DEPARTMENT OF STATE REVENUE

04-20140206.LOF

Letter of Findings: 04-20140206
Gross Retail Tax
For the Years 2010, 2011, and 2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and circumstances. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

ISSUES

I. Gross Retail Tax - Out-of-State Vehicle Sales.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-5-15 (Repealed July 1, 2004); IC § 6-2.5-9-3; IC § 6-8.1-5-1(c); IC § 6-8.1-3-12(b); IC § 34-37-1-7; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Jordan v. Deery, 609 N.E.2d 1104 (Ind. 1993); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 2.2-6-8; Commissioner's Directive 25 (July 2004); Sales Tax Information Bulletin 28S (April 2012); Sales Tax Information Bulletin 28S (October 2011); Sales Tax Information Bulletin 28S (December 2009); Sales Tax Information Bulletin 28 (July 2004).

Taxpayer argues that the Department erred in assessing additional tax on the sale of vehicles it sold to out-of-state customers.

II. Tax Administration - Ten-Percent Negligence Penalty.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-10-2.1(a)(3); IC § 6-8.1-10-2.1(a)(2); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer maintains that the Department should exercise its discretionary authority to abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana company which sells new and used cars at multiple Indiana dealership locations. Taxpayer also operates a parts supply service, repair shop, and body shop.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and tax returns. The audit resulted in an assessment of additional sales/use tax.

Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for its protest. This Letter of Findings results.

I. Gross Retail Tax - Out-of-State Vehicle Sales.

DISCUSSION

The issue is whether the Department was correct in relying on a statistical sample to assess additional sales tax on Taxpayer's sales of vehicles to its out-of-state customers.

The Department's audit reviewed Taxpayer's sales journals, "dealer jackets," and invoices. The audit found that Taxpayer sold vehicles to out-of-state customers and did not collect sales tax on those sales. The audit report explained that sales of vehicles in "interstate commerce" were not subject to Indiana's sales tax.

> To qualify as being "sold in interstate commerce," the vehicle must be physically delivered, by the selling dealer, to a delivery point outside Indiana. The delivery must be made by the dealer, or the dealer may hire a third-party carrier. Terms and the method of delivery must be indicated on the sales invoice. The dealer must

> document terms of delivery and must keep a copy of such terms of delivery to substantiate the interstate sale. The [T]axpayer did have on file bills of ladings signed by the out of state customer stating that delivery had taken place at an out of state location. The exemption does not apply to sales to out-of-state buyers in which the buyer takes physical possession of a vehicle in Indiana. Possession taken within the state does not qualify as an interstate sale.

In order to verify the validity of signed customer affidavits, the audit sent letters to 207 out-of-state customers. Of those, 173 customers responded with 30 of those customers indicating - under penalty of perjury - that "they picked up the vehicle at the dealership in Indiana."

The audit assessed sales tax on the 30 transactions where delivery took place in Indiana. In addition, the audit applied an "error rate" to transactions for which no response was received. The error rate was based upon a comparison between the total number of responses received (173) and the number of responses (30) which indicated that the vehicle was not delivered to an out-of-state location.

This "error rate" of approximately 17.6 percent "was used to determine the taxable vehicles where there was no response." The same rate "was also applied to 2010 [and] 2011 vehicle sales to out of state customers where no sales tax was collected to arrive at 'Taxable Vehicle Sales' in these years."

During the course of the audit, Taxpayer signed an "Agreement for Projecting Audit Results" which allowed for employment of an "error rate" "with the numerator being the taxable amount of sales . . . where the customer responded that delivery of the vehicle took place at the car dealership in Indiana; and the denominator being the total taxable amount of sales on all customer responses to the letters." Under IC § 6-8.1-3-12(b), "If the taxpayer and the department agree to a sampling method to be used, the sampling method is binding on the taxpayer and the department in determining the total amount of additional tax due or amounts to be refunded."

As authority for its decision assessing additional tax, the audit cited to 45 IAC 2.2-6-8 which provides as follows:

> (a) In determining the retail merchants' tax liability for a particular reporting period, the retail merchant shall multiply the retail merchant's total gross retail income from taxable transactions made during the reporting period except as otherwise provided in IC 6-2.5-5-7 or in this chapter of Regulations [45 IAC 2.2-6], by the sales tax rate.
> (b) The amount determined under this Regulation [45 IAC 2.2] is the retail merchant's state gross retail and use tax liability regardless of the amount of tax he actually collects.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A retail merchant - such as Taxpayer - is required to "collect the tax as agent for the state." IC § 6-2.5-2-1(b). The retail merchant "holds those taxes in trust for the state and is personally liable for the payment of those taxes . . . ." IC § 6-2.5-9-3.

