DEPARTMENT OF STATE REVENUE

04-20150640.LOF

Letter of Findings: 04-20150640
Use Tax
For the Tax Years 2010-2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. 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

Business did not provide sufficient documentation to prove the Department's assessment of use tax incorrect.

I. Use Tax–Audit Methodology.

Authority: IC § 6-3-2-2; IC § 6-8.1-3-3; IC § 6-8.1-5-1; IC § 6-8.1-5-2; IC § 6-8.1-3-12; Indiana Dep't of State Revenue v. Horizon Bancorp, 644 N.E.2d 870 (Ind. 1994); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); State ex rel. Zoeller v. Aisin USA Mfg., Inc., 946 N.E.2d 1148 (Ind. 2011); Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Perrin v. United States, 444 U.S. 37 (1979); Will Yancey, Statistical Sampling in Sales and Use Tax Audits, CCH Inc. (2002); Black's Law Dictionary 394 (9th ed. 2009).

Taxpayer protests the assessment of use tax.

II. Tax Administration–Penalty.

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

Taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana business in the automotive industry. Taxpayer began production in 2002 and ceased production in 2012 pending certain customer orders.

In 2013, the Indiana Department of Revenue ("Department") conducted a sales and use tax audit for the tax years ending 2010-2012. The Department used a statistical sample that resulted in the determination that Taxpayer had overpaid use tax for the years at issue. On January 24, 2014 the Department issued a refund. On March 5, 2014 Taxpayer protested the results of the audit. On May 15, 2014 Taxpayer filed a refund claim that included the audit results plus additional refund requests. The refund claim was not, however, placed into the proper refund review channels. Pursuant to the March 5, 2014 protest, on July 19, 2014 a Memorandum of Decision was issued by the Department sustaining Taxpayer's refund request in part and denying it in part. On July 30, 2014 Taxpayer requested a rehearing. On August 28, 2014, a rehearing was held.

On October 9, 2014 the Department issued a Supplemental Memorandum of Decision rescinding the first decision, because the July 19, 2014 Memorandum of Decision was issued on a claim that had not been previously denied in whole or in part by the Department. The Supplemental Memorandum of Decision referred Taxpayer's refund request to the Department's Refund Division for a decision on the refund. On November 24, 2014 the Department issued Taxpayer a refund claim number, thus beginning the refund review process. During the refund review process the Department conducted a second statistical sample based on a document list ("RE") provided by Taxpayer that was not previously included in the first audit. During the refund review process the Department conducted a review of the original statistical sample ("stat sample") and noted a large additional set of records, document type RE. Taxpayer explained that purchases made using purchase orders are entered information using document type RE. During the course of the investigation the Department determined that Taxpayer had been erroneously refunded. On June 29, 2015 the Department notified Taxpayer that the January 2014 refund was erroneously paid by the Department. The Department then finalized its investigation report on August 19, 2015. Based on the refund claim investigation, the Department assessed Taxpayer to reclaim the

original January 2014 erroneously issued refund as well as for 2012 where the Department found that there was additional use tax due.

The Department assessed Taxpayer use tax. Taxpayer protested the assessments and the imposition of the negligence penalties. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as necessary.

I. Use Tax–Audit Methodology.

DISCUSSION

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 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).

Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to an agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dep't 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.

Taxpayer raises three issues in its protest. The first issue Taxpayer raises is that the Department's statistical sample, used for the 2015 audit is invalid since the sample included non-Indiana cost centers. The second issue Taxpayer raises is that the 2010 and 2011 assessments were issued outside the statute of limitations. The third issue Taxpayer raises is that the 2012 assessment should be given prospective treatment.

A. Whether the Department's 2015 statistical sample is valid.

Taxpayer argues that non-Indiana cost centers should have been excluded from the 2015 statistical sample ("stat sample"). Taxpayer states that by including the non-Indiana cost centers, that inclusion "diminish[ed] relative precision for every zero adjustment." Taxpayer argues that this means that the stat sample is "unreliable," "unreasonable," "imprecise," and "invalid;" the stat sample is therefore, in Taxpayer's opinion, not an accurate representation of the taxable transactions.

IC § 6-8.1-3-12 states:

> (a) The department may audit any returns filed in respect to the listed taxes, may appraise property if the property's value relates to the administration or enforcement of the listed taxes, may audit gasoline distributors for financial responsibility, and may investigate any matters relating to the listed taxes.
> (b) The department may audit any returns with respect to the listed taxes using statistical sampling. 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.

