

Letter of Findings: 10-0149
Sales and Use Tax
For Years 2007 and 2008

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ISSUES

I. Sales and Use Tax–Audit Methodology.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-2.5-9-3; IC § 6-8.1-4-2; IC § 6-8.1-5-1; [45 IAC 2.2-8-12](#); [45 IAC 2.2-4-1](#).

Taxpayer challenges the method used to determine projected sales tax liability for 2007 and 2008.

II. Tax Administration–Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer challenges the imposition of the 10 percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana corporation doing business in Indiana and registered as an Indiana retail merchant. The Indiana Department of Revenue ("Department") conducted an audit of Taxpayer's sales and use tax for the tax years 2007 and 2008. The Department reviewed Taxpayer's sales during a test period and found that taxpayer had not charged sales tax on delivery or media lists on taxable transactions. The Department assessed sales tax by projecting the error rate calculated for the test period. Taxpayer protests that the method was inappropriate due to Taxpayer's small number of taxable clients. Taxpayer also protests the inclusion of an item in the test period where Taxpayer inadvertently charged sales tax to an exempt client, and an item it claims is extraordinary and unrepresentative. Additional facts will be supplied as required.

I. Sales and Use Tax–Audit Methodology.

DISCUSSION

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. IC § 6-2.5-1-2 defines a retail transaction as "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4-1... or that is described in any other section of IC § 6-2.5-4." IC § 6-2.5-4-1(a) provides that "[a] person is a retail merchant making a retail transaction when he engages in selling at retail." IC § 6-2.5-4-1(b) further explains that a person sells at retail when he "(1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration."

IC § 6-2.5-9-3(2) sets out the responsibilities of a retail merchant:

An individual who: (1) is an individual retail merchant or is an employee, officer, or member of a corporate or partnership retail merchant; and (2) has a duty to remit state gross retail or use taxes (as described in [IC 6-2.5-3-2](#)) to the department; holds those taxes in trust for the state and is personally liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state.

The Department found that Taxpayer had made sales to Indiana customers without collecting sales tax, and assessed sales tax on the sales transactions. Taxpayer maintains that sales tax should not be assessed on certain of the sales transactions. Taxpayer asserts that the amount of the assessment is disproportionate because the Department used a sample period in which Taxpayer had a disproportionate number of taxable clients. According to Taxpayer, this method is inappropriate because most of Taxpayer's clients are exempt.

[45 IAC 2.2-8-12\(b\)](#) states, "Retail merchants are required to collect sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used for an exempt purpose." The regulation cautions that, "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 Department notes that a notice of proposed assessment is prima facie evidence that the Department's claim for the unpaid tax is valid, as provided by IC § 6-8.1-5-1(c). The burden of proving the proposed assessment is incorrect rests with Taxpayer. It is not sufficient for the Taxpayer to merely assert that its clients are mostly exempt. It must prove it with exemption certificates and documentation. Having protested the audit results, it is Taxpayer's burden of demonstrating that the sampling method is wrong, and not simply that Taxpayer's method would result in a lower tax burden. Taxpayer has demonstrated that there is an alternative methodology but failed to demonstrate clear error on the part of the audit. Taxpayer's protest on this issue is denied.

In addition, there are two items Taxpayer argues should be excluded from the projection calculation.

Taxpayer inadvertently charged sales tax to a customer on a transaction that was included in the sample, but was able to provide an exemption certificate verifying the client was exempt. Since Taxpayer has shown this transaction should have been exempt, Taxpayer is sustained on this transaction.

The other item in question is a delivery charge Taxpayer argues should be removed because Taxpayer has only had one transaction with that particular client. The Department has the authority to use methods considered necessary to determine a taxpayer's proper tax liability as provided by IC § 6-8.1-4-2. As noted above, it is Taxpayer who must show that the assessment is wrong and there is nothing in the statutes or regulations circumscribing an auditor's choice of time frames for projecting results. It does not matter that Taxpayer has only ever had one transaction with this client. The only relevant fact is that there was a transaction with the client during the projection period. Taxpayer's protest on this issue is denied.

FINDING

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

II. Tax Administration—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, "[I]f a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

[45 IAC 15-11-2](#)(b) clarifies the standard for the imposition of the negligence penalty as follows:

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 standard for waiving the negligence penalty is given at [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.

After a review of the circumstances in this case, Taxpayer has established that it exercised ordinary business care in attempting to carry out its duties regarding the collection and remittance of sales tax. The penalties will be waived, as provided by [45 IAC 15-11-2](#)(c).

FINDING

Taxpayer's protest is sustained.

CONCLUSION

Taxpayer is denied on Issue I regarding the Department's methodology in the sample and projection of sales tax. Taxpayer is sustained on Issue I regarding the imposition of sales tax on the sale to the exempt client. Taxpayer is denied on Issue I regarding the inclusion of the single sale to a particular client in the projection calculations. Taxpayer is sustained regarding the imposition of penalty.

Posted: 09/29/2010 by Legislative Services Agency

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