IC § 6-2.5-5-15 (Repealed July 1, 2004) originally exempted sales of vehicles to out-of-state customers. The Department issued Commissioner's Directive 25 (July 2004), 27 Ind. Reg. 3381, and Sales Tax Information Bulletin 28 (July 2004), 27 Ind. Reg. 3387, to address the change in law. Commissioner's Directive 25 stated that the repeal of IC § 6-2.5-5-15 "only affect[ed] situations where the purchaser [took] possession of the vehicle prior to taking the vehicle out of state." The Directive stated that:

> [The] repeal does not affect out of state sales by Indiana dealers. For a sale of a vehicle to be considered out of state, the purchaser must take possession via delivery outside of Indiana. No exemption certificate is required when making an out of state sale. However, the sales contract must specify that the vehicle is to be delivered out of state and the dealer must maintain shipping documentation to verify that the vehicle was delivered to the purchaser at a specific out of state location.

Sales Tax Information Bulletin 28S (April 2012), 20120530 Ind. Reg. 045120259NRA, provides as follows:

> A vehicle or trailer sold in **interstate commerce** is not subject to the Indiana sales tax. To qualify as being "sold in interstate commerce," the vehicle or trailer **must be physically delivered, by the selling dealer to a delivery point outside Indiana.** The delivery may be made by the dealer, or the dealer may hire a third-party carrier. Terms and the method of delivery must be indicated on the sales invoice. The dealer must document terms of delivery and must keep a copy of such terms of delivery to substantiate the interstate sale. The exemption does not apply to sales to out-of-state buyers in which the buyer takes physical possession of a vehicle or trailer in Indiana, nor is the exemption valid if the buyer, and not the seller, hires a

> third-party carrier to transport the vehicle or trailer outside Indiana. If the buyer hires the carrier, the carrier is acting as an agent for the buyer; thus, the buyer takes physical possession within Indiana. Possession taken within the state does not qualify as an interstate sale. (**Emphasis in original.**) See also Sales Tax Information Bulletin 28S (October 2011), 20110928 Ind. Reg. 045110549NRA; Sales Tax Information Bulletin 28S (December 2009), 20100127 Ind. Reg. 045100029NRA.

Taxpayer challenges the audit's methodology on various grounds. According to Taxpayer:

> [T]he Auditor improperly inferred that the 2012 error rate would remain uniform throughout a three-year span . . . . From a statistical soundness perspective, it was improper for the Auditor to make the unfounded assumption that the error rate would be same over these three years [because] the industry-market conditions, consumer-buying behaviors, dealership behaviors, and the American economy shifted and remained in flux. Moreover, the Auditor's sample included customers who bought many different brands of cars, since [Taxpayer's] operations include multiple-brand stores. The popularity of brands sways from year-to-year.

Taxpayer further objects stating that the audit improperly "applied the same error rate to the group of customers who did not reply to the Department's letter [and that] [t]his clearly tainted the statistical reliability of the calculation[.]"

Taxpayer also objects to the contents of the letter sent to its 207 out-of-state customers. Taxpayer explains that its "customers receiving the letter were confused about the meaning of the delivery question posed in the letter, uneasy about what it mean to answer the delivery question 'under penalties of perjury,' and unsure about why the Department was sending them the letter."

> In other words, the way the Department phrased the question caused some customers to misunderstand the meaning of the question in a way that artificially increased [Taxpayer's] in-state sales, which is yet another factor that led to an invalid error-rate calculation, inaccurate assessment amount, and incorrect computation of [Taxpayer's] Indiana sales tax liability.

Taxpayer concludes that the Department should have relied on its bills of lading and not the response letters received from the 173 customers. As such, Taxpayer "believes that an appropriate error rate is approximately 5[percent]."

Taxpayer impliedly relies on the reliability of the customer affidavits (bills of lading) contained within its own sales records. Indiana law sets out the requirements necessary to determine that reliability. An affidavit is defined as a "written state of fact which is sworn to as the truth before an authorized officer." Jordan v. Deery, 609 N.E.2d 1104, 1110 (Ind. 1993).

IC § 34-37-1-7 sets out the requirements when an affidavit is prepared in an out-of-state location.