The Department has the authority to use statistical sampling methodology when investigating a taxpayer's business records for tax purposes. Taxpayer challenges the inclusion of non-Indiana cost centers that are irrelevant to the Indiana statistical sample, resulting in an invalid sample. After review of the Department's sampling methodology, the Department during the refund evaluation, treated the non-Indiana cost centers as non-adjustments and no tax was assessed on the transactions.

For both the first and second stat samples, reasonable efforts were made to refine the population to exclude irrelevant transactions. The Department's Investigation Report cited Will Yancey's book, Statistical Sampling in Sales and Use Tax Audits, stating that

> Reasonable efforts should be made to exclude irrelevant transactions but that some irrelevant transactions will remain in the sampling frame. It does not call into questions the validity of a sample that contains irrelevant transactions.

Will Yancey, Statistical Sampling in Sales and Use Tax Audits 25 (CCH Inc. 2002).

Furthermore, according to the Department's Investigation Report, interpretation of Yancey's book, subdividing non-purchase order and purchase order transactions into separate samples achieves grouping of transactions with common characteristics; this grouping reduces the variability in the audit result. When the Department conducts an assessment based on a statistical sample, the Department evaluates sampling error using a 90 percent confidence level with a precision goal of 20 percent or less. The original audit sample precision was 5.45 percent and the 2015 audit investigation sample precision was 3.79 percent. These precision percentages mean that the Department is 90 percent confident its projected results are within 3.79 and 5.45 percent respectively. Any impact on transactions for non-Indiana cost centers are included in the precision percentages and have no further impact on the findings.

Taxpayer has not provided any evidence or documentation to show that the Department's sample is invalid. While Taxpayer may not agree with the way the statistical sample was conducted, that does not mean a statistical sample is invalid or even unreasonable. Thus, the audit methodology yielded reasonable results with an appropriate error rate. Taxpayer has not met its burden as described in IC § 6-8.1-5-1(c).

B. Whether 2010 and 2011 assessments were within the statute of limitations for assessment.

Next, Taxpayer argues that the Department was outside its statutory time frame to assess use tax for the years 2010 and 2011. In its Investigation Report, the Department did not assess Taxpayer additional use tax, but rather deemed the January 2014 refunds erroneous.

IC § 6-8.1-5-2 allows the Department to reclaim refunds that were erroneously given by the Department. IC § 6-8.1-5-2(g) states:

> If any part of a listed tax has been erroneously refunded by the department, the erroneous refund may be recovered through the assessment procedures established in this chapter. An assessment issued for an erroneous refund must be issued:
> (1) within two (2) years after making the refund; or
> (2) within five (5) years after making the refund if the refund was induced by fraud or misrepresentation.

Thus, according to IC § 6-8.1-5-2(g)(1) the Department had until January 24, 2016 to assess Taxpayer to recover the refund that was erroneously made by the Department.

Taxpayer, however, argues that in order for the Department to reclaim an erroneous refund there must be a clerical error. Taxpayer came to this conclusion based on State ex rel. Zoeller v. Aisin USA Mfg., Inc., 946 N.E.2d 1148 (Ind. 2011). Taxpayer stated that the Aisin decision generally stands for the proposition that the Department committed a clerical error in issuing Aisin a refund (no citation given), therefore, this case and the clerical error discussed within it, were the basis for the legislature's enactment of IC § 6-8.1-5-2(g) in 2009. Thus, according to the Taxpayer's interpretation of the Indiana Legislature's intent in enacting IC § 6-8.1-5-2(g), the Department must commit a clerical error in order to claim a refund erroneous, nothing else qualifies for refund recovery.

In Aisin, the Department wrongfully issued Aisin a refund check "because of several accounting and clerical errors that had occurred while entering" Taxpayer's information into the Department's internal system. Aisin, 946 N.E.2d at 1150. The errors were due to the Department giving Aisin an erroneous credit for an overpayment of its 2000 taxes; a billing clerk at the Department made a number of errors entering information from Aisin's 2001 paper return into the Department's system which lead to miscalculations; also the Department failed to credit Aisin for taxes previously paid in 2001. Id. These three accounting and clerical errors resulted in a refund of $1,146,062. Id. at 1150-51.

