

Letter of Findings Number: 09-0616
Sales Tax
For Tax Years 2006-08

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ISSUE

I. Sales Tax—Exempt Sales.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-8-8; IC § 6-8.1-4-1; IC § 6-8.1-5-1; [45 IAC 2.2-8-12](#); [45 IAC 15-11-2](#).

Taxpayer protests the imposition of sales tax on certain sales it made.

STATEMENT OF FACTS

Taxpayer operates a retail business in Indiana as a sole proprietorship. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not been collecting sales tax on some sales which were subject to sales tax. The Department therefore issued proposed assessments for sales tax, ten percent negligence penalties, and interest, for the tax years 2006, 2007, and 2008. Taxpayer protests that the taxable percentage determined by the Department was too high and that the resulting proposed assessments are too high. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax—Exempt Sales.

DISCUSSION

Taxpayer protests the Department's proposed assessments for sales tax for the tax years 2006-08. As a preliminary matter, the Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c). Due to the large number of sales, the Department used a sample and projection method to determine the percentage of taxable sales and exempt sales at Taxpayer's retail location. Taxpayer protests that the Department's taxable sales percentage is higher than the percentage Taxpayer calculated.

As explained in the audit report, Taxpayer sometimes sold tangible personal property ("TPP") to individuals, who were members of or participated in exempt organizations, without collecting sales tax. Taxpayer made out the sales invoices using the names of the exempt organizations while the individuals would pay for the purchases themselves, without paying sales tax. As described in correspondence between Taxpayer's representative and the Department after the audit report was issued, a Department employee who was also a member of one of the exempt organizations in question had personally been offered the use of the exempt organization's exemption number. The Department employee witnessed Taxpayer making the same offer to other customers.

In its protest, Taxpayer questioned why the Department employee did not inform Taxpayer that the exemption numbers were being misused. Further, Taxpayer questioned if it was the subject of a "sting" operation by the Department. The Department refers to IC § 6-8.1-4-1, which states:

(a) The commissioner may establish within the department various divisions to assist in the administration and collection of the listed taxes.

(b) Subject to the discretion of the commissioner as set forth in subsection (c), the commissioner shall establish within the department a division of audit, which shall:

(1) upon the commissioner's request, conduct studies of the department's operations and recommend whatever changes seem advisable;

(2) annually audit a statistical sampling of the returns filed for the listed taxes that are not administered by the special tax division;

(3) review such federal tax returns and other data as may be helpful in performing the audit function;

(4) furnish the commissioner, at the commissioner's request, with information showing the treatment that the Indiana tax statutes are given by the taxpayers and by the taxing officials and with other requested information; and

(5) conduct audits requested by the commissioner or the commissioner's designee.

(c) Notwithstanding the requirements set forth in this chapter regarding the establishment and duties of divisions within the department, if the commissioner finds that a transfer of duties or functions will increase the efficiency of the department, the commissioner may transfer any duties or functions from one (1) division to another division within the department.

(Emphasis added).

Therefore, as explained by IC § 6-8.1-4-1(a), not every employee of the Department is an auditor. Neither is every employee of the Department authorized to dispense tax advice or information to the public. Rather, as explained by the same post-audit correspondence which mentioned the employee's experience in Taxpayer's

store, the Department employee in question was merely an ordinary customer making an ordinary purchase. Also, there is no prohibition against that employee reporting the event to the appropriate Department personnel when a Departmental employee witnesses a questionable Indiana tax transaction. While there is no indication in the audit report or in the post-audit correspondence that the Department employee's experience triggered the Department's audit, the fact that an audit might result from such a string of events is entirely reasonable, normal, and within the Department's authority.

Regarding the substance of Taxpayer's protest, the first relevant statute is 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, IC § 6-2.5-5-25 states:

- (a) Transactions involving tangible personal property or service are exempt from the state gross retail tax, if the person acquiring the property or service:
 - (1) is an organization described in section 21(b)(1) of this chapter;
 - (2) primarily uses the property or service to carry on or to raise money to carry on its not-for-profit purpose; and
 - (3) is not an organization operated predominantly for social purposes.
- (b) Transactions occurring after December 31, 1976, and involving tangible personal property or service are exempt from the state gross retail tax, if the person acquiring the property or service:
 - (1) is a fraternity, sorority, or student cooperative housing organization described in section 21(b)(1)(A) of this chapter; and
 - (2) uses the property or service to carry on its ordinary and usual activities and operations as a fraternity, sorority, or student cooperative housing organization.

