

Letter of Findings: 07-0155
Sales Tax
For the Years 2004 and 2005

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ISSUES

I. Sales Tax – Imposition Based on Deposits to Taxpayer's Bank Account.

Authority: IC § 6-2.5-2-1; IC § 6-8.1-5-1; IC § 6-8.1-5-4.

Taxpayer protests the inclusion of loans its shareholders made to Taxpayer in the Department's BIA sales tax assessments based on Taxpayer's bank deposits.

Taxpayer protests that Department did not properly calculate sales tax based on bank deposits for the calendar years in question.

II. Tax Administration – Ten Percent Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; IC § 6-8.1-5-1; IC § 6-8.1-5-4; [45 IAC 15-11-2](#)(b),(c).

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer sells and installs wood and gas stoves and related accessories. Taxpayer was incorporated in Indiana in 1984 and files an Indiana S-Corporation income tax return, IT-20S.

The Indiana Department of Revenue (Department) conducted a sales and use tax audit of Taxpayer for the years 2004 and 2005. Taxpayer's shareholders (Shareholders) also own and operate another Subchapter S corporation. The sales of the two companies were co-mingled. Due to discrepancies in Taxpayer's records and missing sales invoices, the Department based its audit on the best information available (BIA) and all sales were allocated to Taxpayer.

Taxpayer protested the assessment. A hearing was held and this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales Tax – Imposition Based on Deposits to Taxpayer's Bank Account.

DISCUSSION

Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a). The person who acquires property in a retail transaction is liable for the tax on the transaction and, unless exempt, shall pay the tax to the retail merchant. The retail merchant shall collect the tax as agent for the state. IC § 6-2.5-2-1(b). 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. IC § 6-8.1-5-1(a). 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 that tax by reviewing those books and records. IC § 6-8.1-5-4 (a). A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times. IC § 6-8.1-5-4 (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. IC § 6-8.1-5-1(b).

At the time of the audit, the Taxpayer's records necessary for determining the gross sales subject to the imposition of sales tax were unavailable or what was available was inadequate. Therefore, the Department determined the sales tax liability as follows (Audit's BIA Methodology):

Using the amount of bank deposits as gross income, the following method was used to determine additional taxable sales. Invoices made available were separated into taxable and non-taxable categories. The total amount determined to be non-taxable was divided by the total invoice amount to determine a percentage of nontaxable sales. This percentage was then used to subtract out nontaxable sales from the amount of bank deposits for each year. Sales tax was also calculated and backed out from the remaining bank deposit balance. The amount of taxable sales previously reported was subtracted from this balance to determine additional taxable sales.

Taxpayer raises three issues relating to the Department's calculations that resulted in the BIA assessment of sales tax.

Taxpayer protested that the BIA assessment deemed all the bank deposits gross income to Taxpayer when some of those deposits, according to Taxpayer, were cash advances from Shareholders' *[sic]* personal credit cards that were transferred to Taxpayer. At the hearing, Taxpayer stated that it and Shareholders had several checking accounts. Shareholders would deposit some of these cash advances in an individual account, then when Taxpayer needed money Shareholders would transfer the money to a business account. Sometimes the cash

advances were deposited directly to the business account. Cash advances were made from numerous credit cards.

During the protest Taxpayer provided some additional documentation. There is sufficient evidence in the form of identifiable Shareholder deposits to Taxpayer to suggest that some of Taxpayer's protest is justified. However, for some of the records it was not clear how these transactions flowed and whether the accounts they flowed from and to were business or individual accounts.

Therefore, in calculating Taxpayer's sales tax assessment, the Department should exclude those monies that were clearly deposited from Shareholder's personal checking accounts to Taxpayer's account. These items are identified in Taxpayer's documentation. For the remainder of the protest, however, Taxpayer has not sustained its burden of proof.

A second related issue Taxpayer protests that Department did not properly calculate sales tax based on calendar deposits to its bank. Taxpayer is a cash basis filer. Taxpayer's bank statements are dated on or about the 20th of the month, so the first statement of 2004 includes deposits that actually were made in December 2003. These 2003 deposits should be excluded from the Department's calculation of sales tax owed. Also, the Department should include in its calculations deposits made in 2005 that appear on the first statement of 2006, unless a deposit is excluded from the calculation because it is a loan from Shareholders to Taxpayer (see above).

Lastly, Taxpayer points out that a \$2,602.87 deposit to its account on July 28, 2004, is comprised of \$902.87 on a taxable sale to a customer and \$1,700 that Shareholders personally loaned to Taxpayer. Taxpayer explains that Shareholders received the \$1,700 as income to them as individuals on a lease of land to a cable company for a cable television tower. Shareholders provided a copy of their 2004 federal individual income tax return (Form 1040) that shows \$1,700 of rental income. Taxpayer has provided sufficient proof of this protest. In its calculations, the Department correctly only taxed the sale to Taxpayer's customer; however, the Department should subtract \$1,700 from the bank deposit totals it used to arrive at its BIA assessment.

FINDING

Taxpayer's protest is sustained in part and denied in part.

II. Tax Administration – Ten Percent Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides, "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive the negligence penalty as provided in [45 IAC 15-11-2\(c\)](#), as follows:

The department shall waive the negligence penalty imposed under IC § 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. 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 this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under [45 IAC 15-11-2\(b\)](#), and was subject to a penalty under IC § 6-8.1-10-2.1(a).

Under IC § 6-8.1-5-1(b), "the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Taxpayer is under a legal obligation to maintain its books and records in such a manner that the Department can determine the amount, if any, of Taxpayer's tax liabilities by reviewing those books and records. IC § 6-8.1-5-4(a). Taxpayer has not affirmatively established that its failure to

maintain its books and records or pay the deficiencies was due to reasonable cause and not due to negligence, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest is respectfully denied.

CONCLUSION

I. Sales Tax – Imposition Based on Deposits to Taxpayer's Bank Account.

In recalculating Taxpayer's sales tax assessment:

- (1) The Department should subtract only those monies that were clearly deposited from Shareholder's personal checking accounts to Taxpayer's account. These items are identified in Taxpayer's documentation.
- (2) The Department should review the 12/18/03 – 01/22/04 bank statement to exclude December 2003 deposits from the Department's calculations. The Department should review the 12/19/05 – 01/19/06 bank statement to include December 2005 deposits in the Department's calculations, unless the deposit is excluded based on (1).
- (3) The Department should subtract \$1,700 from the bank deposit totals it used to arrive at its BIA assessment.

II. Negligence Penalty

The negligence penalty is not waived.

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