The Department does not agree with Taxpayer's statutory interpretation. "A statute that is clear and unambiguous on its face needs no further interpretation beyond the plain and ordinary meaning of the words contained therein," and "must be applied and enforced as written." Indiana Dep't of State Revenue v. Horizon Bancorp, 644 N.E.2d 870, 872 (Ind. 1994). "[U]nless otherwise defined, words [in a statute] will be interpreted as taking their ordinary, contemporary, common meaning." Perrin v. United States, 444 U.S. 37, 42 (1979). There is no mention of "clerical error" in IC § 6-8.1-5-2(g), therefore, the Department cannot interpret the statute to have meant a refund can only be erroneous if there was a "clerical error." If the legislature had intended to limit erroneous refunds to when the Department committed clerical errors, it would have done so. Next, since "erroneous" is not defined in the Indiana tax code, the Department turns to the plain and ordinary meaning of "erroneous." "Erroneous" means "[i]ncorrect; inconsistent with the law or the facts." Black's Law Dictionary 621 (9th ed. 2009).

Thus, IC § 6-8.1-5-2(g) does not require a clerical error in order for the Department to reclaim erroneously given

refunds. In this case, the error, the failure to include document type RE in the original sample frame that calculated the refund. This error was remedied in the 2015 audit investigation. During the investigation the Department determined that the refund Taxpayer received in the original audit was erroneous. Since the Department had two years from the date the erroneous refund was issued to reclaim the erroneous refund, the Department was within the statute of limitations to recover the erroneous refunds for the years 2010 and 2011. Taxpayer has not met its burden as described in IC § 6-8.1-5-1(c), therefore Taxpayer's protest regarding the erroneous refunds is denied.

C. Whether prospective treatment should be given for the year 2012.

Taxpayer argues that it should be granted prospective treatment for 2012. Taxpayer stated "it is against Department policy to re-audit." Taxpayer provided Letter of Findings 04-20140145 (June 6, 2014), 20140827 Ind. Reg. 045140316 NRA, to demonstrate when the Department applies prospective treatment. Taxpayer also cites to IC § 6-8.1-3-3 which states in relevant part:

> (b) No change in the department's interpretation of a listed tax may take effect before the date the change is:
> (1) adopted in a rule under this section; or
> (2) published in the Indiana Register under IC 4-22-7-7(a)(5), if IC 4-22-2 does not require the interpretation to be adopted as a rule; if the change would increase a taxpayer's liability for a listed tax.

Prospective treatment does not apply in this instance. First, Letters of Findings, in general, are only binding between the Department and the taxpayer involved in that decision. Next, IC § 6-8.1-3-3, prospective treatment, only applies when there is a reinterpretation of a statute or regulation causing an increase in Taxpayer's liability. In this instance, the Department gave an erroneous refund to Taxpayer. This erroneous refund was the result of the failure to include RE in the first statistical sample; during the original audit Taxpayer had explained to the Department, that the RE document list consisted of inventory items not purchase orders subject to use tax, and the Department relied on that representation. The subsequent analysis of RE was not a reinterpretation of the law, therefore IC § 6-8.1-3-3 does not apply. Taxpayer has not met its burden as described in IC § 6-8.1-5-1(c).

D. Summary

In this case, Taxpayer has not shown that it has met its burden under IC § 6-8.1-5-1(c). Taxpayer has not provided documentation or legal arguments that show the Department's statistical sample was invalid or even unreasonable. Taxpayer also did not demonstrate that IC § 6-8.1-5-2(g) does not apply in this instance, nor that the Department can only reclaim a refund granted because of a clerical error. Finally, Taxpayer could not provide sufficient evidence to show that it should be given prospective treatment because the Department reinterpreted a statute or regulation. Thus, Taxpayer's protest is denied.

FINDING

Taxpayer's protest is denied.

II. Tax Administration–Penalty.

Taxpayer requested that the Department abate the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a 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 when "the taxpayer affirmatively establishes that the failure . . . was due to reasonable cause and not due to negligence." 45 IAC 15-11-2(c). 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." Id. The Department is mindful that "[r]easonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case." Id.

In this instance, Taxpayer has demonstrated that its actions were reasonable as described in 45 IAC 15-11-2(c). Thus, Taxpayer's request for penalty abatement is sustained.

FINDING

Taxpayer's protest of the negligence penalty is sustained.

SUMMARY

Taxpayer's protest regarding the audit methodology of the use tax refund investigation report is denied. Taxpayer's protest of the negligence penalty is sustained.

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