> When an affidavit taken in another state is:
> (1) certified by the officer or justice of the peace taking the affidavit, under the:
> (A) hand of the officer or justice of the peace; and
> (B) seal of office, if the officer or justice of the peace has a seal; and
> (2) attested by the clerk of the:
> (A) circuit or district court; or
> (B) court of common pleas;
> of the county where the officer exercises the duties of office, under the hand of the clerk and seal of the court; and the clerk certifies that the officer or justice of the peace is, by the laws of the other state, duly empowered to administer oaths and affirmations and to take affidavits, the affidavit is sufficiently authenticated and may be received and used in any Indiana court.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing sales tax assessment is incorrect and that the audit's 17.6 percent error rate should be replaced with a 5 percent error rate. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); Wendt LLP v.

Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Taxpayer's argument that the out-of-state customers were confused by the audit letter is speculative. A review of the letter reveals nothing prejudicial or intimidating in either the contents or tone of the letter. Taxpayer also argues that the person who signed and returned the letter may not have been aware of nor had actual knowledge of the circumstances surrounding the original vehicle transaction. Again, Taxpayer speculates but it is reasonable to assume that the purchase of a car represents a major investment and commitment by the purchaser. Parties making such a purchase are unlikely to be only dimly aware of the circumstances surrounding that purchase. "Did I take delivery of my new car at the dealer or did the dealer deliver that car across state lines to my front door?" is a question a customer might reasonably be expected to answer with a substantial degree of certainty and reliability.

Taxpayer also argues that the 17.6 percent error rate is unreliable because the nature and substances of its vehicle sales fluctuates from year-to-year. Taxpayer contends that, depending on the vagaries of the local and national economy, Taxpayer may have sold more upscale, expensive cars one year and less expensive cars the next. Perhaps so, but the Taxpayer again asks the Department to speculate but also asks the Department to speculate in Taxpayer's favor. Given the variance in sales from year-to-year and from one dealer location to the next, the audit's error rate could just as well have been too low rather than - as Taxpayer suggests - too high.

Taxpayer maintains that the correct error rate is 5 percent but provides no substantive rationale for arriving at that rate. The Department is unable to agree that Taxpayer has met its burden under IC § 6-8.1-5-1(c) of establishing that the audit's 17.6 percent error rate was "wrong" and that the proposed 5 percent error rate should be substituted in its place.

However, Taxpayer maintains that of the 30 transactions which the owner indicated were taxable, Indiana transactions, that Taxpayer did collect sales tax on four of those transactions and can provide documentation to that effect. The Audit Division is requested to review Taxpayer's "Exhibit 1" and to make whatever adjustment is warranted by the documentation provided.

FINDING

The Audit Division is requested to review Taxpayer's "Exhibit 1." In all other respects, Taxpayer's protest is respectfully denied.

II. Tax Administration - Ten-Percent Negligence Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty because "the evidence does show a good faith effort to comply with the Department's position . . . ."

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "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."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall wave the penalty."

Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

Departmental regulation 45 IAC 15-11-2(c) requires that 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 IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment - including the negligence penalty - is presumptively valid.

In addition to issues stemming from the assessment of tax on sales of vehicles to out-of-state customers, the audit assessed use tax on "[s]hop supplies consumed by the [T]axpayer." These were purchases purchased without paying sales tax but which were consumed by Taxpayer or given away to customers. The audit found that "[T]axpayer did not remit any use tax during the audit period." The audit found that taxpayer had purchased "shop tools and consumable supplies, office supplies, software license agreements, promotional items, direct mailings . . . computer equipment, car stickers and buyers guides" without paying sales tax and without self-assessing use tax. The audit also found that Taxpayer purchased capital assets without paying sales tax including "a lawnmower, a wet vacuum, shop tools, alignment frame equipment, showroom furniture, and a floor scrubber" and then failed to self-asses *[sic]* use tax.

Given the number of items for which taxpayer failed to self-assess use tax, and the fact that the taxpayer had no apparent internal procedure by which to self-assess use tax, the Department is unable to agree that the taxpayer exercised ordinary business care in determining its use tax liabilities.

Based on a "case-by-case" analysis and after reviewing "the facts and circumstances" of this Taxpayer the Department does not agree that the ten-percent negligence penalty should be abated.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Subject to the Audit Division's review of the documents contained in Taxpayer's "Exhibit 1," Taxpayer's challenge to the assessment of additional tax on the sale of vehicles to out-of-state customers is denied; the Department does not agree to abatement of the ten-percent negligence penalty.

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