Audit Manual

May 2020

Indiana Department of Revenue

DISCLAIMER

The purpose of this manual is to provide general guidance to the public about the procedures employed by the Department of Revenue's Audit and Compliance Operations Division. The Department of Revenue reserves the right to depart from the procedures outlined herein, if the facts and circumstances of a particular audit warrant such a departure. Such departure will in no way undermine or invalidate any audit assessment where all applicable statutory and regulatory requirements are met.

This manual does not reflect changes in laws, regulations, notices, decisions, or administrative procedures that may have been enacted, issued or adopted since the manual was last updated. This manual and the information contained herein is not authorized to support any audit position or used as citation. The controlling statutes, regulations and case law should guide customers and the Department of Revenue auditors in presenting their respective positions when conducting an audit or investigation.

This manual does not constitute a public policy statement of the Department of Revenue. Moreover, this manual does not constitute written guidance by the Department of Revenue to the public at large or any specific customer.

The auditing methods and techniques suggested in this manual serve primarily as administrative guidance, and may not be appropriate, applicable or necessary for every audit. Auditors should use discretion when deciding which techniques to use in a particular audit and consult with their supervisors whenever unique factual patterns or legal issues arise.

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CHAPTER 1 OVERVIEW

ABOUT THE DEPARTMENT OF REVENUE

The Indiana Department of Revenue (DOR) has been serving Indiana and its diverse population and business community since 1947.

DOR's more than 700 dedicated team members administer over 60 different tax types and annually process more than $19 billion of tax revenue including:

- Processing millions of tax returns
- Handling pieces of correspondence and phone calls for hundreds of thousands of Hoosiers
- Completing thousands of diverse audits
- Addressing tax protests and legal issues
- Working in-person with individuals, business owners, tax preparers and a variety of stakeholders

The DOR headquarters is located in the Indiana Government Center North in downtown Indianapolis. Other locations include the Ameriplex complex west of Indianapolis, 11 District Offices throughout Indiana and 9 other states.

DOR conducts operations through eight internal divisions, each responsible for a specific business function:

- Office of the Commissioner
- Communications Division
- Finance Division
- Information Technology Division
- Revenue Inspector General
- Legal Division
- Tax Policy Division
- Operations Division

Meet the DOR's Leadership team at dor.in.gov/6276.htm.

DOR introduced new programs and initiatives in 2017 focused on improving the design, operation, management, and level of service for all DOR functions. As part of these initiatives, DOR has updated the mission and vision statements to provide forward-looking statements that are part of a big picture focused on continual improvement of DOR's culture.

Mission: To serve Indiana by administering tax laws in a fair, secure and efficient manner.

Vision: To be recognized as the premier tax administrator in the nation and a great place to work.

Pyramid of Excellence: DOR's Pyramid of Excellence serves as the guiding principles for all DOR's transformational initiatives – improving customer service, becoming passionate about continuous improvement and making DOR a great place to work.

Core Values

- Integrity
- Respect
- Fun!
- Service
- Teamwork
- Continuous Improvement
- Leadership

PURPOSE OF THE AUDIT MANUAL

The DOR Audit Manual provides a comprehensive overview of the procedures and guidelines available to aid in the completion of various types of audits.

The manual is a starting point for understanding audit procedures and guidelines. The manual is for members of DOR's Audit Operations Division to ensure consistency in conducting audits and preparing audit reports as well as a reference guide for customers. This manual should not be a substitute for good judgement, experience, and training in accounting.

New laws, regulations, court decisions, or changes in DOR's policies and procedures could affect the validity of the information contained in this manual at any given time. DOR will do its best to update the manual regularly to account for these external influences.

DOR Tax Audits
Completed by the Audit Operations team, tax audits verify the accuracy of the information reported by the customer and compliance with statutory requirements. Additionally, audits increase tax law education and understanding among customers and secure tax payments that are due to the State of Indiana. Audits are essential for the efficient administration of self- assessed taxes and for ensuring customers pay the correct amount of tax required by law.

An auditor will identify reporting errors and provide the customer with suggestions to avoid future errors in reporting. DOR has the right to examine any customer's records, including electronic records, to determine if taxes were properly calculated and paid.

DOR auditors are qualified and well trained, and expected to treat the customer with professional courtesy and respect. Auditors will need a place to work to complete the audit of customer's records, however if the customer cannot accommodate the auditors, an alternative audit location may be discussed.

DOR RESOURCES AND REFERENCE MATERIAL
Tax Library - Annual reports, information bulletins, legal resources, public hearings and other reference material can be found on DOR's website at dor.in.gov/3330.htm or in the Indiana Register in.gov/legislative/iac/irtoc.htm.

Subscribing to Updates - Subscribe to e-mail updates from DOR including the latest updates to DOR publications, notices, news releases, and other important news at public.govdelivery.com/accounts/INDOR/subscribers/new.

DOR Contacts - DOR e-mail addresses, phone numbers, and mailing addresses can be found on our website at dor.in.gov/3325.htm.

FinDOR - Legal FinDOR is a document retrieval tool designed for individuals with both legal and financial interest. The tool enables customers to search for and retrieve previously issued Letters of Finding, Memoranda of Decision, Final Orders Denying Refund, Revenue Rulings and Information Bulletins. Legal FinDOR can be found in the Tax Library under Legal Resources at https://legalsearch.dor.in.gov/km/Session/SignOn?ReturnUrl=%2fkm.

To access FinDOR, please use the following information:

Username: dorsearch
Password: dorsearch

CHAPTER 2 AUDIT DIVISION

AUTHORITY

The State of Indiana established the Department of revenue for the purpose of administering, collecting, and enforcing the taxes placed under its authority. (IC 6-8.1-2-1) The Department is under the control of the governor who shall appoint or employ the commissioner. (IC 6-8.1-2-2). The commissioner may establish within the Department various divisions to assist in the administration and collection of the listed taxes. (IC 6-8.1-4-1(a)) Subject to the discretion of the commissioner as set forth in subsection (c), the commissioner shall establish within the Department a division of audit. (IC 6-8.1-4-1(b)

AUDIT DIVISION POWERS AND DUTIES

As described in IC 6-8.1-4-2(a), the division of audit may:

- inspect any books, records, or property of any customer which is relevant to the determination of the customer's tax liabilities;
- detect and correct mathematical errors on taxpayer returns;
- detect and correct tax evasion; and
- employ the use of such devices and techniques as may be necessary to improve audit practices.

