

DEPARTMENT OF STATE REVENUE

04-20160684.LOF

Letter of Findings Number: 04-20160684
Indiana Sales and Use Tax
For Tax Years 2011 - 2014

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 Indiana Department of Revenue'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 This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.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 supplier is not entitled to a change in audit methodology nor is it entitled to a review of a specific transaction which was already included in the audit sample. Because Indiana supplier provided sufficient documentation, it is entitled to an adjustment of additional taxable amounts for two fixed assets. Finally, Indiana supplier is granted a waiver of penalty.

ISSUES**I. Sales Tax - Audit Methodology.**

Authority: IC § 6-8.1-5-1; IC § 6-8.1-5-4; IC § 6-8.1-3-12; IC § 6-2.5-4-1; IC § 6-2.5-2-1; IC § 6-2.5-9-3; IC § 6-2.5-8-8; *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); *Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014).

Taxpayer protests the methodology used in the audit.

II. Sales Tax - Refund of Use Tax.

Authority: IC § 6-8.1-9-1; IC § 6-8.1-3-12.

Taxpayer requests a refund of use tax it mistakenly accrued and remitted to the Department.

III. Sales Tax - Imposition - Fixed Assets.

Authority: IC § 6-2.5-3-2; [45 IAC 2.2-3-4](#).

Taxpayer argues that the audit overstated the additional taxable amounts for two fixed assets.

IV. Tax Administration - Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer requests that the Department abate the negligence penalty.

STATEMENT OF FACTS

Taxpayer is a limited partnership that supplies specialty hardware, tools, and materials to contractors. Taxpayer was subject to an Indiana sales and use tax audit for tax years 2011 - 2014. As a result, Taxpayer was assessed with additional tax and negligence penalty for each tax year at issue.

Taxpayer agreed to and paid a portion of the assessment. Taxpayer protested the remaining assessments as well as the negligence penalties. An administrative hearing was held. This Letter of Findings results. Further facts will be supplied as required.

I. Sales Tax - Audit Methodology.

DISCUSSION

Pursuant to the audit, the Department assessed additional sales tax on sales which did not qualify for the sales tax exemption using a block sampling method which included one month from each quarter of each audit year. At the time of the audit, both the Department and Taxpayer agreed upon the sampling method, and signed an agreement commemorating as much.

Taxpayer now protests, arguing that they "are not in agreement with the audit projection methodology and . . . request[s] a recalculation of the projected tax due to be based on calculated yearly error rates rather than an overall combined error rate for all years." Taxpayer believes the recalculation will better take into account changes it made to its procedures for validating and retaining exemption documentation during the audit period as well as the change in ERP systems it made during the audit period.

Taxpayer also requests that one customer be removed from the projection and be assessed separately as it believes this customer represents an isolated exception. This particular customer performed a job for a third party and submitted exemption documentation with the third-party's name rather than the customer's name. Taxpayer accepted this documentation and did not collect sales tax in relation to the project.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the 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 Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). The retail merchant "must keep books and records so that the department can determine the amount, if any, of the [retail merchant's] liability for that tax by reviewing those books and records." IC § 6-8.1-5-4(a). Thus, a taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. 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.

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.**

(Emphasis added).

Thus, the Department has the authority to use block sampling when auditing a taxpayer's business records for tax purposes. Taxpayer agreed to the method chosen during the audit and signed an agreement to that effect. The sample accounts for all years at issue in the audit and, in recognition that the Taxpayer used two different systems during the audit period, the audit performed two separate sales tax reviews, the error rates of which were combined and applied to the entire population.

Under IC § 6-2.5-4-1(a), "[a] person is a retail merchant making a retail transaction when the person engages in selling at retail." Further, "[a] person is engaged in selling at retail when . . . the person (1) acquires tangible personal property for the purpose of resale[] and (2) transfers that property to another person for consideration." IC § 6-2.5-4-1(b). As a retail merchant, Taxpayer is required to "collect [sales] tax as [an] agent for the state." IC § 6-2.5-2-1(b). Taxpayer, and all retail merchants, hold the collected taxes "in trust for the state and is personally liable for the payment of those taxes" IC § 6-2.5-9-3. If a customer is exempt from sales tax and presents a proper exemption certificate, Taxpayer does not have the duty to collect and remit sales tax when making a sale to that customer. IC § 6-2.5-8-8.

Taxpayer requested that a particular customer be removed from the projection and treated as actual. This customer provided exemption documentation for a third party for which they were performing a job and purchasing items from Taxpayer in performance of that job. The customer did not provide exemption certification for itself. During the audit, the Department notified Taxpayer of all missing exemption certificates and gave

Taxpayer 60 days to obtain those certificates. The audit report contains a note that Taxpayer was later given an additional six months to obtain these missing certificates. Taxpayer was given ample time to provide documentation that customer was exempt from Indiana sales tax but failed to do so.

