

Letter of Findings: 04-20160006
Sales and Use Tax
For the Years 2012 and 2013

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Indiana S Corporation demonstrated that it was not responsible for sales tax on Food Stamp sales. It however was liable for the sales tax on some sales inside its convenience store determined by the audit because it failed to maintain adequate records. Indiana S Corporation demonstrated that negligence penalty should be abated.

ISSUES

I. Sales & Use Tax - Imposition.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-1-2; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-1 et seq.; IC § 6-2.5-5-33; IC § 6-2.5-9-3; IC § 6-8.1-5-1; IC § 6-8.1-5-4; 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); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012); [45 IAC 2.2-3-14](#); [45 IAC 2.2-8-12](#); Sales Tax Information Bulletin 61 (December 2002).

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

II. 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 S Corporation, operates a combination gas station and convenience store in Indiana. Taxpayer sells gasoline at its gas station; it also sells tangible personal property, which includes grocery items, newspapers, candy, coffee, soft drinks, snacks, various tobacco products, automotive products, health/beauty products, and lottery tickets inside its convenience store ("In-store Sales").

In 2014, the Indiana Department of Revenue ("Department") audited Taxpayer's business records for the 2012 and 2013 tax years ("Tax Years at Issue"). Pursuant to the audit, the Department found that Taxpayer did not maintain adequate sales records and source documents, such as cash register tapes (Z tapes), as statutorily required.

The Department's audit used Taxpayer's purchase records pertaining to the tax periods and publicly available industry financial reports as the best information available to determine the proper amount of sales tax Taxpayer should have collected for the Tax Years at Issue. The Department determined that Taxpayer had underreported its sales and made adjustments for additional taxable sales. The audit also assessed additional use tax on various purchases of tangible personal property which Taxpayer purchased for its business without paying sales tax or use tax on the purchases. Based on the best information available during the audit, the Department imposed additional sales tax, use tax, negligence penalty, and interest.

Taxpayer protested the assessment on additional taxable In-store Sales and asked the penalty to be abated. A hearing was held. This Letter of Findings results. Additional facts will be provided as necessary.

I. Sales & 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). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment 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). IC § 6-8.1-5-4(a) further 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. (Emphasis added).**

The taxpayer "must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times." IC § 6-8.1-5-4(c). "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." IC § 6-8.1-5-1(b). Thus, the issue is whether Taxpayer provided sufficient supporting documentation to demonstrate that the Department's proposed assessment – additional sales tax – is not correct.

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. "Retail transaction" is "a transaction of a retail merchant that constitutes selling at retail as described in IC [§] 6-2.5-4-1 . . . or . . . in any other section of [IC 6-2.5-4](#)." IC § 6-2.5-1-2(a). A person who acquires property in a retail transaction (a "purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). "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." The purchaser in general "shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction." IC § 6-2.5-2-1(b). "The retail merchant shall collect the tax as agent for the state." *Id.* Thus, unless the purchaser presents a valid exemption certificate at the time of the transaction, when the retail merchant fails to collect the sales tax, the retail merchant "is personally 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; [45 IAC 2.2-8-12](#).

In addition to the statutory mandate of record-keeping, Taxpayer in this instance is a retail merchant selling tangible personal property in Indiana and 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 § 6-2.5-5-1 et seq. outlines specific retail transactions which are exempt from sales or use tax. See also IC § 6-2.5-3-4(a); [45 IAC 2.2-3-14](#). 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.).

