

Letter of Findings: 04-20130258
Sales and Use Tax
For the Years 2009, 2010, and 2011

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ISSUES

I. Sales and Use Tax – Imposition.

Authority: IC § 6-2.5-1 et seq.; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-2.5-5 et seq.; IC § 6-2.5-5-33; IC § 6-8.1-3-12; IC § 6-8.1-5-1; IC § 6-8.1-5-4; [45 IAC 2.2-7-3](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Sales Tax Information Bulletin 61 (December 2002).

Taxpayer protests the assessment of sales tax, claiming that the assessment is overstated.

II. Tax Administration – Interest.

Authority: IC § 6-8.1-10-1.

Taxpayer protests the imposition of statutory interest.

III. Tax Administration – Negligence Penalty.

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

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, an Indiana company, operates a gas station/convenience store in Indiana. Taxpayer sells gasoline at its gas station; it also sells tangible personal property, which includes grocery items, candy, soft drinks, prepaid telephone calling cards (i.e., prepaid phone cards), cigarettes, money orders, and lottery tickets, inside its convenience store ("In-store Sales").

In 2012, the Indiana Department of Revenue ("Department") audited Taxpayer's business records for the 2009, 2010, and 2011 tax years ("Tax Years at Issue"). Pursuant to the audit, the Department found that Taxpayer did not maintain sales records and source documents, such as cash register tapes and closing tapes (Z tapes), as statutorily required. Based on the best information available at the time of the audit, the Department imposed additional sales tax, penalty, and interest. The Department's audit used Taxpayer's purchase records pertaining to the tax periods from January through and including June, 2011, as to the best information available to determine the proper amount of sales tax for the Tax Years at Issue. The Department determined that Taxpayer had underreported its sales and made adjustments for additional taxable sales.

Taxpayer protests the assessment related to its additional taxable In-store Sales. A hearing was held. This Letter of Findings addresses Taxpayer's protest of the sales tax assessment. Taxpayer also protests assessments other than the sales tax assessment, including corporate income tax and withholding tax. Letter of Findings 02-20130400 addresses Taxpayer's protest of the additional composite return withholding tax on its additional sales, determined by the Department's audit. Letter of Findings 03-20130399 addresses Taxpayer's protest of county income tax withholding on wages paid to its employees. Letter of Findings 01-20130403P addresses the issue of penalty assessed against Taxpayer for failure to withhold the additional income tax on behalf of its nonresident shareholders. Additional facts will be provided as necessary.

I. Sales and Use Tax – Imposition.

DISCUSSION

The Department's audit imposed additional sales tax on the ground that Taxpayer failed to remit the proper amount of sales tax it collected on its In-store Sales. Taxpayer, to the contrary, argued that the Department's assessment is overstated for various reasons.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; 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); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. "Tangible personal property," as defined in IC § 6-2.5-1-27, "means personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses," including "electricity, water, gas, steam, and prewritten computer software."

IC § 6-2.5-2-1 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.

IC § 6-2.5-4-1, in pertinent part, states:

(a) A person is a retail merchant making a retail transaction when he engages in selling at retail.

(b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:

(1) acquires tangible personal property for the purpose of resale; and

(2) transfers that property to another person for consideration.

(c) For purposes of determining what constitutes selling at retail, it does not matter whether:

(1) the property is transferred in the same form as when it was acquired;

(2) the property is transferred alone or in conjunction with other property or services; or

(3) the property is transferred conditionally or otherwise.

Taxpayer, as a retail merchant selling tangible personal property in Indiana, is responsible for collecting and remitting the sales tax on its In-store Sales unless the customers have provided fully completed exemption certificates to Taxpayer or Taxpayer can provide information to substantiate that the transactions are exempt transactions.

IC § 6-2.5-5 et seq. outlines specific retail transactions which are exempt from sales/use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 101 (citing Conklin v. Town of Cambridge City (1877), 58 Ind. 130, 133.).

IC § 6-8.1-5-4(a) provides:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

IC § 6-8.1-5-1(b), in relevant part, further states "[i]f 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 amount of the assessment is considered a tax payment not made by the due date and is subject to [IC 6-8.1-10](#) concerning the imposition of penalties and interest." (**Emphasis added**).

