

Letter of Findings 02-20211033
Corporate Income Tax
For the Years 2017 and 2018

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 disagreed with Roofing Contractor that it had provided detailed and organized documentation sufficient to refute the substantive conclusions contained in the Department's original audit report or to warrant adjusting the amount of the proposed assessment of corporate income tax.

ISSUE

I. Indiana Corporate Income Tax - Business Expenses / Best Information Available.

Authority: IC § 6-3-6-10; IC § 6-3-6-11; 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 Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 15-5-1](#).

Taxpayer argues that the Department erred in assessing additional corporate income tax, that purchases and payments in question were directly related to its business, and that it has provided evidence of additional business expenses overlooked in the original audit.

STATEMENT OF FACTS

Taxpayer is an Indiana roofing company specializing in the construction and installation of flat and metal roofs for commercial buildings. Taxpayer routinely files Indiana Corporate Adjusted Gross Income Tax Returns. The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's IT-20 returns and business records.

In conducting the review, Taxpayer provided federal and state returns, depreciation schedules, income statements, credit card statements, bank card statements, and check registers. Taxpayer was unable or unwilling to provide a chart of accounts, general ledgers, and trial balance reports.

The audit concluded that Taxpayer had overstated the amount of its business expenses and understated the amount of its taxable income. Therefore, the audit disallowed expenses which the audit found were non-business expenses. Disallowing the deductions - along with certain other adjustments - resulted in an assessment of additional income tax which, according to the audit report, was based on the "best information available." Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted by telephone during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Indiana Corporate Income Tax - Business Expenses / Best Information Available.

DISCUSSION

The issue is whether Taxpayer can establish that the items and expenses it listed as deductible or exempt on its income tax returns are attributable to the operation of the Taxpayer's business and that the additional documentation provided gives evidence of additional business expenses overlooked during the original audit. As noted, Taxpayer did not provide the chart of accounts, general ledger, and trial balance reports. Instead, during the original audit, Taxpayer provided the Department with state and federal tax returns, depreciation schedules, income statements, credit cards, and check registers.

Taxpayer explained that it did not maintain and could not provide the requested information. Taxpayer explained that the audit was conducted in haste during the Pandemic and that communication with the auditor was inadequate. Taxpayer explains further as follows:

When the auditors made us aware of how many expenses they were not allowing we realized that we needed to provide additional information so we requested additional time to get the information, but they denied our request and provided us with protest forms.

....

We have created a spreadsheet for each year (2017 & 2018) with additional expenses that we should be able to use as deductions that are from our check registers, bank card statements, bank statements, credit card statements and detail reports.

A. Burden of Proof.

As a threshold issue, it is the Taxpayer's responsibility to establish that the tax assessment is 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 Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. 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. Further, "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, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

B. Indiana Corporate Income Tax.

As mentioned earlier, Taxpayer is a roofing company specializing in the construction and installation of flat and metal roofs for commercial buildings. Pursuant to the audit, the Department adjusted Taxpayer's claimed business expense deductions, as follows:

(1) Cost of Goods Sold.

The Department's audit challenged Taxpayer's calculation of its "cost of goods sold" ("COGS"). The audit agreed that the COGS correctly included the price of roofing materials, construction materials, cell phones, fuel, lodging, small tools, equipment rentals and the like. The audit also reviewed Taxpayer's bank and credit card statements and found "other purchases that the [T]axpayer does not include in COGS." As a result, the audit considered "advertising, postage, office supplies, and other miscellaneous expenses" but did not include them in COGS because "they were deducted elsewhere for federal tax purposes."

However, "The auditor excluded any personal purchases that were made with Taxpayer's credit and bank cards."

(2) Depreciation of Business Property.

The Department's audit found that Taxpayer had reported a net gain from the sale of business property in 2018. The audit found that this "business property" included a Corvette and a Cadillac Escalade. The audit concluded that the purchases of these vehicles were not "not ordinary and necessary business expenses" and disallowed the two vehicles which had been claimed as "depreciable assets."

(3) Disallowed Deductions and Expenses.

The audit disallowed specific deductions for "repairs and maintenance" since these costs "were included in COGS."

The audit disallowed "bad debt deductions," which according to the audit report "are limited to the amount

charged off on the books during the year." Because Taxpayer did not maintain general ledgers, the bad debt deductions "could not be verified and [are] being disallowed."

The audit modified Taxpayer's deduction for rent and telephone expenses because Taxpayer deducted the telephone expenses twice; first as "rents" and then again as "other deductions."

The audit reduced Taxpayer's deductions for taxes and licenses. The audit limited the deduction to "allowable tax deduction amounts as reported on the income statements provided by the [T]axpayer."

The audit allowed expenses for auto and truck expenses, bank charges, commissions, insurance, office expenses, postage, telephone, and utility charges.

The audit disallowed expenses related to the purchase of cell phones. The audit did so because the only credit card phone costs were for cell phone repairs.

The audit disallowed separately claimed "travel and fuel" expenses because "all lodging and fuel expenses are already included in COGS." In addition, the audit disallowed travel expenses which "were related to vacation travel."

The audit disallowed claimed "warranty fees" because a review of Taxpayer's records established that these "fees" were "OSHA fines" and that "OSHA fines are not deductible per IRS guidelines."