In this instance, the Department's audit found that Taxpayer failed to maintain adequate records as required. The audit noted, in relevant part, that "[t]he only records maintained to support the reported sales, including the exempt sales sold, was a handwritten worksheet with the totals which did not correspond to the amounts reported on the sales tax returns. There were no source records to verify the amounts reported by [Taxpayer]." In the absence of "the cash register report (Z-tapes) for the audit period as requested," the audit used Taxpayer's purchases records as the starting point to determine total sales using Cost of Sales ratio - the best information

available to the Department during the audit. Cost of Sales ratio is "relationship between cost of goods sold and sales, also known as cost of sales to revenue ratio." The audit noted in relevant part as follows:

[T]he auditor scheduled out the merchandise purchase invoices for the audit period. The merchandise invoices were reviewed and classified as an item either subject to sales tax or exempt when sold to customers. The auditor determined the audited convenience store sales using the Cost of Sales ratio per www.bizstats.com, which compiles industry specific data from Internal Revenue Service. Per the website the Cost of Sales ratio for Food and Beverage Stores was determined to be 73.66[percent] of sales. The audited total purchases (tally of A/P records) is a figure based on actual invoices from [Taxpayer's] vendors. The audited convenience store sales were calculated by dividing the audited total purchases by the BizStats ratio of 73.66[percent]. The total of the exempt merchandise invoices, such as newspapers, dairy and nontaxable grocery items, was divided by the grand total of the merchandise invoices for each year to determine the audited exempt percentage. . . . Since [Taxpayer] did not have the Z-tape sales records, this was the best information available to determine the sales.

To make adjustments, the audit explained in relevant part, as follows:

The merchandise purchase invoices (tally of A/P records) for each year were totaled to determine the audited total purchases. The audited tally of A/P records were divided by the BizStats ratio of 73.66[percent] to determine the calculated total retail convenience store sales. [Taxpayer's] audited exempt sales were subtracted from the total audited sales to determine the audited taxable retail sales. The audited taxable sales less the amount reported by [Taxpayer] as taxable sales equals the additional taxable sales. . . .

The audit concluded that the percentage of exempt sales for Taxpayer's In-store sales was eleven (11) percent for 2012 and twelve (12) percent for 2013. Taxpayer reported 22.90 percent of the total sales for 2012 and 23.70 percent of the total sales were exempt sales.

At the hearing, Taxpayer argued that the Department's audit assessment is overstated. Specifically, Taxpayer claimed that the audit did not consider the amount of "merchandise returned to vendors" and the exempt "food stamps sales." Taxpayer also asserted that its profits from cigarette sales were not as high as the audit determined because it participated in a cigarette "buy-down" program, an incentive program to cigarette retailers, including Taxpayer. Taxpayer receives payments periodically from the cigarette manufacturers and abided by the Indiana "Minimum Cigarette Pricing." Taxpayer stated that under the buy-downs program, the retail sales price of cigarettes was stipulated and thus its profits were capped. Taxpayer further asserted that the Cost of Sales ratio should be "84.11" percent for 2012 and "80.06" percent for 2013 when it calculated the total sales. Taxpayer maintained that the percentage of exempt sales should also be revised.

This Letter of Findings addresses Taxpayer's arguments as follows:

A. Returned Merchandise

Taxpayer claimed that the Department's audit assessment is overstated because the audit did not consider the "merchandise returned to vendors" when the audit used Taxpayer's purchase records to calculate the additional sales tax on the In-store Sales. In addition to an Excel spreadsheet that summarized the amounts with corresponding invoice numbers, Taxpayer provided records it designated as "Returned Merchandise Invoices" to support its protest.

Upon review, however, Taxpayer's documentation demonstrated that its "Returned Merchandise Invoices" actually are billing statements ("Statements") from one of its primary vendors, a wholesale distributor. Taxpayer offered the "Statements" to suggest that when it made the payments on those purchase invoices for each billing period, it received credits which represented the amount of the returned merchandises for that billing period.

The Department acknowledges that Taxpayer probably returned merchandise and received credits from its vendor during each of billing periods as a business normally would have done. However, the Statements are not "Returned Merchandise Invoices" and thus Statements alone are not sufficient to support its assertion that the audit failed to consider the amount of the "Returned Merchandise."

