

Letter of Findings: 04-20110298
Sales and Use Tax
For the Periods August and December of 2004 through 2009

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ISSUES

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-1; IC § 6-2.5-9-3; IC § 6-8.1-5-1; [45 IAC 2.2-8-12](#); Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (U.S. 1977); Quill Corp. v. N.D., 504 U.S. 298, (U.S. 1992); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); U.S. Const. art. I, § 8, cl. 3.

Entity protests the assessment of sales tax on tangible personal property purchased by Indiana residents.

II. Tax Administration – Negligence Penalty.

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

Entity protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

This protest involves consideration of the activities of two related companies: (1) a limited liability company that was assessed Indiana sales tax ("Entity"), and (2) a related corporation that engaged in retail transactions in Indiana but was not assessed Indiana sales tax ("Retail Merchant"). In the protest letter and at hearing, Entity, as the company subjected to Indiana sales tax, represented its facts and those of Retail Merchant.

After an audit investigation, the Indiana Department of Revenue ("Department") determined that Entity had failed to remit sales tax on sales of tangible personal property to Indiana residents for certain periods of the years 2004 through 2009. Accordingly, the Department determined that Entity owed the State of Indiana the uncollected sales tax for the periods August and December of 2004 through 2009 and assessed the tax, interest and penalty for those periods. Entity protested the imposition of the tax and penalty arguing that it did not make any sales in Indiana, but rather Retail Merchant did. A hearing was held and this Letter of Findings ensues. Additional information will be provided as necessary.

Retail Merchant was founded in the 1990s and is a leader in the Sci-Fi "Gaming Industry" ("Games"). Retail Merchant states that most of its sales are to distributors and retailers. These Games were also available for purchase in Indiana at a convention during the years at issue. Entity is the company's storefront in its domiciliary state and does not do business in Indiana. Neither Entity nor Retail Merchant filed any Indiana sales tax returns for any years up through the periods at issue. Retail Merchant has since registered for an Indiana retail merchant certificate.

I. Sales and Use Tax – Imposition.

DISCUSSION

Entity protests the imposition of sales tax on Games sold to Indiana residents. In support of its position, Entity argues that it does not have any nexus with Indiana and did not make any sales in Indiana.

As a threshold issue, although a statute that imposes a tax is strictly construed against the State, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

In accordance with IC § 6-2.5-2-1(a), a sales tax, known as state gross retail tax, is imposed on Indiana retail transactions unless a valid exemption is applicable. Pursuant to IC § 6-2.5-2-1, when a retail transaction is made in Indiana, the retail merchant is required to collect a state gross retail (sales) tax as an agent for the state. IC § 6-3-2-2(e)(1). Also, [45 IAC 2.2-8-12\(b\)](#) states that "[r]etail 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." When the retail merchant has a duty to collect state gross retail (sales) or use taxes and fails to do so, then the retail merchant is "liable for the payment of those taxes, plus any penalties and interest attributable to those taxes, to the state." IC § 6-2.5-9-3.

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."

Entity argues that Indiana lacks a jurisdictional nexus to impose a sales tax liability on it. Entity is correct. Entity did not do any business in Indiana. However, its related company Retail Merchant did sell Games in

Indiana.

The Commerce Clause, U.S. Const. art. I, § 8, cl. 3, prohibits a state from exercising taxing authority over entities that do not have a "substantial nexus" with the state. Put another way, the Commerce Clause requires that there exist a "substantial nexus" between a state and the object of the tax before the state can exercise taxing authority over the object of the tax. Whether the Department can establish the required "substantial nexus" to impose tax liability on Retail Merchant is evaluated under a four-part test first enunciated by the Supreme Court of the United States in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and further explained in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). Under the test, which is viewed under a Commerce Clause analysis, a tax imposed against a non-resident taxpayer is constitutionally sound as long as it [1] is imposed on a taxpayer "with a substantial nexus with the taxing state, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." *Id.* at 311. Retail Merchant argues that the assessed tax violates the Commerce Clause because taxpayer does not have a "substantial nexus" with Indiana.

Under *Quill*, "a vendor whose only contacts with the taxing State are by mail or common carrier lacks the 'substantial nexus' required by the Commerce Clause." *Id.* However, the facts detailed in this Letter of Findings involve more than the mere solicitation of business or delivery by a third-party carrier. Retail Merchant regularly sold tangible personal property in Indiana for the periods at issue. Taken in its totality, Retail Merchant's actions represent a substantial nexus with Indiana.

Entity also argues that any tax liability resulting from Retail Merchant's sales of Games should be borne by the Indiana residents who purchased the items. Pursuant to IC § 6-2.5-3-2, when an Indiana resident fails to pay sales tax on the purchase of an otherwise taxable item, the Department may assess and impose on the resident a use tax. However, more importantly, under IC § 6-2.5-2-1, a retail merchant doing business in Indiana is required to collect and remit sales tax. The Department is authorized under IC § 6-2.5-9-3 to assess tax liability against the retail merchant.

However, in this instance, the Department incorrectly assessed the sales tax against Entity. Entity was not formed until January of 2010 and does not conduct any sales in Indiana. The Department should have assessed Retail Merchant for the sales tax Retail Merchant should have collected on its sales of Games in Indiana.

FINDING

Entity's protest is sustained.

II. Tax Administration – Negligence Penalty.

DISCUSSION

Entity protests the imposition of the negligence penalty assessed on the sales tax the Department found Retail Merchant owed pursuant to an audit by the Department.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, [45 IAC 15-11-2](#) further provides:

(b) "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.

(c) 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. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Since Entity was incorrectly assessed the sales tax, the question of penalty is moot.

FINDING

Entity's protest of the negligence penalty is sustained.

CONCLUSION

Entity is sustained on both its protest of the imposition of sales tax and penalty.

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