

**Final Order Denying Refund: 01-20211060**  
**Indiana Individual Income Tax**  
**For The Tax Year 2020**

**NOTICE:** IC § 4-22-7-7 permits the publication of this document in the Indiana Register. The publication of this document provides the general public with information about the Indiana Department of Revenue's official position concerning a specific set of facts and issues. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Order Denying Refund.

**HOLDING**

Married Individuals were not entitled to additional refund for 2020 because Married Individuals (1) were W-2 employees and did not have a "Qualified Joint Venture," (2) together formed and became both individual members of a limited liability corporation, which was required to file a partnership return or a corporation return, (3) were not allowed to claim business expense deductions by filing two separate Schedule C forms on their joint income tax return, and (4) failed to provide verifiable supporting documentation to substantiate the deductions claimed.

**ISSUE**

**I. Indiana Individual Income Tax - Refund.**

**Authority:** I.R.C. § 162; I.R.C. § 262; I.R.C. § 280A; I.R.C. § 6001; IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-8.1-5-4; *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435 (1934); *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79 (1992); *Deputy v. du Pont*, 308 U.S. 488 (1940); *Commissioner v. Tellier*, 383 U.S. 687 (1966); *Welch v. Helvering*, 290 U.S. 111 (1933); Treas. Reg. § 1.6001-1; *Internal Revenue Service, Sole Proprietorships*, available at <https://www.irs.gov/businesses/small-businesses-self-employed/sole-proprietorships>; *Internal Revenue Service, Limited Liability Company (LLC)*, available at <https://www.irs.gov/businesses/small-businesses-self-employed/limited-liability-company-llc>; *Internal Revenue Service, Married Couples in Business*, available at <https://www.irs.gov/businesses/small-businesses-self-employed/married-couples-in-business>; *Internal Revenue Service, Topic No. 509 Business Use of Home*, <https://www.irs.gov/taxtopics/tc509>; *Internal Revenue Service, New Releases, IRS reminds taxpayers of the home office deduction rules during Small Business Week (IR-2020-220, September 23, 2020)*, <https://www.irs.gov/newsroom/irs-reminds-taxpayers-of-the-home-office-deduction-rules-during-small-business-week>; Small Business and Work Opportunity Tax Act of 2007 (Public Law 110-28).

Taxpayers protest the Department's partial refund denial of individual income tax for 2020.

**STATEMENT OF FACTS**

Taxpayers are Indiana residents who elected to file a married-filing-jointly Indiana income tax return, Form IT-40. Taxpayers requested a refund of \$4,666 pursuant to their 2020 joint return. Taxpayers' refund request was based on two separate Schedule C forms ("Schedule Cs") to their joint federal income tax return (Form 1040), which claimed two separate sets of deductions - totaling approximately \$100,000 - with respect to an Indiana limited liability corporation ("Indiana LLC"). Taxpayers have been the only two members of the Indiana LLC since 2018.

Upon review, the Indiana Department of Revenue ("Department") granted a \$236 refund and denied the remainder. Taxpayers timely protested the refund denial. Taxpayers asked that the Department make the determination without an administrative hearing. This final determination ensues and addresses Taxpayers' protest. Additional facts will be provided as necessary.

**I. Indiana Individual Income Tax - Refund.**

**DISCUSSION**

The Department granted a partial refund in the amount of \$236. Taxpayers protested the partial refund denial,

claiming that they were entitled to additional refund attributable to deductions - totaling approximately \$100,000 - as stated on their two separate Schedule Cs. The issue is whether Taxpayers were entitled to the additional refund because they correctly filed their 2020 return and demonstrated that they were entitled to the claimed deductions.

As a threshold issue, Taxpayers are required to provide documentation explaining and supporting their challenge that the Department's determination is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Also, it is well settled that deductions are legislative grace and therefore, strictly construed against the taxpayer. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934). To obtain the benefit of the deductions, both Indiana and federal law require that the taxpayer maintain and produce contemporaneous records sufficient to verify those deductions. When deductions are in dispute, the taxpayer must satisfy the specific requirements for any deduction claimed. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992). Specifically, pursuant to I.R.C. § 6001, the taxpayers are required to maintain records sufficient to substantiate items underlying their claimed deductions. See also Treas. Reg. § 1.6001-1(e) ("The books or records . . . shall be retained so long as the contents thereof may become material in the administration of any internal revenue law."). In addition, IC § 6-8.1-5-4 provides, "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. . . ."

Indiana imposes a tax "on the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person." IC § 6-3-2-1(a). To compute what is considered the residents/taxpayers' Indiana income tax, the Indiana statute refers to the Internal Revenue Code. IC § 6-3-1-3.5(a) provides the starting point to determine the taxpayer's taxable income and to calculate what would be their Indiana income tax after applying certain additions and subtractions to that starting point, with modifications thereafter.