Upon request by DOR, a customer shall furnish to the Department a true and correct copy of any tax return that the customer has filed with the United States Internal Revenue Service. The customer under penalties of perjury shall certify the copy. (IC 6-3-4-6(a) and IC 6-5.5-6-5)

AUDIT OPERATIONS

Audit Operations is comprised of dedicated audit professionals located in Indianapolis, DOR's 11 Indiana District Offces, and in select locations across the United States. The Audit Operations team is responsible for conducting audits of individual and business taxes. The team designs and executes efficient and consistent audit processes, focused on increasing tax education and understanding, and to support the DOR Policy, Legal, and Operations Divisions.

Audit Group

The audit group consists of auditors located in the Indiana Government Center, in district offices located in Bloomington, Clarksville, Columbus, Evansville, Fort Wayne, Kokomo, Lafayette, Merrillville, Muncie, South Bend, and Terre Haute, and in several cities across the United States.

AUDIT AND COMPLIANCE SUPPORT

The Audit and Compliance Support Division is comprised of over 50 specialists in desk audit, analytic, and audit support functions, such as audit selection, quality assurance, billing, computer assisted audit support, and protest support. The support team also coordinates all audit training and process improvement activities within the audit operations team.

Desk Audit

The desk audit group typically performs audits that are limited in scope to a specific tax issue, income tax deduction, credit, exemption, etc. The desk audit group is located at the Indiana Government Center in Indianapolis.

Computer Audit Specialists

The Computer Audit Specialist (CAS) Group within audit operations is responsible for assisting the auditor in reviewing and analyzing electronic records. The CAS group assists the auditor in minimizing the number of records reviewed and in improving the effectiveness and efficiency of the audit process.

Audit Selection

The audit selection group facilitates the selection of potential audit candidates through the analysis of internal and external information, historical data and prior audits. The audit selection group provides the data obtained during the selection process to the audit support team. Before assigning a case to an auditor, the support team further analyzes the data. Depending on the individual circumstances involved in each case, DOR conducts either a full scope or limited scope examination.

Quality Assurance

The Quality Assurance team performs a detailed examination of each completed audit report to make sure that a quality audit report reaches the customer. They do this by ensuring that all audit adjustments are thoroughly explained, well supported, and justified by statute, regulation, or Departmental policy. The Quality Assurance team also serves an internal control function for audit operations ensuring proper checks and balances to the audit process, and consistency in treatment of similarly situated taxpayers.

Audit Training

The audit training team is comprised of highly skilled and experienced trainers who were former auditors. The training team develops and delivers training modules along with job aids for the entire audit group.

Protest Support

The protest support team provides support to the audit group, legal division, and our customers throughout the protest process. For complete information on how to file an appeal and other information about the appeals process, refer to the dor.in.gov/5691.htm. For a copy of the protest guide, please refer to dor.in.gov/files/dor-protest-guide.pdf.

When a customer files a written protest, that protest is generally resolved with the issuance of a written document that makes the DOR's final determination on the protest. In some instances, when a customer provides additional documentation in the appeals process, the customer and/or the Legal Division may ask for a review of that new documentation to resolve factual/documentation type issues before the protest continues in the appeals process. When completed, the Protest Support's interim review returns to the Legal Division for a final review before sharing with the customer. The goal of this interim review is to focus the appeal to only the unresolved issues of the case.

The protest support team is also responsible for completing supplemental audit reports that incorporate the final determinations of administrative appeals or tax court decisions when the final determinations are litigated. The supplemental audit report is mailed to the customer and the bill related to the resolved issue is revised when appropriate.

Fraud, Compliance, and Analytics

The Fraud, Compliance and Analytics Division is a specialized service team that uses data and sophisticated analytics to improve DOR decision making, enhance business processes, protect the identity of Indiana citizens, and guard against fraud.

Non-Filer Program

In 2014, as part of its strategic goal of increasing compliance to create a level playing field for all taxpayers, the Department initiated a compliance program aimed at pinpointing non-filing and other non-compliant taxpayers in Indiana. To implement this program, various data sources are combined and analyzed. This includes data from the IRS and other state agencies.

This effort has improved the overall rate of compliance and ensures that all individuals in Indiana are treated consistently and properly report income earned in Indiana. This program also ensures that counties receive the correct amount of funding as they do not receive their funds until a tax return has been filed, regardless of whether or not the withholding was remitted to the Department from the individual's employer.

Common issues include domicile, taxability of cancellation of debt income, and issues with the homestead credits. Each case has very specific facts and circumstances requiring special consideration. In response to numerous questions on this program, the Department revised regulations and guidance to provide clarification on the domicile / residency issue. These revisions were recently published in the Indiana register.

After determining a preliminary non-filer status, the Department contacts those taxpayers via letter. Indiana statute requires that a notice be sent to the taxpayer 30 days before a liability is created. In accordance with this statute, RPS creates a 30-day notice notifying the customer that it appears they have failed to file a return for a specific tax year. These letters encourage customers to either file the missing return for the periods noted or to contact the Department to discuss why a return was not filed.

If an individual receives a letter from the Department, it is important that they contact the Department early in the process to begin working with one of our analysts. We have a designated call center phone number and address for this program to route these issues to analysts that have been specially trained to handle these issues.

