DEPARTMENT OF STATE REVENUE

04-20140623.LOF

Letter of Findings Number: 04-20140623
Sales and Use Tax
For Tax Years 2011-13

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 issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Retail business did not prove that the Department's calculations of sales tax which should have been collected were incorrect. Therefore, the Department's proposed assessments for sales tax were proper. Retail business failed to keep records, which resulted in the imposition of a negligence penalty.

ISSUE

I. Sales/Use Tax–Audit Methodology.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-5-4; IC § 6-2.5-2-1; IC § 6-2.5-1-2; IC § 6-2-5-4-1; IC § 6-2.5-3-2; Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); 45 IAC 15-3-2.

Taxpayer protests proposed assessments for additional sales and use tax.

II. Tax Administration–Penalties and Interest.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of penalties and interest.

STATEMENT OF FACTS

Taxpayer is a retail business that operates a station and convenience store. As the result of a sales and use tax audit, the Indiana Department of Revenue ("Department") issued proposed assessments for the tax years 2011, 2012, and 2013. The proposed assessments also included penalties and interest for those years. Taxpayer protested, and an administrative hearing was held and this Letter of Findings results (the Department notes that Taxpayer was also audited for food and beverage tax, however Taxpayer in a letter stated it was not protesting the food and beverage audit). Further facts will be supplied as needed.

I. Sales/Use Tax–Audit Methodology.

DISCUSSION

Taxpayer protests a portion of the Department's proposed assessments of sales tax for the tax years 2011 through 2013. Specifically, Taxpayer states that the cost of goods sold ("COGS") percentage used by the Department was too low and resulted in overstated calculation of profits. Taxpayer believes that a different COGS percentage is more accurate and its use in the Department's calculations would result in a more accurate calculation of profits.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. 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 Dept. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining

and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing. . .[courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

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 § 6-2.5-5 et seq. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-1-2; IC § 6-2-5-4-1. A complementary excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2.

As noted, sales tax is imposed by IC § 6-2.5-2-1:

> (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).

Therefore, retail merchants are required to collect sales tax on retail transactions, unless the transaction is exempt from sales tax.

Next, the Department refers to IC § 6-8.1-5-1(b), which states:

> If 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. The department shall send the person a notice of the proposed assessment through the United States mail.
> (Emphasis added).

Also, the Department refers to IC § 6-8.1-5-4(a), which states:

> 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.
> (Emphasis added).

Therefore, all taxpayers subject to a listed tax must keep books and records such as, but not limited to, invoices, register tapes, receipts, and cancelled checks, as provided by IC § 6-8.1-5-4-(a). If 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, as provided by IC § 6-8.1-5-1(b).

Regarding sales tax the audit report states that:

> A review of taxpayer records provided, including ST-103MP sales tax returns, fuel purchase invoices, and prepaid credits documentation was completed for calendar years 2011, 2012 and 2013. The lottery sales were not reported on ST-103MP, therefore the exempt sales from ST-103MP did not include the lottery sales.

The audit report further notes:

> [T]axpayer provided limited records for the audit, including only the fuel invoices, copies of the ST-103MP sales tax returns and profit and loss statements. No source documents were provided to verify the sales of gasoline, sales inside the convenience store, or the exempt sales claimed. In addition, no lottery sales were able to be verified.

The audit report states that for fuel the "difference between gallons purchased and sold per year is minimal and acceptable," that the "prepaid credits reported by the taxpayer on the ST-103MP were compared to prepaid

credits on the fuel purchase invoices and were found to be correct." The audit report states that the selling price of the fuel "was within the acceptable parameters of the historical pricing index." The issues that arose were sales inside the convenience store, with the audit report stating that the "reported total inside sales from the convenience store were less than the gross sales determined by the audit," that Taxpayer presented only partial inventory purchase invoices "which did not allow the auditor to verify the cost of goods sold as reported by the taxpayer." The audit report states that for exempt sales, "[n]o inside sales records from the convenience store were presented for review . . . ." The auditor did "allow exempt sales of 5[percent] for each year in the audit," with the auditor noting that there are "other convenience stores or grocery stores nearby."

Regarding use tax, it was "imposed on purchases for which no documentation was provided to substantiate that sales tax was paid at the point of purchase." The auditor found that Taxpayer "could not provide invoices for capital asset purchases made during the audit period."

Taxpayer states in a letter that it "is a gasoline station that is a convenience store" but that it "does not sell any alcohol." Taxpayer also states the two owners of the business "had no business or accounting classes while in high school" and that the owners "relied upon their accountant [at that time] on what information they should compile and what they should keep. No one ever told them that they should keep Z tapes relating to sales." Taxpayer's protest makes three main types of arguments: (1) Taxpayer "contend[s] that the sales, sales tax, and income were correctly reported"; (2) Taxpayer argues that it conducted its own "forensic analysis"; and (3) that the auditor used the wrong category for BizStats.

Turning to Taxpayer's first argument, Taxpayer did not keep records pursuant to IC § 6-8.1-5-4(a) and thus because of Taxpayer's failure to comply with its statutory duties (See infra **Section II**) the Department had to use the best information available at the time according to IC § 6-8.1-5-1(b). Taxpayer has not established that it correctly reported the sales, thus Taxpayer's argument is denied.

Taxpayer's second argument is that a "forensic reconstruction" was conducted by Taxpayer's current accountant.

