment Penalties.

Authority: IC § 6-3-4-4.1; IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; I.R.C. § 6655; 45 IAC 15-11-2; Annualized Income, https://www.investopedia.com/terms/a/annualized-income.asp.

Taxpayers argue that the Department erred in assessing them underpayment penalties and associated interest charges.

STATEMENT OF FACTS

Taxpayers object to the imposition of the ten percent "underpayment penalty." Taxpayers are two related companies both of which are in the business of selling goods at retail.

Both companies filed Indiana income tax returns for the period beginning September 2, 2019 and ending August 30, 2020. In both cases, the Indiana Department of Revenue issued "Notice[s] of Proposed Assessment" representing "underpayment penalties." The first company was assessed an underpayment penalty of approximately $14,000 while the second company was assessed an underpayment penalty of approximately $47,000.

Taxpayers disagreed with both assessments arguing that they "utilize[] the annualized method for estimating quarterly tax payments" and that their Indiana IT-2220s (Penalty for Underpayment of Corporate Tax) verified that the penalties - as assessed - were unwarranted. Taxpayers submitted a protest to that effect, and an administrative hearing was conducted by telephone during which Taxpayers' representative explained the basis for the protest.

I. Indiana Corporate Income Tax - Underpayment Penalties.

DISCUSSION

The issue is whether Taxpayers have provided information sufficient to establish that the Department's decision assessing "underpayment" penalties was incorrect.

A. Indiana Corporate Estimated Payments.

IC § 6-3-4-4.1(b) imposes on each taxpayer the responsibility to make and pay a "declaration of estimated tax for the taxable years" if the amount of that estimated tax is more than $1,000. *Id.*

IC § 6-3-4-4.1(c) provides:

> Every corporation subject to the adjusted gross income tax liability imposed by this article shall be required to report and pay an estimated tax equal to the lesser of:
> (1) twenty-five percent (25[percent]) of such corporation's estimated adjusted gross income tax liability for the taxable year; or
> (2) the annualized income installment calculated in the manner provided by Section 6655(e) of the Internal Revenue Code as applied to the corporation's liability for adjusted gross income tax. (Effective January 1, 2017 to June 30, 2021).

B. Underpayment Penalty.

IC § 6-3-4-4.1(d) imposes a penalty if a taxpayer fails to pay the correct amount of estimated tax.

> The penalty prescribed by IC 6-8.1-10-2.1(b) shall be assessed by the department on corporations failing to make payments as required in subsection (c) or (f). However, no penalty shall be assessed as to any estimated payments of adjusted gross income tax which equal or exceed:
> (1) the *annualized income* installment calculated under subsection
> (c); or
> (2) twenty-five percent (25[percent]) of the final tax liability for the taxpayer's previous taxable year. *Id.* (*Emphasis added*).

For reference, "annualized income" may be defined as:

> Annualized income is an estimate of the sum of money that an individual or a business generates over a year's time. Annualized income is calculated with less than one year's worth of data, so it is only an approximation of total income for the year. Annualized income figures can be helpful for creating budgets and making estimated income tax payments. Annualized Income, https://www.investopedia.com/terms/a/annualized-income.asp. (Last visited September 14, 2021).

IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty."

Department regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." *Id*.

Departmental regulation 45 IAC 15-11-2(c) requires that 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 IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment - including the negligence penalty - is presumptively valid.

C. Taxpayer Number One's Estimated Payments.

Both Taxpayers were required to file estimated returns on December 20, 2019; February 20, 2020; May 30, 2020; and August 20, 2020.

For Taxpayer Number One, its tax liability for the period was $1,016,986. Although Taxpayer Number One is an annualized filer, it may fulfill its quarterly filing requirement one of two ways under IC § 6-3-4-4.1(c).

> Every corporation subject to the adjusted gross income tax liability imposed by this article shall be required to report and pay an estimated tax equal *to the lesser of*:
> (1) twenty-five percent (25[percent]) of such corporation's estimated adjusted gross income tax liability for the taxable year; or
> (2) the annualized income installment calculated in the manner provided by Section 6655(e) of the Internal Revenue Code as applied to the corporation's liability for adjusted gross income tax. IC § 6-3-4-4.1(c)

Emphasis added) (Effective January 1, 2017, to June 30, 2021).

Calculating a "annualized income" can be computed as follows:

> Annualized income can be calculated by multiplying the earned income figure by the ratio of the number of months in a year divided by the number of months for which income data is available. If, for example, a consultant earned $10,000 in January, $12,000 in February, $9,000 in March and $13,000 in April, the earned income figure for those four months totals $44,000. To annualize the consultant's income, multiply $44,000 by 12/4 to equal $132,000. *Id.* Annualized Income, Investopedia.

