

DEPARTMENT OF STATE REVENUE

04-20181392.LOF

Letter of Findings Number: 04-20181392
Sales and Use Tax
For Tax Years 2014-16

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 This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.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

Retail business established that the Department's calculations of sales tax which should have been collected were partially incorrect. Therefore, the Department's proposed assessments for sales tax will be recalculated.

ISSUES

I. Sales Tax—Additional Sales.

Authority: IC § 6-8.1-5-1; IC § 6-8.1-5-4; IC § 6-2.5-2-1; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests proposed assessments for additional sales tax.

II. Tax Administration—Penalties.

Authority: IC § 6-8.1-5-4; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of penalties.

STATEMENT OF FACTS

Taxpayer is a retail business with gasoline sales and an attached convenience store. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had underreported taxable sales for the tax years 2014, 2015, and 2016. The Department therefore issued proposed assessments for sales tax, penalties, and interest for those years. Taxpayer protested a portion of the assessments. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as needed.

I. Sales Tax—Additional Sales.

DISCUSSION

Taxpayer protests a portion of the Department's proposed assessments of sales tax for the tax years 2014 through 2016. The Department found that Taxpayer had failed to keep daily z tapes from its register to verify reported exempt sales. The Department therefore used alternate methods to determine Taxpayer's total purchases, total sales, and exempt sales. Taxpayer disagrees with the Department's calculations and results. Specifically, Taxpayer protests that the Department erred in relying on certain purchase documents and online resources rather than using Taxpayer's own documentation. Had the Department done so, Taxpayer argues, the resulting liabilities would have been significantly lower than those calculated by the Department in its audit.

As a threshold issue, it is the Taxpayer's 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 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 Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer 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, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Sales tax is imposed by IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. *The retail merchant shall collect the tax as agent for the state.*

(Emphasis added).

Therefore, retail merchants are required to collect sales tax on retail transactions, unless the transaction is exempt from sales tax.

Next, the Department refers to IC § 6-8.1-5-1(b), which states:

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. The amount of the assessment is considered a tax payment not made by the due date and is subject to [IC 6-8.1-10](#) concerning the imposition of penalties and interest. The department shall send the person a notice of the proposed assessment through the United States mail.
(Emphasis added).

Also, the Department refers to IC § 6-8.1-5-4(a), which states:

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).

Therefore, all taxpayers subject to a listed tax must keep books and records such as, but not limited to, invoices, register tapes, receipts, and cancelled checks, as provided by IC § 6-8.1-5-4-(a). 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, as provided by IC § 6-8.1-5-1(b).

In the instant case, Taxpayer provided the Department with documentation it believes is adequate to determine its taxable and non-taxable sales percentages. The Department determined that this documentation was not sufficient to determine taxable and exempt sales. As explained above, Taxpayer did not supply daily sales records such as cash register z tapes. Rather, Taxpayer provided monthly close reports from the cash register, along with other purchase documents, and hand-written monthly summaries of sales, including details such as taxable and exempt inside sales, gasoline sales, money orders, ATM activities, etc. . . . Taxpayer reported exempt sales percentages of forty-one percent, forty-two percent, and thirty-six percent for 2014, 2015, and 2016 respectively. The Department determined that the records supplied were insufficient to verify those reported percentages and therefore decided to use the best information available to determine taxable and exempt sales.

The Department reviewed the invoices and calculated Taxpayer's taxable sales by using Taxpayer's actual purchases combined with a Cost of Goods Sold ("COGS", also referred to as "Cost of Sales") percentage for food and beverage stores found on "BizStats.com" ("BizStats"). While COGS is an income tax concept and the tax at issue is sales tax, the Department used the BizStats COGS numbers to determine the average markup which Taxpayer applied to the goods it purchased and sold. In doing so, the Department was able to determine total taxable sales and total exempt sales. In turn, those calculations resulted in the determination that Taxpayer had additional taxable sales for the tax years at issue, which resulted in additional sales tax which Taxpayer should have collected and remitted, as provided by IC § 6-2.5-2-1(b).

Taxpayer protests that the BizStats category used by the Department is not the most accurate category for its business. Particularly, Taxpayer believes that its large percentage of cigarette sales compared to its overall sales makes the Department's reliance on BizStats inappropriate. This is due, Taxpayer argues, to minimum pricing on

cigarettes. Since cigarette sales were such a large part of Taxpayer's overall sales, Taxpayer argues, the minimum markup on them makes Taxpayer's COGS significantly higher than the BizStats COGS which the Department used. Rather, Taxpayer believes that more accurate calculations of its rate of exempt sales may be achieved through review of its purchase records and third-party cigarette pricing reports.