Taxpayer has not provided any evidence to show that the Department's sample is invalid. While Taxpayer, post-audit, may not agree with the Department's sampling methodology that does not mean the sample was invalid or even unreasonable. Taxpayer agreed to the methodology at the time of the audit. 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).

FINDING

Taxpayer's protest is denied.

II. Sales Tax - Refund of Use Tax.

DISCUSSION

Taxpayer requests a refund of use tax it mistakenly accrued and remitted to the Department. In support of its request, Taxpayer has provided a copy of the expense invoice on which the use tax was accrued. The invoice shows that the purchase was made in January of 2012 and per Taxpayer's records use tax was accrued and remitted in July of 2012.

Taxpayer requested refund of the use tax during the audit. The audit denied the request as expenses were audited using a block sample therefore individual expenses cannot be reviewed. Taxpayer protests the denial stating that the expense was for property that was "shipped-to, stored, and used outside the state of Indiana," thus no tax was due in Indiana. Taxpayer cites IC § 6-8.1-9-1 which states, "[i]f a person has paid more tax than the person determines is legally due for a particular taxable period, the person may file a claim for refund with the department."

Taxpayer and the Department agreed to use a block sample to audit expenses as that method "would be the most effective method of reviewing invoices." The audit report explains that "[i]n order to reflect all periods of the year, one month from each quarter of each audit year was selected as a test month." The sampling agreement, which both parties signed, stipulates that the sampling method chosen is followed "in lieu of actual figures." The agreement further designates the test months as July 2011, October 2012, May 2013 and March 2014. Thus, these test months represent all transactions that fall within the audit period and the parties agreed that the results of testing these months would be applied to all expenses in the audit period.

IC § 6-8.1-3-12(b) states, in part, "[i]f the taxpayer and the department agree to a sampling method . . . 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." Because the transaction at issue falls within the sampling frame, it has been effectively reviewed and included in the results of the audit. Therefore, it cannot be separately reviewed.

FINDING

Taxpayer's protest is denied.

III. Sales Tax - Imposition - Fixed Assets.

DISCUSSION

Taxpayer claims that the audit overstated the additional taxable amounts for two fixed assets. "An 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, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2. "Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase." [45 IAC 2.2-3-4](#).

The audit assessed use tax on those purchases of fixed assets made during the audit period for which no sales tax was paid. Taxpayer believes that the additional taxable amount on assets A and B is overstated in the audit.

Each is discussed below.

Asset A

For asset A the audit assessed tax on an amount of approximately \$20,000 which is comprised of two separate amounts for which invoices were missing. Taxpayer claims that just under \$600 should not be included in the additional taxable amount. In support of its claim, Taxpayer provided copies of the invoices which comprise asset A. Taxpayer also provided an email from the audit supervisor confirming that the additional taxable amount of asset A should not include the \$600. Based on this evidence, the additional taxable amount of asset A should be reduced.

Asset B

Asset B is listed in the audit report with an additional taxable amount of approximately \$12,000. Taxpayer claims that the additional taxable amount should actually be just under \$11,000. Taxpayer provided copies of the invoices which comprise asset B. Taxpayer also provided an email from the audit supervisor confirming the additional taxable amount of just under \$11,000. After review of the invoices and notes in the audit file, the Department agrees that the additional taxable amount of asset B should be just under \$11,000.

The file will be sent back to the audit division with the request that the adjustments be made for these assets.

FINDING

Taxpayer is sustained.

IV. Tax Administration - Negligence Penalty.

DISCUSSION

Pursuant to the audit and the Department's policy, the Department imposed a ten percent negligence penalty for the tax years at issue. Taxpayer argues that it should not be subject to the penalty and requests an abatement.

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), 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.

As the result of the audit, the Department assessed a ten percent negligence penalty in addition to the tax assessment. Taxpayer requested that the penalty be abated because "[d]uring the audit period, [Taxpayer] underwent many restructuring changes. Due to the changes, employee turnover was extensive. Despite the turnover and many changes beyond our control, [Taxpayer] remitted all taxes collected and filed the returns in a timely manner."

The audit reported noted that Taxpayer remitted no sales tax for the audit period, yet the audit resulted in a sales tax assessment, thus the penalty was assessed. A review of Taxpayer's history with the Department does not support this statement. The audit report also noted that the percentage of errors used to calculate additional tax due were very small, especially once Taxpayer switched to its new ERP system. Such small percentages of error indicate that Taxpayer acted reasonably in collecting sales tax. The Department further notes that the Taxpayer has a history of compliance with the Department. The small percentages of error and Taxpayer's positive history justifies waiver of the negligence penalty in this case. Thus, the negligence penalty will be abated.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer is denied in relation to its protest of the audit methodology and request for refund of use tax. Taxpayer's protest pertaining to fixed assets and penalty is sustained.

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