

**Letter of Findings: 01-20211059**  
**Indiana Individual Income Tax**  
**For the Tax Years 2018 and 2019**

**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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 Residents, as shareholders of an Indiana S corporation, were responsible for additional Indiana individual income tax attributable to their jointly owned cigarette distribution business; in an earlier corporate tax audit, the Department determined that the S corporation distribution business underreported sales received from its cigarette customers, and Residents failed to meet their burden of establishing that either the cigarette tax or individual income tax assessments were wrong.

### ISSUE

#### I. Indiana Individual Income Tax - S Corporation Income.

**Authority:** IC § 6-3-4-11; IC § 6-7-1-17; 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 15-5-1](#).

Taxpayers protest the Department's assessment of 2018 and 2019 individual income tax.

### STATEMENT OF FACTS

Taxpayers are Indiana residents who filed joint 2018 and 2019 individual income tax returns reporting income received from their cigarette distribution business. The distribution business is organized as an S corporation and income attributable to that business flowed through to Taxpayers.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayers' distribution business' records and tax returns. That audit found that the distribution business had underreported income received from the distribution and sale of cigarettes. Taxpayers previously protested the results of the cigarette tax audit. That protest was addressed by the Department in Letter of Findings 05-20210141 (March 1, 2022) ("LOF").

That LOF agreed with the Department's audit that the S corporation failed to account for or document transactions involving approximately 3.9 million cigarettes. As summarized in the LOF:

The Department disagreed with mid-level Cigarette Distributor that it presented evidence sufficient to warrant abating the Department's assessment of additional cigarette tax; Cigarette Distributor failed to present verifiable, contemporary records which would have justified such an adjustment.

Simultaneously with the cigarette tax protest, Taxpayers challenged the Department's assessments of additional individual income tax. An administrative hearing was conducted during which Taxpayers and their representative explained the basis for their protest. This companion LOF results.

#### I. Indiana Individual Income Tax - S Corporation Income.

### DISCUSSION

The issue is whether Taxpayers - as individuals - have met their burden of establishing that the Department was wrong in assessing additional income tax based on adjustments to their distribution business' income.

As a threshold issue, it is the Taxpayers' responsibility to establish that the income 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 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).

In meeting that statutory burden, the protesting taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[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). As a result, interpretations of Indiana tax law contained within this decision, as well as the two audits at issue, are entitled to deference.

As shareholder/owners of the cigarette distribution business, Taxpayers were required to maintain complete, contemporaneous, and accurate financial records of their distribution company's cigarette transactions. "Every 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). The "records" referenced "include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks." *Id.*

As the operators of a licensed Indiana distributorship, Taxpayers were acting as and have the responsibility of Indiana agents. IC § 6-7-1-17(a) provides in relevant part:

Distributors who hold certificates and retailers shall be agents of the state in the collection of the taxes imposed by this chapter and the amount of the tax levied, assessed, and imposed by this chapter on cigarettes sold, exchanged, bartered, furnished, given away, or otherwise disposed of by distributors or to retailers. Distributors who hold certificates *shall be agents of the department* to affix the required stamps . . . . (*Emphasis added*).

In the absence of accurate or complete records, Indiana law requires that the Department issue a proposed assessment based on the best information the Department has available. As the law requires, "If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment *shall make a proposed assessment* of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(b) (*Emphasis added*). See also [45 IAC 15-5-1](#). In this case, and in the case of the distributorship's cigarette tax audit, the Department did no more and no less than the law requires.

Because they operated the distributorship as an S-corporation, IC § 6-3-4-11 imposes on the Taxpayers the responsibility for paying Indiana individual income tax on their share of the income earned from or attributable to their cigarette distribution business.

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*).

The Department is unable to agree that Taxpayers have made a coherent or quantifiably specific objection to the results of their individual audit or the cigarette tax audit. Rather than offering a specific alternative, Taxpayers have offered complaints, criticisms, and a suggestion that the discrepancies are attributable to the accounting firm they hired to monitor their distributorship's cigarette transactions and file accurate cigarette tax returns. The Department does not disagree with Taxpayers' suggestion that there *may* be rational explanation for the 3.9 million cigarette discrepancy, but Taxpayers have done little to meet their burden of providing that explanation or of establishing that the assessments are "wrong" as required by IC § 6-8.1-5-1(c).

## FINDING

Taxpayers' protest is respectfully denied.

March 1, 2022

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