In this instance, during the initial review - "Line-by-line" - the Department determined that Taxpayers had additional federal adjusted gross income than what was reported in their IT-40 return. The additional income was primarily attributable to two separate W-2 Wage and Tax Statements ("W-2s"). In 2020, each Taxpayer was employed. Each Taxpayer had one W-2 from their own respective employer. Therefore, the Department adjusted Taxpayers' federal adjusted gross income to comport with the record.

Taxpayers, to the contrary, asserted that they were entitled to additional refund because they were entitled to deduct various business expenses, including claiming depreciation of their own home and expenses in maintaining their home. Taxpayers claimed that they own an Indiana LLC and have been members of the Indiana LLC since September 2018. As such, Taxpayers argued that they were entitled to deduct expenses - approximately \$100,000 in total - stated on two separate Schedule Cs. Taxpayers stated, in relevant part, the following:

(1) We use Quickbooks Self-Employed to track our expenses, income and other accounting. This software automatically categorizes, sorts and subsequently completes our tax forms through Turbo Tax from the information we automatically include throughout the year as it's our bookkeeping software. I've attached my 2020 business ledger export from Quick Books that shows all the income and expenses we accounted for in 2020 that were used for our business [Indiana] LLC.

(A) We are currently living in the building that we are working on in an effort to reduce further costs and losses. A portion of the property as noted on the tax forms is specifically for the business as it's got [its] own ingress/egress from the main structure. We've spent money and resources on getting this office and showroom space ready to use for our business but it was not completed in 2020.

(B) [One of Taxpayers] had parking costs, fuel costs, licensing fees, insurance, tires and maintenance on this car.

(2) Explanation for both Schedule C deduction forms.

(A) My husband and I own [Indiana] LLC together and we have 2 divisions we run. We keep the accounting between each division separate.

(i) Division One "Graphic Designer"

. . . This is a business where we do photography, graphic design, building renderings, videography, cartography (map making), business and property branding, primarily for real estate services. . . .

(ii) Division Two "Interior Design"

. . . [I]t offers more services including home renovation and restoration consultancy that assists clients with restoring their older historic homes and positioning them for sale as a staging consultant. We

recently started doing our own project in 2019, where we are restoring a property for our business. We also acquired inventory such as decor, supplies, small furniture and other home furnishings with the expectation the items would be sold in a completed, restored home during 2020. . . .

To support their protest, in addition to their 2020 federal income tax return and schedules, two W-2s and one Form 1099-MISC for royalties, Taxpayers offered a three-page summary and three receipts. The three-page summary contained general information of transactions that occurred in 2020, including date, bank or credit card company, account, description, amount, and category. Taxpayer also provide three receipts of their purchases but two of them were illegible. This final determination addressed issues based on Taxpayers' arguments, as follows:

### **A. Two Schedule Cs to Taxpayers' Joint 1040 Form**

In general, a taxpayer is permitted to use Schedule C to report his or her income from a trade or business if the taxpayer (i) is a sole proprietor, (ii) is a single-member LLC, or (iii) has a qualified joint venture. A sole proprietor is a person who owns an *unincorporated* business by himself or herself. *Internal Revenue Service, Sole Proprietorships*, available at <https://www.irs.gov/businesses/small-businesses-self-employed/sole-propriatorships> (last visited March 10, 2022). A single-member LLC is an individual and the sole member of a domestic LLC incorporated under state law and does not elect to have the LLC treated as a corporation. *Internal Revenue Service, Limited Liability Company (LLC)*, available at <https://www.irs.gov/businesses/small-businesses-self-employed/limited-liability-company-llc> (last visited March 10, 2022).

Internal Revenue Service further provides:

A qualified joint venture is a joint venture involving the conduct of a trade or business, if (1) the only members of the joint venture are a married couple who file a joint tax return, (2) both spouses materially participate in the trade or business, (3) both spouses elect to have the provision apply, and the business is co-owned by both spouses and (4) isn't held in the name of a state law entity such as a partnership or limited liability company (LLC).

*Internal Revenue Service, Married Couples in Business*, available at <https://www.irs.gov/businesses/small-businesses-self-employed/married-couples-in-business> (last visited March 10, 2022).

In this instance, based on the verifiable supporting documents, both Taxpayers have been employed with their own respective employers. As such, both Taxpayers do not qualify as self-employed. In addition, both Taxpayers have been the members of the Indiana LLC since 2018. In other words, the Indiana LLC has more than one member and must be treated as a partnership or a corporation by the operation of law. As such, Taxpayers did not qualify to use two Schedule Cs to report their income or claim deductions attributable to business or trade because they did not qualify as the "single- member" of the Indiana LLC and they did not have a "qualified joint venture" under the Small Business and Work Opportunity Tax Act of 2007 (Public Law 110-28).

