

Letter of Findings: 04-20160538
Gross Retail Tax Administration
For the Years 2013, 2014, and 2015

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

HOLDING

After taking specific steps to foreclose the possibility of future accounting and inventory errors which led to its understatement of taxable sales, the Department agreed that Indiana Firearms Dealer met its burden of establishing that the negligence penalty should be abated.

ISSUE

I. Tax Administration - Negligence Penalty.

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

Taxpayer asks that the Department exercise its discretion to abate the ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana firearms dealer with two business locations. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's business records and tax returns.

The audit resulted in an assessment of additional sales/use tax. Taxpayer agreed with the assessment, paid the tax, and paid the interest. However, Taxpayer disagreed with the assessment of an additional ten-percent negligence penalty. Taxpayer submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Tax Administration - Negligence Penalty.

DISCUSSION

The issue is whether Taxpayer has provided sufficient information justifying abatement of the ten-percent negligence penalty.

Although Taxpayer has two business locations from which it sell firearms, Taxpayer did not file a "consolidated" sales tax return. Instead Taxpayer chose to file two separate sales tax returns.

Taxpayer did not have a "point of sale" reporting system at one of the two locations. Taxpayer did have a "point of sale" reporting system at the second location but - according to the audit report - "was in beta form and was not used for sales tax reporting."

The Department's audit calculated the amount of sales due as follows. "[T]otal sales were calculated by using total cash and credit receipts. Exempt sales were then backed out of total sales to arrive at taxable sales." An example of an "exempt sale" was the on-line sale of a firearm to a resident outside the state.

However, Taxpayer made an error in calculating its taxable sales. Taxpayer frequently transferred inventory from one location to another. These transfers were treated as exempt sales. Taxpayer deducted those amounts from total sales to arrive at its taxable sales.

In other words, Taxpayer determined its total sales by adding together its cash and credit receipts. Of course, no

cash or credit was earned when Taxpayer transferred its inventory from one store to the next and the transfers were not included in Taxpayer's total sales. However, Taxpayer deducted the inter-location transfers as "exempt" in calculating its taxable sales; that error resulted in Taxpayer overstating its exempt sales and understating its taxable sales.

Taxpayer's total sales averaged approximately \$4,000,000 during the three years under audit. The audit assessment - largely attributable to the Taxpayer's erroneous treatment of inter-location sales - was approximately \$100,000.

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.

Taxpayer committed - or failed to correct - a fundamental calculation error which led to a substantial understating of its tax liability. However, Taxpayer states that it recognizes the error and has taken steps to assure that this error - or a similar error - does not recur.

Taxpayer states that: (1) it has dismissed its previous accounting firm and engaged a replacement firm; (2) it updated its computer system to properly and accurately account for taxable and nontaxable sales and reconcile sales which take place at its two locations; (3) it purchased new computer software for its updated computers and point-of-sale registers; (4) it trained its employees on the proper usage of the updated point-of-sales registers and software; (5) it has limited transfer of its inventory from one business location to the second; (6) it re-categorized its inventory "to better document non-taxable sales."

Taxpayer clearly erred in determining its sales and use tax liability. However, there is insufficient information to establish that Taxpayer's error was so egregious as to constitute "willful neglect." IC § 6-8.1-10-2.1(d). Taking into account the fact Taxpayer has taken specific steps to correct the error and foreclose the possibility of future, similar errors, based on a "case-by-case" analysis, and after reviewing "the facts and circumstances of each taxpayer" the Department agrees that the ten-percent negligence penalty should be abated.

FINDING

Taxpayer's protest is sustained.

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