CHAPTER 3 TAXPAYER RIGHTS AND RESPONSIBILITIES

TAXPAYER'S BILL OF RIGHTS

The Taxpayer's Bill of Rights, established by IC 6-8.1-1-8 and Public Law 332-1989(ss), ensures that all customers have certain rights and responsibilities that correspond to the Indiana tax laws. The Taxpayer Bill of Rights sets forth the following rights and responsibilities for the Indiana Taxpayer:

1. Quality Taxpayer (Customer) Service

DOR has developed a two-part system to provide best-in-class customer service. DOR provides walk-in customer service centers, as well as a full-service telephone staff. Representatives throughout the state and in the main office in Indianapolis are equipped to answer questions, assist customers in filing Indiana tax returns and provide support with other general tax information.

Customers can find the status of their individual tax refund or get answers to common tax questions by calling DOR's information line at 317-233-4018. The line is available Monday through Friday, 8 a.m. to 4:30 p.m. EST. For additional information, visit dor.in.gov.

2. Preservation of Taxpayer Rights

State law provides taxpayer advocates who ensure the protection of customer's rights. The Indiana Taxpayer Advocate Office (TAO) provides an avenue for the successful resolution of customer problems that have not been resolved through normal channels. TAO also researches and resolves hardship claims, offers-in-compromise and customer complaints. The advocate brings about resolution as a final resource for the customer.

3. Customer Education and Information

Through online and print media, outreach programs, and press releases, the Communications Division helps familiarize customers with new legislative and administrative changes, tax preparation tips, and more. The Division includes both internal and external communications to ensure the sharing of information in a timely manner both within and outside of DOR.

4. Fair Collection Process

DOR provides notices (billings) when taxes are due. For more information, visit dor.in.gov/3959.htm.

5. Appointed Hearing Time and Representation

The customer reserves the right to protest a liability, with a few exceptions. All protests must be in writing and received within the 60-day protest period. If the customer protests a liability, DOR may conduct a hearing on that case. When the case is presented, the customer is entitled to representation at the hearing.

6. Demand Notices

When a liability is not paid or protested within 60 days of the first notice, DOR will issue a "Demand Notice" for payment before issuing a tax warrant. A Demand Notice includes:

- A 20-day notice requiring the customer to either pay the liability or prove reasonable cause for not paying.
- The statutory authority of DOR to issue a tax warrant.
- The earliest date a tax warrant may be filed and recorded.
- How customers may prevent a lien against their property.

7. Warrants for Collection of Tax

When DOR does not receive a response to the Demand Notice within 20 days, a warrant for the collection of tax follows. When a tax warrant is filed with the customer's county clerk, the warrant becomes a judgment (lien) against all of the customer's property within the county or counties.

8. Judgment Liens against Property
When a warrant becomes a judgment lien or levy against the customer's property in that county, it is also a public record. The sheriff is responsible for collecting on a judgment lien. The amount of a judgment lien equals the amount of tax due, penalties, interest, collection fees and the clerk's cost and damages. In order to collect the amount due, the sheriff may sell the customer's property, garnish the customer's wages or levy bank accounts.

DOR may release a lien against property if the cost of selling it is greater than the tax liability or if the sale would not reduce the liability by either 10% or $1,000.

9. Annual Public Hearing and Department Report
DOR conducts an annual hearing before July 1 of each year. The purpose of the hearing is to provide customers with an opportunity to recommend changes in statutes and Departmental policies, processes and procedures. An announcement about the public hearing is included in the individual and corporate income tax booklets (IT-20, IT-40 and IT-40PNR) found on the DOR's website at dor.in.gov/3489.htm.

DOR also submits an annual report (dor.in.gov/3600.htm) to the Governor each year on October 1. The annual report outlines the agency's accomplishments with statistics about the audit process, and recommendations for improving customer compliance and DOR administration.

RESPONSIBILITIES AS AN INDIANA TAXPAYER

- File tax returns and pay any taxes due on time.
- Notify DOR in writing when the customer has an address change.
- Know the tax laws that relate to the customer as an individual or a business, and comply with those laws.
- Contact DOR if customers have any questions or concerns.

RIGHT TO REPRESENTATION

Customers may authorize another person to represent them at any time during an audit by submitting a Power of Attorney form (POA-1) to DOR. The customer (or an individual authorized to execute the Power of Attorney on the customer's behalf) must sign a properly completed POA-1 form. Once the customer executes a Power of Attorney, DOR will communicate primarily with the customer's representative.

A properly completed POA-1 form must be submitted to DOR as follows:

- By mail with a hardcopy of the original to: Indiana Department of Revenue
  P.O. Box 7230
  Indianapolis, IN 46207-7230
- By fax as a copy of the original: (317) 615-2605
- Submitted electronically through INTIME, the Department's online service portal

DOR accepts faxed copies of original Power of Attorney forms. When providing a copy, the person forwarding the copy certifies, under penalties for perjury, that the copy is a true, accurate, and complete copy of the original document.

In addition, a company cannot be named on the POA-1 form; by law, DOR can accept only an individual's name as a POA representative. The POA-1 form is effective for 5 years from the date signed on the form. Therefore, every five years customers need to renew the POA to continue any DOR communication with the customer's representative. A subsequent Power of Attorney alone will NOT revoke a prior Power of Attorney.

Revocation of a POA before expiration requires a written and signed notice.

TAXPAYER ADVOCATE OFFICE

The Taxpayer Advocate Office (TAO) was established in accordance with Public Law 332-1989(ss), to assist customers with complex and unusual tax situations that could not be resolved through the normal collection process.

Areas of focus for TAO include:

- Complaints and complex tax issues that have not been resolved through the normal areas of DOR;
- Hardships with financial or medical situations that do not allow a customer to pay within the normal time limits offered;
- Offers-in-compromise that include an offer from the customer to satisfy the tax bill for a lesser amount; and
- Warrant expungement requests and service members in active duty status with tax debts.