If Taxpayer One calculates its filing responsibility based on IC § 6-3-4-4.1(c)(1), Taxpayer would have been required to file minimum quarterly payments of $161,372 ($645,491/4).

If Taxpayer One calculates its filing responsibility based on IC § 6-3-4-4.1(c)(2), Taxpayer calculates its quarterly payment under the provisions of I.R.C. § 6655(e) which provides as to the required installments:

> Lower required installment where annualized income installment or adjusted seasonal installment is less than amount determined under subsection (d)
> (1) In general
> In the case of any required installment, if the corporation establishes that the annualized income installment or the adjusted seasonal installment is less than the amount determined under subsection (d)(1) (as modified by paragraphs (2) and (3) of subsection (d))–
> (A) the amount of such required installment shall be the annualized income installment (or, if lesser, the adjusted seasonal installment), and
> (B) any reduction in a required installment resulting from the application of this paragraph shall be recaptured by increasing the amount of the next required installment determined under subsection (d)(1) (as so modified) by the amount of such reduction (and by increasing subsequent required installments to the extent that the reduction has not previously been recaptured under this subparagraph).
> (2) Determination of annualized income installment
> (A) In general
> In the case of any required installment, the annualized income installment is the excess (if any) of–
> (i) an amount equal to the applicable percentage of the tax for the taxable year computed by placing on an annualized basis the taxable income and modified taxable income–
> (I) for the first 3 months of the taxable year, in the case of the 1st required installment,
> (II) for the first 3 months of the taxable year, in the case of the 2nd required installment,
> (III) for the first 6 months of the taxable year in the case of the 3rd required installment, and
> (IV) for the first 9 months of the taxable year, in the case of the 4th required installment, over
> (ii) the aggregate amount of any prior required installments for the taxable year.

Taxpayer Number One supplied a copy of its Indiana Form IT-2220 "Penalty for Underpayment of Corporate Income Tax". The document sets out Taxpayer Number One's calculation of its annualized income, the individual payments it paid each quarter, and the determination that Taxpayer Number One *was* underpaid for the period. The penalty for that payment was calculated at $262 as per the directions on the Form IT-2220 ("Compute 10[percent] penalty on the underpayment shown on line 14 for each column.") Taxpayer underpaid the fourth quarter by $2,620 and Taxpayer's calculation of the penalty amount is correct; the penalty assessed was $262.

A review of the Department's own records ticks-and-ties those records to the quarterly payments - including (carry-forward amounts) - to the numbers Taxpayer reported on its IT-2220. In other words, there is no discrepancy between what Taxpayer reported and what it actually paid each quarter. Taxpayer Number One is correct. The Department miscalculated the underpayment penalty amount; the correct penalty amount is $262.

Although not raised directly in Taxpayer's protest, the Department also assessed an approximately $36,000 "late penalty" over and above the purported underpayment penalty. There is nothing in the Department's records which supports such a penalty, and it should now be abated.

D. Taxpayer Number Two's Estimated Payments.

Taxpayer Number Two was required to make quarterly, estimated tax payments on the following dates. December 20, 2019; February 20, 2020; May 30, 2020; and August 20, 2020.

Taxpayer Number Two determined that its tax liability for the tax year was $654,491. Although Taxpayer Number

Two is an annualized filer, it may also fulfill its quarterly filing requirement one of two ways under IC § 6-3-4-4.1(c).

If Taxpayer Two calculates its filing responsibility based on IC § 6-3-4-4.1(c)(1), Taxpayer would have been required to file minimum quarterly payments of $161,372 ($645,491/4).

If Taxpayer Two calculates its filing responsibility based on IC § 6-3-4-4.1(c)(2), the taxpayer must calculate its quarterly payment under the provisions of I.R.C. § 6655(e) which provides for the required installments.

Taxpayer Number Two also supplied a copy of its Indiana Form IT-2220 "Penalty for Underpayment of Corporate Income Tax." The document sets out Taxpayer Number Two's calculation of its annualized income, the individual payments it paid each quarter, and the determination that Taxpayer Number Two was *not* underpaid for any of the quarterly periods.

A review of the Department's own records ticks-and-ties those records to the quarterly payments - including (carry-forward amounts) - to the numbers Taxpayer reported on its IT-2220. In other words, there is no discrepancy between what Taxpayer Number Two reported and what it actually paid each quarter. Taxpayer Number Two is correct. The Department misapplied the underpayment penalty.

FINDING

Taxpayers' protests are sustained.

September 21, 2021

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An html version of this document.