

Letter of Findings Number: 09-0322P
Sales Tax
For Tax Years 2005-07

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ISSUE

I. Tax Administration–Fraud Penalty.

Authority: IC § 6-2.5-2-1; IC § 6-8.1-10-4; [45 IAC 15-5-7](#); [45 IAC 15-11-2](#); [45 IAC 15-11-4](#).

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

STATEMENT OF FACTS

Taxpayer is an Indiana subchapter S corporation operating as a retail merchant in Indiana. The S corporation shareholders were the workers at the retail location and received distributions from the S corporation instead of wages. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had reported and remitted precisely seventy-five (75) percent of the sales tax which it collected at its retail location for thirty-four (34) of the thirty-six (36) months for the tax years 2005, 2006, and 2007. The Department therefore issued proposed assessments for sales and use taxes, along with one hundred (100) percent fraud penalties and interest. Taxpayer does not protest the proposed assessments for sales and use taxes, but does protest the imposition of the one hundred percent fraud penalties. Taxpayer did not request an administrative hearing. The Letter of Findings was written based on the materials in the file. Further facts will be supplied as required.

I. Tax Administration–Fraud Penalty.

DISCUSSION

Taxpayer protests the imposition of one hundred percent fraud penalties for the tax years 2005, 2006, and 2007. Taxpayer states that the penalties will cause an extreme financial burden. This is the extent of Taxpayer's protest.

The Department first refers to IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

(Emphasis added).

Next, the Department refers to 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](#), [IC 6-6-5.1](#), 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.

(Emphasis added).

Next, the Department refers to [45 IAC 15-11-4](#), which states:

The penalty for failure to file a return or to make full payment with that return with the fraudulent intent of evading the tax is one hundred percent (100[percent]) of the tax owing. Fraudulent intent encompasses the making of a misrepresentation of a material fact (See [45 IAC 15-5-7\(f\)\(3\)](#)) which is known (See [45 IAC 15-5-7\(f\)\(3\)\(B\)](#)) to be false, or believed not to be true, in order to evade taxes. Negligence, whether slight or great, is not equivalent to the intent required. An act is fraudulent if it is an actual, intentional wrongdoing, and the intent required is the specific purpose of evading tax believed to be owing.

Also, [45 IAC 15-5-7](#) provides in relevant part:

(f) The running of the statute of limitations for purposes of assessing unpaid taxes will not start if the taxpayer fails to file a return which is required by any listed tax provision. Also, a substantially blank, unsigned or fraudulent return will not start the running of the statute of limitations.

- (1) A substantially blank return is one which does not furnish all the information necessary to determine a

taxpayer's liability for the tax in question. In order for a return to be complete enough to determine the taxpayer's liability, the information does not have to be correct. Any denotation *[sic]* by the taxpayer which clearly indicates a positive denial of liability for any tax listed on the tax form shall constitute a completed return. Thus, a return which has "zero," or "-0-" or "none" written on a given line is not substantially blank. Also, if a taxpayer makes a positive indication of liability on a line which constitutes a total of one or more taxes, a return is deemed to be completed for all such taxes even if the particular line for the tax(es) is left blank.

(2) An unsigned return is one which does not have the original hand written signature of the individual taxpayer or corporate officer or their authorized designee. The return also must be dated.

(3) 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.

(Emphasis added).

Finally, [45 IAC 15-11-2\(b\)](#) provides:

"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 information in the protest file establishes that Taxpayer reported and remitted exactly seventy-five percent of the actual sales tax it collected as an agent for the State of Indiana in thirty-four of the thirty-six months at issue. For the other two months, Taxpayer reported and remitted sales tax on seventy-four (74) percent and eighty-two (82) percent of actual sales tax. The primary shareholder, who owned fifty-nine point thirty-three (59.33) percent of the S corporation's shares, was also the founder of an accounting firm which provided bookkeeping and tax return services to Taxpayer and other clients. Three other shareholders in Taxpayer's S corporation received W-2 wages from the accounting firm. Taxpayer reported one hundred percent of total actual sales on its federal 1120S form.

The first element of fraud, as provided by [45 IAC 15-5-7\(f\)](#), is misrepresentation. This element is satisfied by the fact that Taxpayer did not truthfully and correctly report all information required by the Indiana Code and the department's regulations. The second element of fraud is *scienter*, which is satisfied by the fact that Taxpayer had actual knowledge of the responsibility of reporting the information under contention. This is confirmed by the fact that Taxpayer's primary shareholder founded an accounting firm which performed bookkeeping and tax return services for Taxpayer and other clients. Also, three of Taxpayer's shareholders were employed at that accounting firm. The third and fourth elements are deception and reliance, and are considered together. Taxpayer did deceive the Department and the State of Indiana as confirmed by the fact that Taxpayer's actions caused the Department to believe that the monthly sales tax returns were accurate and true when they were not accurate and true. Also, the reliance element is satisfied as confirmed by the fact that Taxpayer's actions caused the Department to rely on Taxpayer's misrepresentations to the detriment of the Department and the State of Indiana. The fifth element of fraud is injury, which is satisfied by the fact that Taxpayer's misrepresentations caused the Department to not collect the money which properly belonged to the state of Indiana.

In conclusion, Taxpayer was acting as an agent of the State of Indiana, as provided by IC § 6-2.5-2-1. All five

elements of fraud, as provided by [45 IAC 15-5-7](#)(f), have been satisfied. The consistent and constant underreporting of sales tax, combined with Taxpayer's shareholder/employee's accounting and tax reporting expertise, confirms that Taxpayer's actions rise above mere negligence as defined by [45 IAC 15-11-2](#)(b). The penalty imposed under IC § 6-8.1-10-4 is appropriate and correct.

FINDING

Taxpayer's protest is denied.

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