In this instance, the Department's audit used Taxpayer's purchase records from January through and including June 2011 as the best information available to determine the proper amount of sales tax regarding Taxpayer's In-store Sales because Taxpayer did not maintain adequate business records and source documents, as required by the statute.

At the hearing, Taxpayer argued that the Department's audit assessment is overstated because the audit did not consider the exempt "food stamp sales" and its year-end inventory information. Taxpayer also asserted that the audit assessment is overstated because the audit used an estimated 25.5 percent mark-up to compute the sales tax on its In-Store Sales. This Letter of Findings addresses Taxpayer's arguments as follows:

A. Food Stamp Sales.

Taxpayer first asserted that the audit's assessment is overstated because the audit erroneously assessed additional sales tax on its "food stamp sales," which are sales exempt from the Indiana sales tax. To support its protest, Taxpayer submitted a copy of "Food Stamp Program Permit" issued by the U.S. Department of Agriculture – Food and Nutrition Service, a copy of executed Agreement between Taxpayer and a financial institution contractor, which administers the Food Stamp reimbursement program, and a copy of 1099-K form for the 2011 year.

IC § 6-2.5-5-33 states that "[s]ales of tangible personal property purchased with food stamps are exempt from the state gross retail tax." The Department's Sales Tax Information Bulletin 61 (December 2002), 26 Ind. Reg. 935, further explains, as follows:

The purchase of food items with food stamps will be exempt from sales tax.

(1) Normally, taxable items will be exempt from sales tax when food stamps are used for the purchase, even if cash is submitted with food stamps, provided the amount of cash does not represent a disproportionate amount of the purchase price.

Example: When \$20.00 in food stamps and \$2.00 in cash is tendered for the purchase of a group of items that are food stamp eligible, the entire transaction is exempt from tax.

(2) Non-food stamp eligible items (i.e., tobacco products, alcoholic beverages, paper products, etc.) will be unaffected. Applicable sales tax will be collected on all non-food stamp eligible items.

(3) Tax will not be due on the coupon value of any food stamp eligible item paid for with food stamps, or in combination with cash. The full amount of the item would be exempt from tax under (1) above, if purchased without the coupon.

Example: When food stamp eligible items are purchased with \$2.00 cash, \$20.00 in food stamps and various coupons, the tax will not be due on the coupon value of any food stamp eligible items, resulting in an entire tax exempt transaction.

Stores which accept food stamps are to exempt the entire food stamp purchase including any transaction that provides cash in combination with the food stamps and coupons submitted for food stamp eligible items.

Upon review, Taxpayer's documentation demonstrates that it is a participating retail merchant of the U.S. "Food Stamp Program." Taxpayer's documentation also shows that it received monthly reimbursements during the tax periods January through June 2011 from the financial institution contractor. However, Taxpayer's documentation did not demonstrate which retail transactions (or which Items at issue) were considered as exempt "food stamp" transactions. Therefore, Taxpayer's file will be returned to the Department's Audit Division for a review of the information. The Department's Audit Division will review the information and determine an amount of allowable exempt sales, if any, in a supplemental audit review to be conducted consistent with the audit's methodology used in the audit.

In short, Taxpayer's protest of the "food stamp sales" is sustained to the extent that the Audit Division determines that the above mentioned Taxpayer's information submitted is sufficient to support an allowable amount of exempt sales.

B. Inventory.

Taxpayer claimed that the Department's audit assessment is overstated because the audit did not consider its year-end inventory information when the audit used Taxpayer's purchase records to calculate the additional sales tax on the In-store Sales. To support its protest, Taxpayer provided a copy of its 2011 federal form 1125-A "Cost of Goods Sold." Taxpayer, referencing that 2011 "Cost of Goods Sold" information, maintained that not all its purchases in 2011 were sold in 2011.

Upon review, however, Taxpayer's reliance on that 2011 "Cost of Goods Sold" information is misplaced. Taxpayer stated that it had an increase in inventory for the 2011 year. However, Taxpayer's documentation does not contain monthly inventory information; rather, its documentation represents a summary for the 2011 year as information collected December 31, 2011. As mentioned earlier, without adequate source documentation, the Department had to rely on Taxpayer's purchase records pertaining to the tax periods from January through and including June 2011. Taxpayer did not maintain its inventory information for the tax periods from January through and including June 2011. Thus, given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden.

