

**Letter of Findings: 70-20170813
Other Tobacco Products Tax
For the Years 2013 through 2016**

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 This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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 did not agree with Other Tobacco Product Distributor that it provided sufficient, adequately documented evidence that the Department erred in its assessment of Other Tobacco Product Tax.

ISSUES

I. Other Tobacco Product Tax - Imposition.

Authority: IC § 6-7-2-2; IC § 6-7-2-5; IC § 6-7-2-7; IC § 6-7-2-22; IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); IC § 6-8.1-5-4(c); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the assessment of Other Tobacco Product tax.

II. 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 protests the imposition of a ten-percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an out-of-state and in-state distributor of tobacco products. The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's tax returns and business records.

The Department's audit found that Taxpayer purchased tobacco product - other than cigarettes ("OTP") - from various manufacturers or suppliers. Taxpayer then sells the OTP to other distributors, merchants, and retailers located in Indiana, Illinois, and other states.

The auditor reviewed Taxpayer's documents to determine the amount of OTP that was sold to customers in Indiana and to customers in other states. According to the audit report, "The comparisons found unreported purchases from out of state suppliers and unsupported exports." As explained in the audit report:

It is the auditor's opinion that the [T]axpayer chose to report purchases from out of state distributors only when there were sales to Indiana customers. This practice occurred even when the purchase[] invoices clearly showed that the product was delivered to an Indiana location.

The auditor met with and requested from Taxpayer an explanation for the apparent discrepancies. Taxpayer stated that all OTP products purchased from its Illinois distributor was delivered in Illinois.

The audit resulted in an assessment of additional OTP tax. Taxpayer disagreed with the assessment and asked that the Audit Division conduct a supplemental audit. The Special Tax/Audit Division agreed and conducted that secondary review. Following that supplemental review, the Department responded in a nine-page letter dated July 2017 concluding that there was insufficient information justifying any change to the original assessment. As stated

in the July letter, "The additional information did not lend support to any changes in the original audit."

Despite the findings in the supplemental audit review, Taxpayer continued to disagree with the Department's analysis, conclusions, consequent assessments, and submitted an administrative protest with the Department's Legal Division. An administrative hearing was conducted during which Taxpayer and Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Other Tobacco Products Tax - Imposition.

DISCUSSION

Taxpayer argues that the Department's assessment of additional OTP tax is incorrect because the OTP was purchased from an Illinois supplier and delivered to Illinois recipients.

As a threshold issue, it is the Taxpayer's responsibility to establish that the OTP 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). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position 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).

Consequently, a taxpayer submitting a protest is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

The OTP tax is imposed on the distribution of OTP in Indiana. IC § 6-7-2-7, in relevant part, states:

- (a) **A tax is imposed on the distribution of tobacco products in Indiana** at the rate of:
- (1) twenty-four percent (24 [percent]) of the wholesale price of tobacco products other than moist snuff; or
 - (2) for moist snuff, forty cents (\$0.40) per ounce, and a proportionate tax at the same rate on all fractional parts of an ounce. If the tax calculated for a fractional part of an ounce carried to the third decimal place results in the numeral in the third decimal place being greater than four (4), the amount of the tax shall be rounded to the next additional cent.
- (b) **The distributor of the tobacco products [] is liable for the tax** imposed under subsection (a). **The tax is imposed at the time the distributor:**
- (1) **brings or causes tobacco products to be brought into Indiana for distribution;**
 - (2) **manufactures tobacco products in Indiana for distribution; or**
 - (3) **transports tobacco products to retail dealers in Indiana for resale by those retail dealers.** (Emphasis added).

"Distributor" is defined in IC § 6-7-2-2, which states:

As used in this chapter, "distributor" means a person who:

- (1) manufactures, **sells**, barter, exchanges, or **distributes tobacco products in Indiana to retail dealers for the purpose of resale;**
- (2) purchases tobacco products directly from a manufacturer of tobacco products; or
- (3) purchases for resale tobacco products from a wholesaler, jobber, or distributor outside of Indiana who is not a distributor holding a license issued under this chapter. (Emphasis added).

