DEPARTMENT OF STATE REVENUE

04-20080520.LOF

Letter of Findings: 08-0520
Gross Retail Tax
For the Years 2004, 2005, and 2006

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ISSUES

I. Proposed Assessment – Gross Retail Tax.
Authority: IC § 6-8.1-5-1(a); IC § 6-8.1-5-1(b); 45 IAC 15-5-3(b).

Taxpayer argues that the Department of Revenue's calculation of Gross Retail Tax overstates the actual amount of tax liability.

II. Tax Administration – Fraud Penalty.
Authority: IC § 6-8.1-10-4(a); 45 IAC 15-5-7(f)(3); 45 IAC 15-5-7(f)(3)(A); 45 IAC 15-5-7(f)(3)(B); 45 IAC 15-5-7(f)(3)(C), (D), (E).

Taxpayer maintains that the Department of Revenue's imposition of the 100 percent fraud penalty is unwarranted.

III. Tax Administration – Jeopardy Assessment.
Authority: IC § 6-8.1-5-1(b); IC § 6-8.1-5-3(a); IC § 6-8.1-5-3(b); IC § 6-8.1-8-2.

Taxpayer claims that the Department of Revenue erred when it issued "jeopardy assessments" without first allowing taxpayer the opportunity to protest the assessment.

STATEMENT OF FACTS

Taxpayer is the responsible officer of an Indiana jewelry store. Taxpayer's wife owns and operates the jewelry store. The Department of Revenue (Department) instituted an audit of the store. The Department's auditor reviewed certain business records and determined that those records disclosed substantial irregularities in the assessment and collection of gross retail (sales) tax. The records allegedly demonstrated that taxpayer's business failed to collect sales tax on certain transactions and that, during the years under review, taxpayer's business and taxpayer himself incorrectly represented that approximately 80 percent of the jewelry store's retail sales were exempt. The Department requested copies of original invoices but, despite repeated requests, the invoices were not provided. Eventually, the Department subpoenaed the records. When the subpoenaed records were not obtained, the Department sought and obtained a search warrant for the jewelry store and taxpayer's residence.

Taxpayer was determined to be the jewelry store's "responsible officer" because he had prepared and signed the purportedly fraudulent sales tax returns. Taxpayer does not challenge the Department's conclusion that he was acting as the jewelry store's responsible officer.

As a result of reviewing the available records and disallowing the claimed exempt sales, the Department issued notices of proposed assessment on the ground that taxpayer's business had reported only four percent of its taxable sales. Taxpayer protested the assessment, and the matter was assigned to a hearing officer. An administrative hearing was scheduled in order to permit the taxpayer to explain the basis for his protest, but taxpayer unexplainedly chose not to participate. This Letter of Findings is written based upon the information contained with the taxpayer's protest file.

I. Proposed Assessment – Gross Retail Tax.

DISCUSSION

As with any administrative tax protest, it should be noted at the outset that it is the taxpayer who bears the burden of proof. IC § 6-8.1-5-1(b) states in pertinent part that, "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." The Indiana Administrative Code states "[t]he burden of proving that a proposed assessment is incorrect rests with the taxpayer...." 45 IAC 15-5-3(b).

The Department's use of the best information available to calculate the proposed assessment is authorized under IC § 6-8.1-5-1(a), which provides in part 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 to the department."

The Department found that the jewelry store had failed to remit approximately $400,000 in sales tax. This amount was based upon information contained within the store's records including the general ledger and the ST-103 sales tax reports. Except for alleging that the assessment amount "substantially overstate[s] [taxpayer's] liability," and that the assessment is "without basis in fact," taxpayer has done nothing to demonstrate that the approximately $400,000 assessment is incorrect.

FINDING

Taxpayer's protest is denied.

II. Tax Administration – Fraud Penalty.

DISCUSSION

A 100 percent penalty was assessed because of the substantial disparity between the amount of taxes taxpayer received from its customers and the amount of taxes which were forwarded to the Department. IC § 6-8.1-10-4(a) states that, "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 tax."

The pertinent Indiana regulation, 45 IAC 15-5-7(f)(3), 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 from the record each of the above elements set out in 45 IAC 15-5-7(f)(3). Based upon the substantial disparity between the amount of the store's actual taxable sales and the amount of taxable sales reported to the Department along with documented evidence of sales to Indiana customers for which no sales tax was charged, the Department was entitled to conclude that taxpayer committed a "misrepresentation of material fact," pursuant to 45 IAC 15-5-7(f)(3)(A).

Bearing in mind that taxpayer's jewelry store is a multi-million dollar business and that taxpayer himself is not an unsophisticated business person, the Department was entitled to conclude that taxpayer – as the store's responsible officer and signatory on the sales tax returns – had actual knowledge of the repeated misrepresentations or that, in the alternative, taxpayer exhibited a reckless disregard for the truth. As a result, the Department reasonably concluded that taxpayer exhibited the "scienter" element required under 45 IAC 15-5-7(f)(3)(B).

The Department accepted and relied upon the sales tax returns and taxpayer's representations as to its taxable sales for a period of at least three years. In deciding to impose the 100 percent fraud penalty, the Department was justified in concluding that taxpayer acted with intent to deceive, that the Department had mistakenly relied upon taxpayer's representations, and that the Department was "injured" by failing to collect the amount of sales tax to which it – and by implication the state of Indiana – was entitled. Therefore, the three elements of fraud set out in 45 IAC 15-5-7(f)(3)(C), (D), and (E) are met.

FINDING

Taxpayer's protest is denied.

III. Tax Administration – Jeopardy Assessment.

DISCUSSION

Taxpayer maintains that the Department was not justified in resorting to a "jeopardy assessment" remedy pursuant to IC § 6-8.1-5-3(a). That provision states as follows:

If at any time the department finds that a person owing taxes intends to quickly leave the state, remove his property from the state, conceal his property in the state, or do any other act that would jeopardize the collection of those taxes, the department may declare the person's tax period at an end, may immediately make an assessment for the taxes owing, and may demand immediate payment of the amount due, without providing the notice required in IC § 6-8.1-8-2.

The Department saw fit to collect the sales tax due by requiring immediate payment of the amount assessed and to bypass the notice provisions set out IC § 6-8.1-8-2. Given the taxpayer's egregious, repeated, and substantial misrepresentations, the Department reasonably concluded that any procedural delay in collecting the

amount of tax owed would "jeopardize the collection of those taxes." Taxpayer has failed to meet his burden under IC § 6-8.1-5-1(b) of demonstrating that the Department erred in resorting to the jeopardy assessment remedy available under IC § 6-8.1-5-3(a).

FINDING

Taxpayer's protest is denied.

Posted: 11/26/2008 by Legislative Services Agency
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