> From a forensic standpoint he [Taxpayer's accountant] obtained from the third party vendors what products were purchased by [Taxpayer]. Approximately seventy-five percent of the products [Taxpayer] purchased were from [Vendor H].

And further, Taxpayer states that "[t]he 'Retail Units Purchased' show what the store purchases were by [Taxpayer] and the 'Extended Cost' is the amount that was paid by [Taxpayer]." Taxpayer states that the "Extended Retail" was the vendor's "suggested retail price to [Taxpayer] of how much to charge for the product in their store" but that Taxpayer "did not have to sell it for what is listed in 'Extended Retail.'" The reconstruction by Taxpayer's accountant involved various assumptions made by Taxpayer's accountant (since Taxpayer did not have Z tapes for the years at issue). Again, the Department finds that Taxpayer has not met its burden of proof, thus Taxpayer's argument is denied.

Taxpayer's third argument involves BizStats. As noted, because of a lack of documentation the Department had to use the best information available to determine taxable sales. Taxpayer states in its protest that it "disagree[s] with the cost of goods sold (COGS) percentage used by the auditor to gross up convenience store sales." Taxpayer's argument is that "the auditor pulled the COGS[percentage] from BizStats.com" and that "the rate used was for food-beverage and liquor stores." Taxpayer states that it contacted BizStats and "asked if that was the correct rate to use for a gas station with convenience store" and that Taxpayer was "directed to Bizminer."

Taxpayer offers a different COGS category provided by BizMiner, BizStats' parent company, which it believes is more accurate and which has a higher COGS percentage. Taxpayer argues that the use of a BizStats category which includes alcohol sales and which excludes gasoline sales in the Department's calculations incorrectly lowered the COGS percentage for its store, since it does not sell alcohol and it does combine gasoline store sales with its convenience store sales. This, Taxpayer argues, in turn incorrectly increased the amounts of taxable sales as calculated by the Department.

The Department does not agree with this conclusion. First, the Department separately calculated gasoline store sales, so gasoline sales should not be included in the COGS percentage applied to the convenience store sales calculations. Second, the Department did not use "Food, beverage and liquor stores" as a COGS category from BizStats. Rather, the Department used the sub-category "Food and beverage stores" which only includes food and beverage sales (the category "Food, beverage and liquor stores" breaks out into two separate categories: "Food and beverage stores" and "beer, wine and liquor stores"). Thus alcohol is not included in the category used by the Department. Therefore, the Department did not include alcohol sales in its calculations of Taxpayer's

COGS. Taxpayer's reasoning does not withstand review. Taxpayer also takes issue "with the exemption percentage of sales allowed by the auditor of 5[percent]." Taxpayer cites to Z tapes from 2014. Those Z tapes are from outside the scope of the audit period and thus are not dispositive. Taxpayer also argues that in a Letter of Findings for a different taxpayer the exempt percentage allowed by the auditor was 10 percent. The Department declines Taxpayer's request to in effect second-guess the audit's determinations regarding the exemption percentage, in an administrative process once-removed from both the original audit review (regarding Taxpayer's citing a Letter of Findings for another taxpayer, 45 IAC 15-3-2(d)(3) states: "In respect to rulings issued by the department . . . only the taxpayer to whom the ruling was issued is entitled to rely on it."). Taxpayer's exemption percentage argument is denied.

Taxpayer also claims that it "discovered two errors in calculation." Taxpayer states that one of the errors is "a transposition error that was made by the auditor[.]" The other error that Taxpayer states occurred is "that there was an accounting error that relates to the transferring figures" from the audit "Workpaper" to the Department's "Computations" worksheet. The Legal Division requests that the Audit Division review the matter, and if a transposition error occurred or a calculation error occurred within the audit, to make any adjustments that may be warranted.

In conclusion, the Department was correct to use the best information available to determine Taxpayer's total and taxable sales for the tax years 2011, 2012, and 2013, as provided by IC § 6-8.1-5-1(b), since Taxpayer failed to keep documents it was required to keep under IC § 6-8.1-5-4(a). Taxpayer's position that the Department should have used a different COGS percentage in its calculations of Taxpayer's taxable sales is incorrect. The Department separately calculated gasoline sales and convenience store sales. The BizStats category "Food and beverage stores" does not include alcohol sales and was therefore the correct category to use in its calculations. Taxpayer has not met the burden of proving the proposed assessments wrong, as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is denied. However the Audit Division will review Taxpayer's statement that two errors occurred and make any adjustments if warranted.

II. Tax Administration–Penalties and Interest.

DISCUSSION

Taxpayer protests the imposition of the ten percent negligence penalty. Interest is imposed pursuant to IC § 6-8.1-10-1, and the Department notes that waiver of interest is not permitted under IC § 6-8.1-10-1(e). The waiver of the penalty 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 in relevant part:

> (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.
(Emphasis added).

Taxpayer argues that it relied upon its "accountant on how to report their sales and income . . . ." Taxpayer states that the lack of documentation was "neither willful conduct nor negligence, but rather ignorance on [sic] what documents they were required to keep and relying on their accountant at the time on what documents to keep." As noted by 45 IAC 15-11-2(b), "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." (Emphasis added). Taxpayer has not established reasonable cause, thus its protest of the penalty is denied.

SUMMARY

Taxpayer's protest of the audit is denied. However the Audit Division will review Taxpayer's statement that two errors occurred and make any adjustments if warranted. Taxpayer's protest of penalties and interest is also denied.

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