

Letter of Findings: 04-20170103; 04-20170104; 04-20170105**Gross Retail Tax
For the Year 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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

The Department denied Indiana Restaurants' protest challenging the assessment of additional sales tax because the Department's Special Investigation Division found that the Restaurants had failed to maintain accurate financial records, failed to file sales tax returns, and failed to accurately report their sales. The Department's assessment of tax was based on a "reasonable belief" that the Restaurants under-reported their income.

ISSUE**I. Gross Retail Tax - Best Information Available Assessments.**

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-9-3; IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); IC § 6-8.1-5-1(b); 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); [45 IAC 15-5-1](#).

Taxpayers maintain that the Department's assessments of sales tax are unwarranted because the Department could not have reasonably believed Taxpayers owed additional tax and because the assessments overstate Taxpayers' income.

STATEMENT OF FACTS

Taxpayers are three related Indiana restaurants. The Indiana Department of Revenue ("Department") initiated an investigation of Taxpayers' business practices and sales tax returns. The Department's "Special Investigation Division" executed search warrants of Taxpayers' business locations in November 2013. The Department simultaneously subpoenaed Taxpayers' bank account information. In addition, the Department executed a search warrant of the business which prepared Taxpayers' tax returns. The investigation resulted in the issuance of a "Case Report" dated December 2014. The Case Report concluded that during 2010 through 2012, Taxpayers failed to report approximately \$10,000,000 in sales. Accordingly, the Department issued assessments of additional sales tax for those years.

Subsequently, the Department issued proposed assessments of additional sales tax for 2013. Taxpayer disagreed with the 2013 assessments and submitted protests to that effect. An administrative hearing was conducted during which Taxpayers' representative explained the basis for the protests. This Letter of Findings results.

I. Gross Retail Tax - Best Information Available Assessments.**DISCUSSION**

The issue is whether the Department had sufficient grounds on which to assess Taxpayers additional sales tax for the year 2013. Taxpayers argue that the Department lacked a "reasonable belief" that Taxpayers under-reported their restaurant sales during 2013, that the assessments are "inaccurate [and] grossly overstate[] the amount of sales made by the [T]axpayer[s] for 2013," fails to account for differences in sales between Taxpayers' business locations and other related businesses, and that Taxpayers did not have an opportunity to provide additional information which would have buttressed the claim that their 2013 sales were accurately reported.

As a threshold issue, it is the Taxpayers' 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 [D]epartment'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).

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 Taxpayers - 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.

The audit found that Taxpayers failed to maintain accurate and complete sales records. The audit also found that Taxpayers failed to file all the requisite sales tax returns.

In the absence of returns and source documentation, the audit made a determination of the Indiana tax due based on the "best information available" to the Department.

As businesses conducting retail transactions and collecting sales tax, Taxpayers are required to maintain accurate financial records. "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." IC § 6-8.1-5-4(a). "If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(b). See also [45 IAC 15-5-1](#).

The Department's investigation found that Taxpayers failed to maintain "source documents" and that it was Taxpayers' practice to destroy "guest check tickets" on a regular basis. In addition the audit questioned the accuracy of Taxpayers' daily summary register tapes ("z-tape") because the cash register daily tapes were not retained. The audit report also indicates that it was the practice of Taxpayers' employees to "register a lesser amount than the actual sales price," use the "no sale" register button to ring up particular transactions, and routinely "left the cash register drawer open between customers." Further, the audit found that a review of Taxpayers' bank accounts established "that there were no cash deposits for many months, and often there were no cash deposits for years."

In reviewing Taxpayers' general ledgers, the Department found that Taxpayers' "[r]evenues were increased and cash on hand was increased in order to balance [] accounting entries." According to the Department's investigative report, Taxpayers' practice of adjusting the general ledger entries "indicates the business was not reporting all their sales" and that Taxpayers' records were incomplete and unreliable.

Rather than rely on the available records which it determined were incomplete and unreliable, the audit decided to calculate the amount of sales tax based on Taxpayers' "cost of goods sold." As explained in the 2014 Case Report:

There is sufficient convincing evidence to support the conclusion of under-reporting of sales by [Taxpayers] to the Indiana Department of Revenue. However, the percentage of under-reporting varies among the restaurants. Therefore, an indirect method must be utilized to determine the amount of under-reporting by each restaurant.

A fundamental principle restaurants often utilize is a cost of goods method to determine menu pricing. Cost of goods sold is defined as the direct costs attributable to the production of goods. Restaurants measure the cost of ingredients and mark them up in order to cover their fixed overhead costs such as rent or advertising and variable overhead costs such as utilities or labor. This cost accounting concept is utilized, not only in restaurants but also manufacturing concerns because a direct relationship exists between cost of goods and the associated sales.

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A very reasonable estimate of under-reported sales has been calculated by applying the modest markup of 3.5 to the cost of food and beverages purchased. The cost of goods sold amount is obtained from the year-end financial statement for each location. The costs for food and beverage are then marked up 3.5 times to determine total sales. Reported sales are then subtracted from total sales to determine unreported

sales.

The Department is unable to agree with Taxpayers that the assessments of additional tax were meritless or that the Department had no basis upon which to issue the assessments. Instead, the Department reasonably fulfilled the responsibility imposed upon it by IC § 6-8.1-5-1(b) which mandates that the Department issue proposed assessments when there is a reasonable belief a taxpayer has not reported the correct amount of tax due. As explained in the audit reports, Taxpayers' own records "were inadequate to support a determination of the [T]axpayer's Indiana sales tax liability." Taxpayers have produced no substantive, contemporaneous documents which would directly - or even indirectly - refute the Department's conclusion that the Taxpayers' record keeping practices were questionable at best.

Taxpayers argue that the assessments "grossly overstate the amount of sales" and that the 3.5 multiplier fails to differentiate between the amount of sales which occurred at one of the restaurants with the amount of sales which took place at the other two locations. In other words, Taxpayers maintain that the Department's across-the-board 3.5 multiplier is an overly simplistic approach to a more complex sales tax issue. However, the Department does not agree that abating the sales tax assessments and accepting Taxpayers' original returns as filed is a more satisfactory solution because Taxpayers clearly underreported the amount of their sales and have now provided nothing which establishes that the assessment was "wrong" as required under IC § 6-8.1-5-1(c). Neither the Department's approach nor the Taxpayers' approach authoritatively and definitively establishes the taxable sales at each location. However, the problem Taxpayers face is one of their own making. Taxpayers failed to maintain and/or preserve the records required under IC § 6-8.1-5-4(a) which states that "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 Department fulfilled its statutory responsibility of issuing proposed assessments based on the best information available to it.

FINDING

Taxpayers' protest is denied.

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