For a complete list of assistance provided by TAO, visit dor.in.gov/3883.htm. TAO may be reached by phone at (317) 232-4692, by email at taxadvocate@dor.in.gov or by mail at:

Indiana Department of Revenue Attn:
Taxpayer Advocate Office
P.O. Box 6155
Indianapolis, IN 46206-6155

CHAPTER 4 AUDITOR EXPECTATIONS AND RESPONSIBILITIES

OVERVIEW

The auditor has the responsibility to plan and perform the audit to determine if the tax return information and tax liability reported to DOR is reliable and free from error or fraud. The auditor also helps the customer gain a better understanding of the governing tax laws. A DOR auditor may conduct audits at a customer's place of business, a DOR designated office, or other location as agreed upon by both parties (e.g., designated Power of Attorney's place of business). The chosen location, however, may not be a personal residence.

The DOR auditor may perform any or all of the following functions:

- Review any available information with respect to the customer, before beginning the audit. Refer to Chapter 6 for pre-audit procedures;
- Maintain a chronological list of audit events, as they occur, in the case history log;
- Schedule a pre-audit interview with the customer and/or his/her authorized representative;
- Complete a pre-audit questionnaire with the customer and/or his/her authorized representative;
- Tour the business facility;
- Determine the initial audit approach to be used based on the nature of the business, recognizing that procedures may change as the audit progresses;
- Identify and review returns for any related party to determine if an audit of the related party is necessary;
- Conduct appropriate audit tests, including sampling, to determine whether the customer's records accurately reflect the business activity and whether the data reported on the tax returns is reliable;
- Compute the dollar amount of any tax assessments and summarize the basis for any assessment in the audit report and the audit work papers;
- Hold a post-audit conference with the customer (and/or POA) to present the audit findings; and
- Prepare the audit report.

CONFIDENTIALITY

DOR auditors are required to treat customer information with heightened security to ensure the protection of customers' identities. Information privileged by law in an auditor's possession remains protected and privileged at all times. Auditors shall protect the confidentiality, integrity, and security of all customer information.

Permission to access or request customer information from any DOR information system is limited unless the auditor has a clear job-related reason for accessing such information. Auditors shall only disclose protected information to a person entitled to receive that information.

COMPETENCY

DOR auditors shall provide services within the parameters of their education, training, licensure, professional experience, and job duties. Under no circumstances shall an auditor misrepresent any law or fact, or represent a law or fact outside the scope of his/her knowledge.

INTEGRITY

DOR employees are required to carry out their duties and responsibilities in an objective manner in accordance with federal and state laws, and DOR rules, policies, and established procedures. Furthermore, DOR employees are required to treat everyone, including customers, colleagues, and members of the general public, in a respectful, honest and fair manner.

As with all citizens, auditors are expected to obey all federal, state, and local laws and be particularly attentive to those laws that, if violated, would bring public criticism or disfavor upon DOR. In particular, auditors must abide by all federal, state, and local tax laws, file their tax returns in a timely manner, and promptly pay any tax due or otherwise resolve the liability.

CONFLICTS OF INTEREST

DOR employees may not participate in discussing, examining, investigating, surveying, or auditing customer information when there is any financial interest in the outcome. A DOR employee assigned a case or tax return that might create a real or apparent conflict of interest must immediately bring this matter to the attention of the employee's supervisor. Penalties prescribed by statute for established violations include both a fine and/or imprisonment.

DOR employees should never initiate, terminate, or in any way modify audit actions based on requests from non-DOR executive branch employees. DOR employees should always consult with their supervisor if anyone requests actions related to ongoing or potential audits, examinations or investigations. In addition, DOR employees may not accept gifts, favors, services, entertainment, food or drink that could influence their actions as a state employee.

When assigned a case, the auditor is responsible for reporting any potential conflicts to their supervisor. The supervisor is responsible for reassigning the project to an employee unaffected by a potential conflict. If a conflict is identified, the employee must notify DOR's Ethics Officer so that appropriate steps can be taken, including filing a conflict notice with the OIG, or filing a disclosure with the OIG. For more information, refer to the Indiana Code of Ethics at http://www.in.gov/ig/2336.htm.

DATA SAFEGUARDS

To safeguard customer data from potential threats, when a customer provides the auditor with requested data, the auditor will take the necessary precautions to ensure the customer information remains confidential and properly protected according to the law and DOR established protocol.

Physical Storage

The auditor will store customer-sensitive data in a secure location, such as a locked filing cabinet. The auditor will not leave customer information unattended or unprotected as required by law and DOR protocol.

Electronic Storage

Electronic data containing customer confidential information will only be stored in designated databases and secure storage spaces approved by the DOR Security Team. Such data can also be temporarily stored on DOR issued desktops or laptops that possess appropriately encrypted hard drives, for clear job-related reasons.

Email

Any confidential information transmitted electronically to the auditor must be sent through DOR's secured email system or uploaded through INTIME, the Department's online service portal.

Document Shredding

Original source documents provided during an audit will be returned to the customer. Other paper document copies will be:

1. returned to the customer,
2. shredded, or
3. placed in a secure receptacle marked for shredding.

CHAPTER 5 GENERAL INFORMATION

ACRONYMS

- DN: Departmental Notice
- DOR: Department of Revenue
- FEIN: Federal Employer Identification Number
- FID: Federal Identification Number
- FTI: Federal Tax Information
- IAC: Indiana Administrative Code
- IB: Information Bulletin
- IC: Indiana Code
- IDR: Information Document Request
- IRC: Internal Revenue Code
- IRS: Internal Revenue Service
- OIG: Office of Inspector General
- POA: Power of Attorney
- RFI: Request for Information
- SSN: Social Security Number
- TID: Indiana Customer Identification Number
- AGI: Adjusted Gross Income

GENERAL TERMS

Commissioner: Refers to the Commissioner of DOR. Pursuant to Indiana Code 6-8.1-2-2, the governor shall appoint or employ the Commissioner.

DO: District Office. DOR has 11 full-service District Offices throughout the State of Indiana.

BT-1: Business Tax Application -The application that allows a customer to open a new business or add a tax type and/or location registration to an existing state account.