(Emphasis added).

Next, IC § 6-2.5-8-8 states:

- (a) A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.
- (b) The following are the only persons authorized to issue exemption certificates:
 - (1) retail merchants, wholesalers, and manufacturers, who are registered with the department under this chapter;
 - (2) organizations which are exempt from the state gross retail tax under [IC 6-2.5-5-21](#), [IC 6-2.5-5-25](#), or [IC 6-2.5-5-26](#) and which are registered with the department under this chapter; and
 - (3) other persons who are exempt from the state gross retail tax with respect to any part of their purchases.
- (c) The department may also allow a person to issue a blanket exemption certificate to cover exempt purchases over a stated period of time. The department may impose conditions on the use of the blanket exemption certificate and restrictions on the kind or category of purchases that are exempt. (Emphasis added).

Finally, regulation [45 IAC 2.2-8-12](#) provides:

- (a) Exemption certificates may be issued [sic.] only by purchasers authorized to issue such certificates by the Department of Revenue. Retail merchants, manufacturers, wholesalers and others who must register with the Department of Revenue and who qualify to purchase exempt from tax under this Act [\[IC 6-2.5\]](#) may issue exemption certificates with respect to exempt transactions. All persons or entities not required to register with the Department as retail merchants, manufacturers, or wholesalers, and who are exempt under this Act [\[IC 6-2.5\]](#) with respect to all or a portion of their purchases are authorized to issue exemption certificates with respect to exempt transaction provided an exemption number has been assigned by the Department of Revenue, or provided that the Department of Revenue has specifically provided a form and manner for issuing exemption certificates without the need for assigning an exemption number.
- (b) Retail merchants are required to collect the sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used by the purchaser for an exempt purpose.
- (c) All retail sales of tangible personal property for delivery in the state of Indiana shall be presumed to be subject to sales or use tax until the contrary is established. The burden of proof is on the buyer and also on the seller unless the seller receives an exemption certificate.
- (d) Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order to avoid the

necessity for such proof. The mere filing of a Registered Retail Merchant Certificate number is not sufficient to relieve the seller of the responsibility to collect the sales tax or prove exempt use by the buyer.

(e) No exemption certificates are required for sales in interstate commerce, however, proper records must be maintained to substantiate such sales.

(f) An exemption certificate issued by a purchaser shall not be valid unless it is executed in the prescribed and approved form and unless all information requested on such form is completed.

(g) An exemption certificate or other evidence supporting an exempt sale must be maintained by the seller for at least three (3) years after the due date of the tax return upon which such exempt transaction is reported.

(h) Exemption certificates may be reproduced provided no change is made in the wording or content. (Emphasis added).

Therefore, as provided by IC § 6-2.5-8-8(a), a seller accepting a valid exemption certificate has no duty to collect or remit the state gross retail or use tax on a purchase. However, as explained above, Taxpayer did not accept valid exemption certificates from the individuals in question. Instead, Taxpayer took it upon himself to determine that the individuals ought to be exempt since they were affiliated with an exempt organization. This is obviously an incorrect procedure and all such sales should include sales tax. The "person" purchasing the TPP must be the exempt organization itself.

Taxpayer states that it was misinformed on exemption certificate procedures by a prior tax professional. Further, Taxpayer protests that in its experience many members of exempt organizations will purchase TPP and then donate it to the exempt organization, rather than donate the money which the exempt organization could use to directly purchase the TPP. Taxpayer explains that the individual's purchase and donation of TPP to the exempt organization is easier and faster than the money donation and TPP purchase method.

The Department takes this opportunity to reiterate that the only proper method of utilizing an exemption certificate is for the exempt organization to purchase the TPP itself. Individuals are not exempt organizations and may not purchase TPP free from sales tax by using the exempt organization's exemption certificate. This may add to the effort individuals must undertake in order to make a donation to the exempt organization, but it is also the only valid method to use an exempt organization's exemption certificate.

In the course of the audit, the Department reviewed one month's invoices from each year at issue and determined the number of transactions upon which sales tax should have been but was not collected. The majority of the invoices were made out to exempt organizations but were paid by individuals, not directly by the exempt organization. These were the sales where Taxpayer applied the exempt organization's exemption certificate to individual members of the exempt organizations. In light of Taxpayer's misapplication of exemption certificate procedures, the Department concluded that none of Taxpayer's invoices were relevant in determining the taxable or exempt status of Taxpayer's sales.