IC § 6-7-2-5 also provides:

As used in this chapter, "tobacco product" means:

- (1) any product made from tobacco, other than a cigarette (as defined in [IC 6-7-1-2](#)), that is made for smoking, chewing, or both; or
- (2) snuff, including moist snuff.

Accordingly, Indiana imposes the OTP tax on the distribution of OTP in Indiana at a rate of 24 percent. A distributor becomes liable for the OTP tax at the time the distributor engages in certain specific acts, which include "bring[ing] or caus[ing] tobacco products to be brought into Indiana for distribution."

Taxpayer is, of course, required to maintain detailed records sufficient to determine whether Taxpayer does or does not owe additional tax. Indiana law requires that "[e]very 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 tax by reviewing those books and records." IC § 6-8.1-5-4(a). OTP tax is a "listed tax" under IC § 6-7-2-22.

In addition, IC § 6-8.1-5-4(c) provides that, "A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times."

Taxpayer concludes that the Department's assessment of additional OTP tax was unjustified.

As noted above, the Department's Audit Division agreed to a supplemental review in order to respond to Taxpayer's objections to the original audit results. In its request for this supplemental review, Taxpayer proposed approximately twenty specific, detailed objections to the audit's original findings.

For example, Taxpayer posed this particular objection:

Line 32 sales invoices 14-083 for [vendor one] is a duplicate this invoice is for [vendor two] for \$1,339 and [Taxpayer] explained to the auditor he was using excel and was doing cut and paste. This invoice was not a sale. Line 31 that is correct sale invoices and show \$1,272 when it should be \$1,339 this was consistent with the OTP filing for that month.

The Department's Audit Division responded to this objection:

\$1,339 was reported incorrectly. Line 32 removes that incorrect figure, showing a credit of (\$1,339.00). Line 31 adds the correct amount, \$1,272 to the total.

Taxpayer posed a second objection as follows:

Line 43 invoice 14-132 was sold to [vendor three] and not [vendor four].

The Department responded:

Invoice 14-132 was reported as product shipped out of state to [vendor four] on Schedule B in September 2014. An invoice was not provided to support this transaction to either [vendor four] or [vendor three], so the transaction was disallowed.

Taxpayer posed a third objection:

On line 154 invoice number 10676 [vendor five] Auditor shows non verified reported purchases of [\$]5,388 but invoice clearly shows verified audited price of \$10,188 please refer to [invoice].

To this third objection, the Department responded as follows:

The [T]axpayer reported \$5,388 for this invoice as detailed on Schedule B. The auditor verified the invoiced tobacco price at \$10,188. The adjustment, \$4,800, accounts for the difference.

In like manner, the Department responded to each of Taxpayer's specific and detailed objections. In each case, the Audit Division supplied an equally detailed and specific response and in each case, the Audit Division found the objection either unjustified, incorrect, or that the objection would not have affected the bottom-line assessment.

Taxpayer has now provided some twenty pages of invoices, returns, and spreadsheets intended to bolster its argument that the assessment should either be abated or modified. Nonetheless, the Department is unable to agree that Taxpayer has met its statutory burden under IC § 6-8.1-5-1(c) of establishing that any specific aspect of the audit's analysis or tax calculation was "wrong." Taxpayer has failed to set out a coherent, step-by-step explanation of its objections. The documentation provided does not appear to relate to Taxpayer's previous

objections. In addition, Taxpayer has failed to effectively challenge any portion of the Audit Division's supplemental, nine-page response to its previous objections nor has Taxpayer established that any of the simple factual conclusions in either the audit, supplemental audit, or the Audit Division's nine-page response were wrong.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration - Negligence Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the ten-percent negligence penalty on the apparent ground that Taxpayer acted in good faith when it reported the original amounts of OTP tax.

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.

The Department's audit noted that Taxpayer "did not have any internal controls" and that Taxpayer failed to properly account for OTP that was delivered to Taxpayer's Indiana location. Based on a "case-by-case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department does not agree that Taxpayer has provided sufficient ground justifying abatement of the ten-percent negligence penalty.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

The Department finds there is insufficient documentation justifying abating or modifying the assessment of OTP tax and insufficient grounds to abate the ten-percent negligence penalty.

Posted: 01/31/2018 by Legislative Services Agency
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