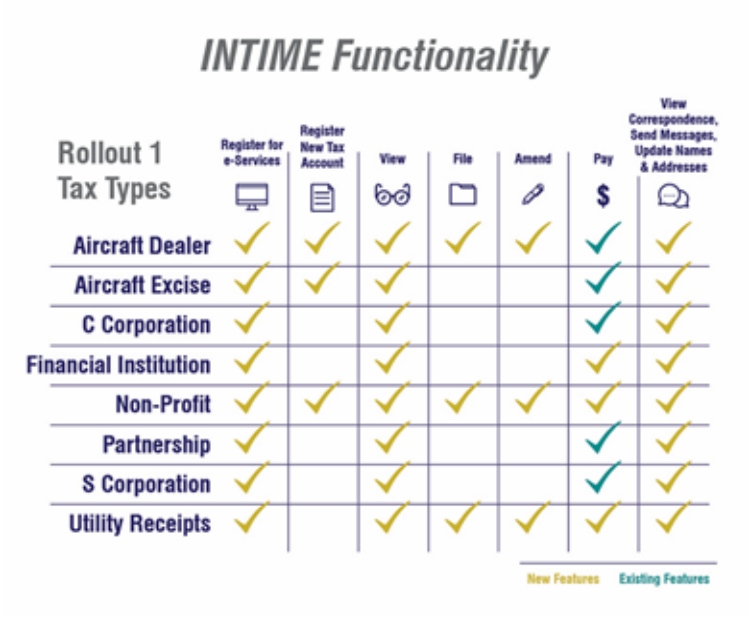
DBA: Doing Business As – an "assumed name" different from the legal registered name of the business.

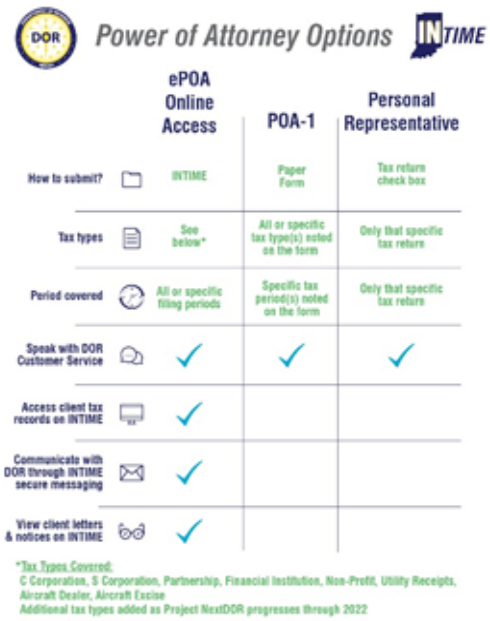
INtax: DOR's online business tax reporting and payment application for certain business taxes that may be used by business customers and preparers. Giving customers direct access to all business tax accounts, ability to file and pay Indiana taxes, and more. Guides are available for customers and tax professionals at www.in.gov/dor/4336.htm.

INBiz: The one-stop resource for registering and managing customer business and ensuring compliance with state laws and regulations: www.inbiz.in.gov.

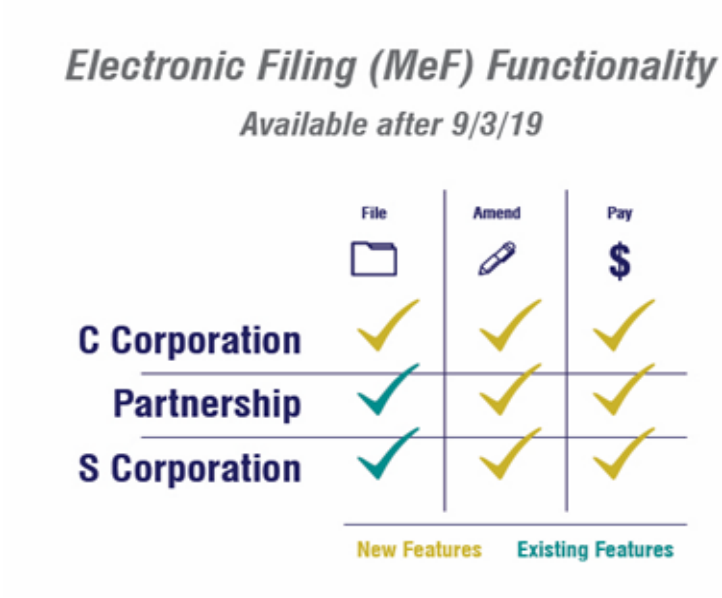
INTIME: The new online service portal, called the Indiana Taxpayer Information Management Engine (INTIME), offers expanded functionality for designated tax types in Rollout 1 of Project NextDOR as noted in this first chart. Project NextDOR is DOR's multi-year modernization effort which will completely replace the current system used to process taxes.

INTIME provides the option to submit an electronic Power of Attorney (ePOA) to streamline the establishment of a POA relationship as noted in the second chart.





Other designated tax types in Rollout 1 benefit from electronic filing (MeF) as noted in this chart.



Confidential Taxpayer (Customer) Information: All information that requires confidentiality and heightened security to ensure the protection of a customer's identity. This information includes all FTI, State Tax Returns, SSNs, FIDs, FEINs, full credit card numbers, bank account numbers, mother's maiden name, and medical information.

In addition, this information includes any combination of two or more of the customer's:

- Full address
- Telephone number on file with DOR date of birth
- Place of birth
- TID
- Document Locator Number
- Driver's License number
- Payment Locator Number
- Financial transactions
- Employment history
- Amount owed to the state

EXTENDING THE STATUTE OF LIMITATIONS

The auditor is responsible for checking the state's rights under the statute of limitations (SOL) by identifying years open to statute and approaching statute expirations. However, the customer and the Department may enter into a written agreement, before the expiration of the statute, to extend the time of assessment or refund for a reporting period. Under IC 6-8.1-5-2(h), the written agreement must contain the following:

1. the date to which the extension is made; and
2. a statement that the person agrees to preserve the person's records until the extension terminates.