In its efforts to reach a reasonable determination of sales tax which should have been collected, the Department decided that any invoice over two hundred dollars (\$200) would be treated as purchased directly by the exempt organization and included in the exempt category, regardless of how the invoice was written. Also, sales for out-of-state delivery were added to the exempt sales category. However, any invoices listing sales to the local school system were determined to be taxable, since the school system informed the Department that it had made no direct payments to Taxpayer. The remaining sales were considered to be taxable sales to individuals.

The Department then calculated the percentages of exempt and taxable sales. The Department concluded that seventy-six (76) percent of Taxpayer's sales were taxable sales. Credit was given for sales tax previously reported and remitted by Taxpayer. The Department subtracted the reported taxable sales from taxable sales determined via audit and the resulting amounts were issued as the proposed assessments.

Taxpayer protests that the Department did not allow enough of the invoices as exempt. Taxpayer provided additional invoices for purchases of \$150-\$200 which it believes should be considered as direct purchases by exempt organizations as well as those over \$200. Taxpayer also protests that the Department seems to have confused some purchases by exempt organizations with purchases by the local school system. Taxpayer believes that, once these factors are taken into account, a more accurate taxable rate is fifty (50) percent.

The Department notes that it did not state that the invoices of \$200 and over listing the name of an exempt organization established valid direct purchases by exempt organizations. Rather, it stated that it was reasonable to treat some purchases as direct purchases by the exempt organizations. The \$200 and over invoices were chosen due to the higher dollar amount of the purchases, which indicate large sales to organizations rather than smaller sales to individuals. Taxpayer's protest that the invoices in the \$150-\$200 range should also be included as exempt is not based on validity of the invoices or application of the exemption certificates. It is only based on Taxpayer's opinion that purchases in that range were also direct purchases by exempt organizations.

The Department cannot agree that Taxpayer's method is superior to the method applied in the audit. In allowing those purchases of \$200 and over as exempt, the Department was attempting to compensate for Taxpayer's improper application of the exemption certificates to many taxable purchases while also allowing that some of Taxpayer's sales were actually to the exempt organizations. Those invoices for purchases \$200 and over are not written differently than the rest of the invoices and it is possible that some of those invoices were for taxable sales to individuals rather than to the exempt organization.

With the knowledge that the exemption certificates were misapplied, the validity of all of Taxpayer's invoices and documents was brought into question. In the presence of incorrect exemption procedures and in the absence of reliable documentation, the Department was left with no alternative other than to use the best information available, as provided by IC § 6-8.1-5-1(b). The Department chose \$200 as a reasonable point to allow as exempt sales. Taxpayer's \$150 point is not demonstrably more reasonable, it is simply lower.

Similarly, Taxpayer's protest that the Department confused the name of the organizations on the invoices is not persuasive. The audit report states that any purchases attributed to any school or extra-curricular account associated with the local school system was not counted as exempt, regardless of the amount. This was due to confirmation by the school system that it made no direct payments to Taxpayer. As part of the protest process, Taxpayer provided invoices and a list of non-school-related organizations which it believes the Department may have confused as school-related. A review of the invoices, the list of organizations, and the audit report, does not establish that the Department confused these organizations with school-related organizations.

In conclusion, the Department is authorized to conduct audits and investigations into a taxpayer's compliance methods. The fact that such an audit might arise from a Department employee's personal experience is expected, normal, and authorized. Taxpayer's protest that the Department employee did not inform Taxpayer of the misapplication of the exemption certificates is unconvincing. The Department employee was not present in an official capacity. However, as a retail merchant, Taxpayer was required to know and follow Indiana's tax statutes and regulations, as provided by [45 IAC 15-11-2](#). Those statutes and regulations make it clear that exempt organizations, not individual members of exempt organizations, are entitled to the use of exemption certificates. Taxpayer's misapplication of the exemption certificates and listing of exempt organizations on invoices for sales to individuals limited the Department's options in the audit. Instead of simply disallowing all sales listed to exempt organizations, the Department chose the category of all sales \$200 and over as exempt and all sales under \$200 as taxable. The names of the purchasers on the invoices are irrelevant, due entirely to Taxpayer's actions. Taxpayer has not met its burden of establishing that the proposed assessments are wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied.

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