The audit disallowed expenses attributable to the depreciation of certain capitalized assets. The property (or assets) excluded in calculating the approved depreciation amount included Corvettes, Cadillacs, and a Lamborghini on the ground that the purchases of these vehicles were not ordinary and necessary business expenses. For similar reasons, the audit disallowed depreciation expenses attributable to a boat and jet skis.

The audit disallowed depreciation expenses attributable to a John Deere tractor because - as explained in the audit report - "any farming activity should be reported on Federal Schedule F (Profit and Loss From Farming) including the depreciation on tractors." The audit determined that Taxpayer is in the business of "providing [customers] with commercial roofing services," and is not in the farming business.

The audit disallowed expenses stemming from "residential rental property and improvements." As explained in the audit report, "[N]o gross rents were reported on the income tax returns. No other supporting documentation was provided to verify income and expenses for rental property." According to the audit report, in order to claim the rental expenses "[p]er IRS guidelines, the property must be used in an income producing activity."

The audit disallowed "excess Section 179 depreciation" claimed on the Cadillac, Lamborghini, boat, jet skis, and John Deere tractor.

The audit adjusted Taxpayer's claimed "Net Bonus Depreciation" to exclude the disallowed capital assets.

(4) Other Adjustments.

The audit noted that Taxpayer had reported "zero" federal taxable income during 2017 and 2018. After review of the returns and Taxpayer's records, the audit made "[a]djustments to federal adjusted gross income for both years of the audit period."

(5) Apportionment.

The audit found that Taxpayer had miscalculated the Indiana portion of its overall income. As explained in the audit report, "A review of the records revealed that the [T]axpayer was not properly apportioning the income." In doing so, the audit relied on [45 IAC 3.1-1-52](#) "to reduce total Indiana receipts to the total sales amounts that were reported to the Department on the [T]axpayer's sales tax returns. The adjustment for 2018 also includes gross receipts from the sales of assets."

C. Indiana's Record Keeping Requirements.

It should be pointed out that, "Every 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 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."

Specifically, IC § 6-3-6-10(a) provides:

A taxpayer subject to taxation under this article shall keep and preserve records and any other books or accounts as required by [IC 6-8.1-5-4](#). All the records shall be kept open for examination at any time by the department or its authorized agents. A taxpayer who violates this subsection or fails to comply with the request of the department pursuant to [IC 6-3-4-6](#) commits a Class A misdemeanor.

IC § 6-3-6-11 in part provides:

It is a Level 6 felony for a person to knowingly fail to permit the examination of any book, paper, account, record, or other data by the department or its authorized agents, as required by this article, to knowingly fail to permit the inspection or appraisal of any property by the department or its authorized agents, or to knowingly refuse to offer testimony or produce any record as required in this article.

The notes associated with the Department's audit point to the "amount of missing invoices, a chart of accounts, and trial balance" and that these items had been repeatedly requested. According to the audit notes, Taxpayer's owner admitted that "not everything gets put into their accounting that at the end of the year they just go through the records and try to get as much as possible."

D. Taxpayer's Documentation Provided Subsequent to the Audit.

As noted above, Taxpayer believes that the additional substantial documentation provided is sufficient to warrant modification of the corporate tax assessment. To that end, Taxpayer provided "Transaction Details" received from "Spark Business," which is a small business credit card company. The pages provide details of restaurant, fuel, travel, car wash, newspaper, and candy purchases. The documents detail purchases from Target, Amazon, and iTunes. The Spark Business records document car rentals, clothing purchases, hotel and motel rentals, drug store purchases, transactions labeled "Hoosier Park Racing," sports and entertainment tickets, airline tickets, and cruise ship expenses. However, the documents also detail expenses which may reasonably be interpreted as "business expenses" such as payments to Bureau of Motor Vehicles but these are outweighed by such costs attributable to "Advance Carpet Care," "Hankerd Sportswear," and "Delta Football Boosters."

Taxpayer has made no attempt to differentiate, index, or to explain the significance of any of the transactions listed on the approximately 500 pages of records provided the Department subsequent to the audit.

E. Application of Law and Conclusion.

The Department prepared the tax assessment based upon authority contained within IC § 6-8.1-5-1(a) which states that "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.'" See also [45 IAC 15-5-1](#). In this instance, a review of the records establishes that the Department's audit acted under a well-founded belief that Taxpayer's original returns were inaccurate and acted properly in preparing an additional assessment based on "the best information available."

As pointed out at the outset, Taxpayer bears the burden of establishing that the audit report erred in its conclusion. IC § 6-8.1-5-1(b) states that, "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In submitting its protest, Taxpayer has the obligation to prepare a careful, methodical, and detailed factual presentation of the evidence sufficient to refute the conclusions contained within the initial report. In order to meet its burden, it is incumbent upon Taxpayer to "walk" the Hearing Officer through each element of the Taxpayer's proffered evidence; Taxpayer does not meet its burden by presenting numerous records or conclusory statements in the hope that those records or statements will speak for themselves. In truth, Taxpayer's records do not speak for themselves and provide no basis on which to reject any substantive portion of the audit's written report. The documents provide no basis on which to make an accurate adjustment to the assessment amount.

The Department is unable to conclude that the records sufficiently refute the conclusions or the results reached in the original report.

FINDING

Taxpayer's protest is respectfully denied.

January 14, 2022

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