INFORMATION DOCUMENT REQUEST (IDR)

Auditors use IDRs to request information during an audit. Auditors must fully document the audit process in the audit file through case log entries, email and IDRs. IDRs may be issued in varying formats depending on the nature of the request and the customer's preferred method of communication including email or an official request for information on form (Form AD14A). Customers must respond to document requests by the date indicated on the IDR.

INTEREST AND PENALTY

Taxpayer Requested Refund and Related Interest Calculation

A customer may claim a refund for an overpayment of state taxes by filing a return or amended return, or a Claim for Refund form (GA110L). Chapter 15 of this manual details the refund claim process.

P.L.242-2015 amended IC 6-8.1-9.2 for interest accruing on refund claims filed on or after July 1, 2015. General Tax Information Bulletin #101 (dor.in.gov/reference/files/gb101.pdf) details procedures: *"when it is determined that a person paid more tax than is legally due, the Department shall apply the amount of the overpayment against any outstanding liability for a listed tax as listed in IC 6- 8.1-1-1. If any excess remains after the Department has applied the overpayment against other outstanding liabilities, the Department shall either refund the amount to the person, or at the person's request, credit the amount to the person's future tax liabilities."*

Audit Generated Refunds and Related Interest Calculation

During an examination when the auditor determines the customer has overpaid a tax and is due a refund in an audit, the auditor writes a report and the Department through the Auditor of State issues the refund check. In this scenario, no interest is paid.

Audit Generated Assessments and Related Interest Calculations

During an examination when the auditor determines the customer has underpaid a tax and generates an audit assessment, the customer receives an audit report and an audit billing. In this scenario, the amount due is delinquent and, therefore, interest will be calculated on the audit billing.

Interest Rates and Calculations

Interest is paid on certain overpayments/refunds based on the average investment yield on state money for the state's previous fiscal year. The following table shows the interest rates used for the past decade. You may view the Departmental Notice #3 at (dor.in.gov/files/dn03.pdf) for more information.

Year	Overpayments/Refunds	Delinquency Payments
2019	**3%**	**3%**
2018	3%	3%
2017	3%	3%
2016	2%	2%
2015	3%	3%
2014	3%	3%
2013	3%	3%
2012	4%	4%
2011	9%	9%
2010	4%	4%

Audit Generated Assessment and Penalty

During an audit or examination when the auditor determines the customer has additional tax due, the auditor writes an audit report and generates an audit billing. In this scenario, depending on the facts and circumstances of the case additional penalties could apply. Examples of penalties that may apply are as follows:

- Liability for penalty – 10% or $5, whichever is greater.
- Failure to file a tax return; preparation by Department – 20% penalty.
- Failure to file a tax return; fraudulent intent to evade tax – 100% penalty.
- Faulty payment (i.e., bad checks) – penalty of 10% of the unpaid tax or the value of the faulty payment, whichever is smaller for the first 10 days, after that a 30% penalty multiplied by the value of the payment or unpaid tax, whichever is smaller.
- Failure to file information return – a penalty of ten dollars ($10) for each failure to file a timely return, not to exceed 25 thousand dollars ($25,000) in any one (1) calendar year, is imposed.
- Failure to include non-resident partner or shareholders in a composite return schedule – $500, AND 20% of any amount required to be withheld as composite tax due that is not remitted timely.

POSTMARK RULE IC 6-8.1-6-3

All tax returns, forms, payments or documents mailed through the USPS have the postmark date as the filing date. When delivered to the Department through any other means other than United States Mail, the filing date will be the date the Department physically receives the document. When using electronic fund transfer, the filing date will be the date the customer issues the payment order for the electronic fund transfer.

TRUST TAXES

Sales tax, withholding tax, food and beverage tax, and county innkeeper's tax are examples of trust tax. With trust taxes, the business acts as an agent for the state and collects the taxes due. The business must file the tax returns and remit the tax due to the state. Bankruptcy does not relinquish liability for non-remittance of trust tax. More information on each tax is available on the DOR website at dor.in.gov/3335.htm.

RESPONSIBLE PERSONS

A Responsible Officer is a person assigned and duly authorized to administer an entity's trust tax matters. This could be the CEO, President, Executive Vice President, COO, CFO, Director of Finance, Treasurer or any other person designated as an officer or rank-and-file employee of the entity. A responsible person may be held personally liable for any trust taxes not remitted. The responsible officer information can be updated with DOR by submitting a completed ROC-1 form.

BANKRUPTCY

A corporation or individual in financial difficulty may elect to file for bankruptcy protection. In the event of bankruptcy, the customer should provide the auditor with the type of bankruptcy, filing date, case number, court where bankruptcy was filed and bar date when known.

The auditor must contact the Bankruptcy Section to determine if a claim has been filed and identify the periods that an audit may be conducted. Bankruptcy Section can file a claim with the courts up to the bar date, based on the customer's estimated tax liability. The claim may be amended downward after the bar date, but cannot be increased.

CHAPTER 6 PRE-AUDIT PREPARATION

PRELIMINARY REVIEW OF CUSTOMER'S RECORDS AND TAX RETURNS

Pre-Audit preparation is the first step before an official audit. With the assistance of the audit support team, the auditor gathers documents and records relevant to the customer's business. The auditor reviews and verifies:

- Customer's contact information and entity type;
- Returns filed with DOR or with the IRS;
- Prior audit files including any related protest final determinations or settlement agreements;
- Information on file with the Secretary of State
- Information from the customer's website
- Publicly available information such as SEC Filings, etc.
- Any claim for refund filed in the prior three years

Through this review, the auditor has the goal of understanding the nature and extent of the customer's business, location(s), hours of operations, special promotions, or other information relevant to the audit. In addition, the auditor notes any discrepancies or concerns to discuss with the customer during the audit or the pre-audit interview.