Specifically, Taxpayer believes that its cigarette purchase records and its agreements with the cigarette manufacturers regarding pricing are sufficient documentation to establish that the COGS on its cigarette purchases was much higher than determined in the Department's audit. A higher COGS would result in a lower markup which would result in a lower sales amount. A lower sales amount would, in turn, result in a lower amount of sales tax which should have been collected and remitted. In support of its position, Taxpayer provided documentation prepared by one cigarette manufacturer which confirmed the selling price per pack of the cigarettes Taxpayer purchased from that manufacturer. Taxpayer believes that a four percent markup on cigarettes is more accurate than the markup calculated by the Department.

After review of the materials provided by Taxpayer in the course of the protest process, the Department agrees with Taxpayer's argument. When combined with the purchase documents which the Department reviewed in the audit process, the sales price confirmation eliminates the need to use the BizStats COGS numbers regarding cigarette purchases. The Department is now convinced that Taxpayer has met the burden imposed under IC § 6-8.1-5-1(c) of proving the proposed assessment wrong regarding the markup it put on cigarettes. However, the Department is not convinced that Taxpayer's four percent markup is accurate either. Therefore, the Department will review the price per pack as verified by the cigarette manufacturer's report and compare it to the purchase price recorded on the purchase documents to arrive at an average markup. That markup percentage will then be applied to all cigarette purchases for the audit period.

The resulting percentage of markup on cigarettes will be calculated separately from other retail sales. Those other sales will still be calculated for total sales using the BizStats COGS method as originally used in the audit, although without including cigarette sales. The Department will then recalculate taxable and exempt percentages for those non-cigarette sales. The Department will then combine the recalculated cigarette sales numbers and the recalculated non-cigarette sales numbers to arrive at a new total sales calculation and a new amount of sales tax that should have been collected and remitted for the tax years.

Finally, Taxpayer protested that the Department itemized purchases from 2015 but did not do so for 2014. Taxpayer believes that 2014 should have been itemized as well. In support of that position, Taxpayer provided its own calculations of 2014 purchases. After review of Taxpayer's documentation and analysis, the Department is not convinced by Taxpayer's argument. The Department reviewed 2015 because Taxpayer's records for 2015 were the most complete of any of the years under audit. The 2015 results were then projected to the other years under audit. While Taxpayer has provided alternate calculations, it has not established that those calculations are more accurate or more reasonable than the Department's. Taxpayer has not met the burden imposed under IC § 6-8.1-5-1(c) of proving that the Department's methodology is wrong.

In conclusion, the Department was correct to use the best information available to determine Taxpayer's total and taxable sales for the tax years 2014, 2015, and 2016, as provided by IC § 6-8.1-5-1(b), since Taxpayer failed to keep documents it was required to keep under IC § 6-8.1-5-4(a). In the course of the protest process, Taxpayer was able to provide additional documentation and analysis to support its position that its cigarette sales were at a lower markup than that initially calculated by the Department. Taxpayer has met the burden of proving the proposed assessments wrong regarding the markup it placed on cigarettes it sold, as required by IC § 6-8.1-5-1(c). Taxpayer has not met the burden imposed under IC § 6-8.1-5-1(c) regarding the application of 2015 calculations to the other tax years.

FINDING

Taxpayer's protest is sustained in part, as provided above.

II. Tax Administration—Penalties.

DISCUSSION

Taxpayer protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Penalty waiver is permitted if a taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. [45 IAC 15-11-2\(b\)](#) clarifies the standard for the imposition of the negligence penalty as follows:

"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 standard for waiving the negligence penalty is given at [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.

Taxpayer protests the Department's assessment of penalties. After review of the documentation and analysis provided in the protest process, the Department does not agree that waiver of penalties is warranted. Taxpayer failed in its duty to keep sales records as required under IC § 6-8.1-5-4(a). While Taxpayer was eventually able to provide additional documentation to support its protest of the Department's calculation of base tax as provided in Issue I above, Taxpayer was not wholly sustained and some sales tax does remain due. Further, Taxpayer failed to keep its register's z tapes, which are necessary records for the determination and verification of total sales and taxable and exempt sales. Taxpayer has not affirmatively established that it exercised ordinary business care in this case. Therefore, waiver of penalties is not warranted under [45 IAC 15-11-2\(c\)](#). However, since base tax is being recalculated, penalties will also be recalculated to reflect the new amount of base tax.

FINDING

Taxpayer's protest to the imposition of penalties is denied.

SUMMARY

Taxpayer's Issue I protest regarding the imposition of sales tax is sustained to the extent of the supplemental audit's recalculations. Taxpayer's Issue II protest regarding the imposition of penalties is denied.

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