C. Gross Profit Percentage ("Mark-ups").

The Department's audit assessed Taxpayer additional sales tax based on the industry averages of a gross profit percentage of 25.5 percent. This information was the best information available during the audit because Taxpayer only provided copies of its purchase invoices to the Department at the time of the audit. The Department's Audit Summary, page 8, in relevant part states:

In order to convert the purchase amount to estimated sales figures, audit has used a gross profit percentage of twenty five and five tenths percent (25.5 [percent]). The gross profit percentage is defined as gross profit (sales less cost of goods sold) divided by sales. Therefore, in algebraically solving for sales, divide the cost of goods sold (purchases) by seventy four and five tenths percent (74.5 [percent]). The estimated sales figures extrapolated from vendors paid by checks are then footed to the unreported sales calculation . . .

Taxpayer claimed that the audit's assessment is overstated because its own mark-ups were less than 25.5 percent. To support its assertion, Taxpayer submitted additional documentation, including a list of its mark-ups by categories concerning the items at issue, a supplier's written statement, and several photos showing retail prices of the items at issue.

Upon review, however, the Department is not able to agree. First, Taxpayer submitted certain documentation pertaining to its purchases and sales of certain items at issue during the 2013 year, but the Department's audit is for 2009, 2010, and 2011 tax years and the audit utilized Taxpayer's January through June, 2011 purchase records. Thus, Taxpayer's supporting documentation is not relevant and is beyond the scope of its protest.

Even if, assuming Taxpayer's documentation is relevant, its documentation does not support its assertion. For example, Taxpayer asserted that it can only have an eight (8) percent mark-up on certain cigarette sales pursuant to the industry requirements imposed by the suppliers or manufacturers. However, Taxpayer's documentation presented demonstrates that the suppliers recommend more than eight (8) percent mark-ups. Additionally, Taxpayer maintained that it only had a five (5) percent mark-up on its sales of prepaid phone cards. However, upon review, its documentation shows that it sells prepaid phone cards, which had various mark-ups ranging from 5 percent to 11.7 percent, depending on the types of prepaid phone cards.

In this instance, Taxpayer did not maintain adequate records for the tax years at issue for the Department to determine the proper amount of sales tax by reviewing Taxpayer's source documentation of the sales. Pursuant to IC § 6-8.1-5-1(b), if the Department reasonably believes that Taxpayer has not reported the proper amount of tax due, the Department is required to make a proposed assessment on the basis of the best information available to the Department. Thus, given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden of proof to demonstrate that the proposed

assessment is wrong.

D. Certain Check Payments to Suppliers.

The Department's audit found that Taxpayer made certain check payments to its suppliers H and L, but the payments did not match the suppliers' billing invoices. Taxpayer asserted that the check payments did not match the invoices (listed in page 19 of the audit Summary) because the "multiple invoices were paid with one check, or the check and invoice did not match up for the reason of a discount." However, Taxpayer did not provide sufficient factual analysis to support its assertion. Thus, the Department is not able to agree that Taxpayer met its burden of proof.

FINDING

Taxpayer's protest of the "food stamp sales" is sustained to the extent that the Audit Division determines that the above mentioned Taxpayer's information submitted is sufficient to support an allowable amount of exempt "food stamp sales." The remainder of Taxpayer's protest is respectfully denied.

II. Tax Administration – Interest.

DISCUSSION

The Department assessed interest on the tax liabilities. Taxpayer protests the imposition of interest.

IC § 6-8.1-10-1(a) provides, as follows:

If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on the person's return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

Pursuant to IC § 6-8.1-10-1(e), the Department does not have the authority to waive the interest.

FINDING

Taxpayer's protest regarding the imposition of interest is respectfully denied.

III. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

[45 IAC 15-11-2](#)(b) further states:

"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 Department may waive a negligence penalty as provided in [45 IAC 15-11-2](#)(c), in part, 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. 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.

Taxpayer did not provide sufficient documentation establishing that its failure to pay tax or timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of the negligence penalty is respectfully denied.

SUMMARY

For the reasons discussed above, under Issue I, Taxpayer's protest of the "food stamp sales" is sustained to the extent that the Audit Division determines that Taxpayer's information submitted is sufficient to support the allowable amount of exempt sales. However, the remainder of Taxpayer's protest is respectfully denied.

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