DEVELOPING THE AUDIT PLAN

Having gathered all the necessary background information, the auditor develops the audit plan that includes:

- The tax type and period under audit;
- The preliminary approach to be used to audit each tax;
- The method for verifying taxable sales, deductions, returns and allowances or other credits;
- The method for testing the validity of exemptions and nontaxable deductions;
- The method for the verification of fixed asset accruals to be examined in its entirety when possible;
- Tracing use tax accruals to the payment register; and
- With respect to expense accruals for Sales and Use Tax audits the sample period and accounts to be examined.

INITIAL CONTACT LETTER

After the pre-audit preparation work is completed, the auditor will prepare and mail the initial contact letter to the customer at the address on record. This letter indicates the tax type and period under audit with any applicable fees. The letter will also provide the customer with the auditor's contact information and next steps.

INITIAL CONTACT-PHONE CALL/EMAIL

The auditor will contact the customer by phone call and email. This discussion should address the customer's initial questions and concerns while resulting in an appointment for either the pre-audit interview and/or audit appointment. The auditor should provide a brief explanation of the audit process and gather additional basic information about the customer. The pre-audit interview can be conducted during the initial call or scheduled for a later date, dependent on the complexity of the business or availability of the customer.

After the initial phone call, the auditor sends a confirmation letter to the customer with appointment dates and a list of records required for the audit.

PRE-AUDIT INTERVIEW, TOUR, AND PRE-AUDIT QUESTIONNAIRE

Before the start of the audit, the auditor must conduct a pre-audit interview with the customer. The interview can be in person, by telephone conference, or via email. A tour of the facility may be required in conjunction with the interview or official audit. The purpose of the interview and tour is to establish a professional rapport with the customer and/or the authorized representative, and to gather an understanding of the customer's business, accounting systems, and any other information relevant to the audit such as the customer's affiliates, if any. The auditor may use a pre-audit questionnaire to record detailed responses from the customer. To gain a better understating of the business, the auditor will request information such as a chart of accounts, Departmental listing, organizational chart, list of the responsible officers, etc. maintained on the audit file. The auditor should also note the name, location, and authority of each person involved in the audit. With respect to sales and use tax audits (and potentially other tax types or income tax credits or deductions); the pre-audit interview includes a discussion of sampling options.

If during the pre-audit interview, the customer indicates being audited by the IRS but did not report the results to the Department, the auditor may obtain the relevant federal audit report and adjust the customer's returns accordingly as part of the audit.

DISCUSSING CUSTOMER'S RECORDS AND RECORDKEEPING SYSTEMS

Items the auditor may discuss with respect to the customer's records and recordkeeping systems include:

- The location of the records to be examined;
- The volume of those records;
- The manner in which the records are filed (e.g., filed alphabetically by vendor or by sales invoice);
- The availability of federal income tax returns, excise tax returns, financial statements, corporate minutes, and depreciation schedules;
- The records that are available electronically;
- The customer's process for producing, handling, recording, and filing source documents;
- The customer's system for identifying, recording, and reporting taxes; and
- The customer's method for identifying Indiana sales and sales in other states.

DISCUSSING CUSTOMER'S ACCOUNTING PRACTICES

Items the auditor may discuss with respect to the customer's accounting practices include:

- Internal control used by the customer to ensure the accuracy and completeness of the records;
- The customer's accounting period (calendar year or fiscal year) and whether the customer maintains a detailed and descriptive chart of accounts;
- The customer's policy for capitalizing fixed assets
- Whether the customer has a use tax accrual account, how the customer codes invoices to indicate that use tax was accrued, and how the customer calculates the use tax due.

EVALUATING INTERNAL CONTROLS

In certain circumstances or for specific tax types, the auditor may evaluate internal controls for strengths and weaknesses that could affect tax collection and/or reporting. Items the auditor needs to evaluate include whether there is a clearly defined segregation of duties, an adequate system of authorization, and supervision of duties. To be effective, internal control requires an adequate division of responsibilities. Depending on the size of the business, ideally, separate employees will perform each of the four major duties:

1. Authorization or approval,
2. Custody of assets,
3. Recording transactions, and
4. Periodic reconciliations.

CHAPTER 7 WITHHOLDING TAX AUDITS

WHAT TO EXPECT FROM A WITHHOLDING TAX AUDIT

The purpose of the withholding tax audit is to determine whether the proper amount of state and county taxes are withheld, reported, and remitted to DOR. Generally, the withholding tax audit is completed in conjunction with the sales and use and income tax audits. This section of the audit manual provides a general overview of the procedures employed by auditors in the examination of withholding taxes (state and county income taxes). Specific guidance on the withholding tax requirements for businesses can be found on the DOR site at dor.in.gov/3988.htm.

WITHHOLDING TAX OVERVIEW

Definition and Liability of a Withholding Agent

Employers making payments of salaries, wages, tips, fees, bonuses, and commissions that are subject to Indiana state and/or county taxes, and are required by the Internal Revenue Code to withhold Federal income tax on those types of payments, are considered withholding agents. As a withholding agent, customers are responsible for withholding Indiana state and county income taxes from payments made to employees. Withholding tax, a trust tax, must be paid to DOR by the due date. If a customer does not file a return and/or pay the proper amount of tax withheld by the due date, penalty and interest will apply. Failure to pay and/or file a withholding return due to fraud or tax evasion may result in criminal prosecution.

State Form WH-4

The withholding agent is required to obtain from each employee a completed Form WH-4, Employee's Withholding Exemption and County Status Certificate. The information included on this certificate tells the withholding agent the number of exemptions each employee is claiming and for which county (if any) county tax is being withheld. The employer should keep this certificate on record for verification purposes. Employees should update their WH-4 by Jan. 1 of the following year if their county of residence or county of principal employment changes and at any time the total exemption changes.

How to Figure State and County Income Tax

Departmental Notice (DN#1) at dor.in.gov/files/dn01.pdf, is updated in September (effective 10/1) and December (effective 1/1) and provides instructions on how to compute the amount of state and county income tax to be withheld from an employee's earnings every pay period and a listing of local income tax rate.

