

**Letter of Findings Number: 07-0626**  
**Penalty**  
**For Tax Years 2004-06**

**NOTICE:** Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUE**

**I. Tax Administration–Fraud Penalty.**

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-10-4; [45 IAC 15-11-2](#); [45 IAC 15-5-7](#).

Taxpayer protests the imposition of a one hundred percent fraud penalty.

**STATEMENT OF FACTS**

Taxpayer operates a restaurant in Indiana. As the result of an audit, the Indiana Department of Revenue issued proposed assessments for sales tax, plus interest and one hundred percent fraud penalties for the tax years 2004, 2005, and 2006. Taxpayer does not protest the base tax or interest, but does protest the one hundred percent fraud penalty. Taxpayer argues that it is subject only to the ten percent negligence penalty. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

**I. Tax Administration–Fraud Penalty.**

**DISCUSSION**

Taxpayer protests the imposition of the one hundred percent fraud penalty for the tax years 2004, 2005, and 2006. Taxpayer does not protest the imposition of the base sales tax or the imposition of interest. Taxpayer argues that it is properly subject to the ten percent negligence penalty for those years. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment was made, as provided by IC § 6-8.1-5-1(c).

The fraud penalty is imposed under IC § 6-8.1-10-4, which states:

- (a) If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, the person is subject to a penalty.
- (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100 [percent]) multiplied by:
  - (1) the full amount of the tax, if the person failed to file a return; or
  - (2) the amount of the tax that is not paid, if the person failed to pay the full amount of the tax.
- (c) In addition to the civil penalty imposed under this section, a person who knowingly fails to file a return with the department or fails to pay the tax due under [IC 6-6-5](#) or [IC 6-6-5.5](#) commits a Class A misdemeanor.
- (d) The penalty imposed under this section is imposed in place of and not in addition to the penalty imposed under section 2.1 of this chapter.

The fraud penalty is further explained by [45 IAC 15-5-7\(f\)\(3\)](#), which states:

A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements to fraud.

- (A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.
- (B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.
- (C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.
- (D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.
- (E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the department is required to prove all of the above elements are present. This must be shown by clear and convincing evidence.

The negligence penalty is imposed under IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...  
...  
...

(3) 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.

A review of the documentation in the file shows that Taxpayer clearly demonstrated carelessness, thoughtlessness, disregard or inattention to duties placed upon Taxpayer by the Indiana Code or departmental regulations. This is negligence as defined by [45 IAC 15-11-2\(b\)](#). Taxpayer does not dispute this, and in fact argues that it is subject to this penalty for each the tax years at issue.

While negligence and fraud share some similarities as defined by statutes and regulations, there are also distinct differences. Review of the documentation in the file shows that the Department has not demonstrated fraud by proving all five elements of: misrepresentation of a material fact, scienter, deception, reliance, and injury, by clear and convincing evidence, as required by [45 IAC 15-5-7\(f\)\(3\)](#). However, the Department hereby notifies Taxpayer that further failure to comply with taxing requirements in a timely and accurate manner may subject future assessments to the one hundred percent fraud penalty. Through its experience via the audit and protest process, and the listing of the elements of fraud explained in this Letter of Findings, Taxpayer is on notice of its duties regarding taxation. Failure to comply with those duties may be determined to be fraud under Indiana's taxing statutes and regulations.

Having established Taxpayer's future duties, in the instant case Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c). Taxpayer will not be subject to the one hundred percent fraud penalty for the years at issue. Rather, Taxpayer will be subject to the ten percent negligence penalty.

#### **FINDING**

Taxpayer's protest is sustained.

#### **CONCLUSION**

Taxpayer will be subject to the ten percent negligence penalty for 2004, 2005, and 2006. Taxpayer will not be subject to the one hundred percent negligence penalty for those years.

*Posted: 04/30/2008 by Legislative Services Agency*

An [html](#) version of this document.