Specifically, the audit noted that "the auditor scheduled out the merchandise purchase invoices for the audit period. The merchandise invoices were reviewed . . . and [t]he audited total purchases (tally of A/P records) is a figure based on actual invoices from [Taxpayer's] vendors." When Taxpayer returned merchandise to its vendors, the vendors' invoices would have reflected the nature of the transactions, including the returned merchandise. In

this instance, each Statement referenced various invoice numbers corresponding to each itemized amount. Statements in this instance summarized each amount concerning each invoice for a billing period, including credit or debit, and the total amount that Taxpayer was required to pay at the end of that billing period. Without the underlying source documentation, namely the specific invoices, the Department is not able to verify Taxpayer's claim and thus is not able to agree that the audit failed to consider the returned merchandise.

To state it differently, the Department's Enforcement Division is requested to conduct a supplemental audit review of the invoices at issue if Taxpayer provides them by November 30, 2016 to verify if the actual invoices referenced in the Statements substantiate the actual transactions of the returned merchandise in question. If the Department's supplemental review finds that the referenced invoices were excluded in the audit initial review, the Department is required to make adjustments and Taxpayer's protest is sustained. Otherwise, Taxpayer's protest on the issue of the returned merchandise must fail.

B. Cost of Sales Ratio

The audit used BizStats ratio of 73.66[percent] to calculate Taxpayer's total retail convenience store sales. Taxpayer disagreed, claiming that the audit erroneously applied 73.66[percent] percentage based upon BizStats.com. Taxpayer stated its ratio should be 84.11[percent] for 2012 and 80.06[percent] for 2013 because "[e]very business has different percentage of cost of goods sold."

To support its protest, Taxpayer prepared an Excel spreadsheet to show its calculation. Its calculation was based on its "analysis of daily sales of 2012 and 2013 with taxable and nontaxable items." Taxpayer also referenced the "returns for all months of 2012 and 2013" as well as "samples of Z tapes for few days to show that what we have reported as sales is as per Z tapes and it is correctly reflected in daily sales analysis. . . ."

Upon review, however, Taxpayer is mistaken. Theoretically, Taxpayer correctly pointed out that "[e]very business has different percentage of cost of goods sold." Nonetheless, Taxpayer in this instance failed to maintain adequate records including Z-tapes. The samples of Z tapes provided by Taxpayer were not the "Z tapes" but the daily summaries, which did not support each transaction, taxable sales or otherwise. Although Taxpayer kept daily summaries of its total In-store sales, the information was manually completed by its employees. Without the source documents, such as Z tapes, the Department is not able to verify Taxpayer's claim that the "ratio should be 84.11[percent] for 2012 and 80.06[percent] for 2013."

In short, the Department is not able to agree that Taxpayer met its burden of proof.

C. Food Stamp Sales

Taxpayer 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 bank statements and transcripts of 1099-K information for the tax years at issue.

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 years. 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 Enforcement Division for a review of the information. The Department's Enforcement 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 Enforcement Division determines that the above mentioned Taxpayer's information submitted is sufficient to support an allowable amount of exempt sales.

FINDING

For the reasons discussed above, Taxpayer's protest of the Department's proposed assessment of additional sales tax is sustained in part and denied in part subject to the results of the pending supplemental audit verification.

Taxpayer must provide invoices of the returned merchandise at issue within 30 days. Only when Taxpayer timely supplements the underlying source documents, the Department's Enforcement Division is requested to verify and determine the amount of the credit should be given. Taxpayer's protest of the "food stamp sales" is sustained to the extent that the Enforcement 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 - 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 provided 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 sustained.

SUMMARY

For the reasons discussed above, under Issue I, Taxpayer's protest of the Department's proposed assessment of additional sales tax is sustained in part and denied in part subject to the results of the pending supplemental audit verification. Taxpayer's protest of Issue II, the negligence penalty, is sustained.

Taxpayer must provide invoices of the returned merchandise at issue within 30 days. Only when Taxpayer timely supplements the underlying source documents, the Department's Enforcement Division is requested to verify and determine the amount of the credit should be given. Taxpayer's protest of the "food stamp sales" is sustained to the extent that the Enforcement 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.

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