In short, Taxpayers erred in filing Schedule Cs to report their income or losses from the Indiana LLC.

### **B. Deductions of Business Expenses**

Next, even if, for the sake of argument, and assuming that Taxpayers or the Indiana LLC filed the appropriate 2020 return, this determination addresses issues that arise from various deductions claimed by Taxpayers.

A taxpayer generally is allowed to deduct "the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . ." pursuant to I.R.C. § 162(a), which provides:

There shall be allowed as a deduction **all the ordinary and necessary expenses** paid or incurred during the taxable year **in carrying on any trade or business**, including--

- (1) a reasonable allowance for salaries or other compensation for personal services actually rendered;
- (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and
- (3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(Emphasis added).

Thus, for income tax purposes, under I.R.C. § 162(a), an expense is "ordinary" if it is "normal, usual, or customary" in the taxpayer's trade or business or it arises from a transaction "of common or frequent occurrence in the type of business involved." *Deputy v. du Pont*, 308 U.S. 488, 495 (1940). An expense is "necessary" if it is "appropriate and helpful" to the taxpayer's business. *Commissioner v. Tellier*, 383 U.S. 687, 689 (1966) (quoting *Welch v. Helvering*, 290 U.S. 111, 113 (1933)). "[I]n the case of a taxpayer who is an individual or an S corporation, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence." I.R.C. § 280A(a). Expenses for the business use of the qualified taxpayer's home may be deductible only if they are attributable to a portion of the home used exclusively on a regular basis. I.R.C. § 280A(c), see also *Internal Revenue Service*, Topic No. 509 Business Use of Home, <https://www.irs.gov/taxtopics/tc509> (last visited March 10, 2022). The taxpayer may not deduct personal, living, or family expenses unless the law expressly provides otherwise. I.R.C. § 262(a). "Employees who receive a paycheck or a W-2 exclusively from an employer are not eligible for the deduction, even if they are currently working from home." *Internal Revenue Service*, New Releases, IRS reminds taxpayers of the home office deduction rules during Small Business Week (IR-2020-220, September 23, 2020), <https://www.irs.gov/newsroom/irs-reminds-taxpayers-of-the-home-office-deduction-rules-during-small-business-week> (last visited March 10, 2022).

Taxpayers here reported that they received \$67 under Graphic Design and \$2,818 under Interior Design in 2020. Taxpayers referenced the Indiana LLC's Certificate of Organization to justify their approximately \$100,000 deductions, as follows:

<b>Graphic Design</b>		<b>Interior Design</b>	
Advertising	\$972	Advertising	\$117
Car and truck expenses	\$6,284	Car and truck expenses	\$3,100
Depreciation	\$13,127	Depreciation	\$8,846
Other	\$10,008	Contract labor	\$2,976
Legal and professional services	\$776	Insurance	\$1,200
Office expense	\$4,357	Legal and professional services	\$199
Supplies	\$2,589	Office expense	\$617
Taxes and licenses	\$31	Rental [] Vehicle, machinery []	\$600
Deductible meals	\$2,214	Repair and maintenance	\$500
Utilities	\$5,620	Supplies	\$17,408
Other expenses	\$4,163	Taxes and licenses	\$180
Expense for business use of your home	\$2,532	Travel	\$144
<b>Net loss</b>	<b>\$52,673</b>	Deductible meals	\$1,022
		Utilities	\$4,012
		Other expenses	\$8,536
		<b>Net loss</b>	<b>\$49,457</b>

Upon review, in this case, Taxpayers' supporting documents demonstrated that both Taxpayers were not self-employed or shareholders of an S corporation. Rather, each Taxpayer received a W-2 from his or her respective employer for 2020. As such, there is a rebuttable presumption that Taxpayers were not entitled to the deduction outlined in I.R.C. § 280A.

As mentioned earlier, Taxpayers are required to provide verifiable supporting documentation to substantiate (1) "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" and (2) a portion of their home was used exclusively on a regular basis pursuant to the statutory requirements. Taxpayers' three-page summary and three purchase receipts failed to substantiate the above estimated \$100,000 deductions.

In conclusion, in the absence of verifiable supporting documentation to substantiate that Taxpayers properly claimed the estimated \$100,000 deductions and correctly reported their federal adjusted gross income, the Department is not able to agree that Taxpayers were entitled to additional refund.

### FINDING

Taxpayers' protest is respectfully denied.

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