When Form WH-4 indicates that an employee was a resident of an Indiana county, the employer must withhold county tax on payments made to the employee using the tax rate for that county (found on DN#1). However, if Form WH-4 indicates an employee was not a resident of an Indiana county, then the employer must look at the county of principal employment or workplace (if self-employed) and withhold on payments made to the employee using that county's tax rate. The county of residence and the county of principal business (or employment) as of January 1 of each year. Therefore, if an employee moves to a different county or changes the county of employment during the year, the county withholding requirements will not change until January 1 of the following year. When both the county of residence and the county of principal employment from Form WH-4 are not listed in the bulletin (county outside of Indiana as of January 1), the employer will not withhold any county tax for that employee.

Reciprocal Agreements and Form WH-47

Residents of Kentucky, Michigan, Ohio, Pennsylvania, and Wisconsin who earn wages, salaries, tips, and commission income from a principal business or employment in Indiana are exempt from Indiana state income tax because Indiana has a reciprocal agreement with these states. Residents of these states working for Indiana employers should complete a certificate of residence (Form WH-47). This certificate is an affidavit of the employee's state of legal residence, providing proof that no withholding of Indiana state income tax is required.

The employer should keep Form WH-47 on record but does not need to file with DOR. Note: Reciprocal agreements do not affect county taxation. The employer must withhold county tax if the county of principal employment of the nonresident employee is listed in DN #1.

Every partnership and small business corporation is required to withhold Indiana adjusted gross income tax on amounts paid or credited to its nonresident partners or shareholders. This is true regardless of reciprocal agreements between Indiana and the partner or shareholder's resident state. If their county of principal business or employment on January 1 is listed on DN #1, then county income tax must also be withheld.

Withholding by Trusts and Estates

When Indiana income (except income from interest or dividends) is distributed to a nonresident beneficiary, trusts and estates are required to withhold state income tax.

REGISTRATION OF NEW WITHHOLDING AGENTS

New employers are required to register as Indiana withholding agents and to obtain an Indiana Taxpayer Identification Number (TID) using the state's one-stop source for businesses, "INBiz" at inbiz.in.gov. Withholding agents are required to remit and report withholding payments through "INtax" at intax.in.gov.

DOCUMENTATION REQUESTS

The auditor will provide the customer a written request for specific documents needed for the withholding tax audit. Examples of the documentation the auditor may request for each audited year include:

- W-2s and 1099s for all employees and subcontractors;
- Federal Annual Withholding Tax Returns, Form W-3;
- Indiana forms WH-4 and WH-47;
- Indiana Withholding Tax Returns, Forms WH-1 and WH-3;
- Payroll reports;
- A complete listing of employees, their principle work location and county of residence as of January 1;
- Commissions, bonuses, fringe benefits, and other payments made to employees or other contractors;
- Description of an employee/contractor's work activity;
- Any other records necessary to verify the proper amount of tax was withheld and reported to DOR.

WITHHOLDING TAX AUDIT PROCEDURES

The auditor performs audit procedures deemed necessary during a withholding tax audit, including:

- Review of W-2 forms for the audit period to determine if the proper amount of state and county tax was withheld from employees who worked in Indiana during that time.
- Review of annual recap forms W-3 and WH-3, and prepare an analysis of total wages and withholdings per Forms W-2 and WH-3 and reconcile them to DOR reports.
- Review any 1099s to ensure the recipients were actual independent contractors (not W-2 employees).
- Review source documents such as payroll checks, work logs, etc. to verify wages or other compensation.
- Perform an analysis of reported wages to determine reasonableness based on the customer's business operations.

In addition to the list above, the auditor may employ other audit techniques and procedures deemed necessary.

CONCLUDING THE AUDIT

Post-Audit Conference

The auditor will schedule a post-audit conference after the initial fieldwork is complete. The purpose of the post-audit conference is to discuss and provide work papers for the audit adjustments (if applicable), discuss follow-up requirements, and establish deadlines for requested information. See Chapter 13 of this manual for further information on audit work paper presentation.

The auditor may also provide information bulletins or other reference material for further explanation of the proposed adjustments. Additional post-audit communication may be necessary to address any issues, provide additional documentation or to clarify questions before finalizing the audit.

Final Conference

Once the audit has concluded, the auditor will schedule the final conference. If no additional time is required to address any issues/concerns or gather additional documentation, the final conference may occur at the same time as the post-conference. The final conference is to inform the customer that the fieldwork for the audit is complete, discuss the results of the audit, and to notify the customer a written report of the findings will be issued. The auditor will also obtain final signatures on any required forms and provide a copy of the Protest Guide, available at dor.in.gov/files/dor-protest-guide.pdf.

If more than one tax type is reviewed as part of the Indiana Tax Audit, the post-audit and final conferences may occur at the same time for all tax types. Further information on the final conference and DOR's protest procedures is provided in Chapter 11 of this manual.

Audit Report and Billing Process

When a withholding tax audit results in no changes to the reported tax, and is performed in conjunction with a sales and use tax audit, the customer will not receive a separate audit report for the withholding tax audit. The auditor will include a brief statement on the sales and use tax audit report indicating the withholding tax returns were reviewed and no discrepancies were found.

If changes to the reported tax are necessary, the auditor will prepare a written report of the findings and submit the report for approval and billing with DOR before being sent to the customer. The audit bills and the official audit report is mailed to the customer at the address on file or as requested during the audit; if applicable, a copy of the audit report will also be e-mailed to the power of attorney.

WITHHOLDING TAX REFERENCE MATERIAL

1. Departmental Notice #1–How to Compute Withholding for State and County Income Tax
2. Departmental Notice #5–Reporting Employee Taxes Withheld
3. Departmental Notice #16–Withholding of Tax on Riverboat Gaming Winnings
4. Tax Policy Directive #5–Withholding on Nonresident Individual Partners and Shareholders Who Are Domiciled in a Reverse Credit State
5. Income Tax Information Bulletin #88B–Income Tax Liability and Withholding for Race Teams
6. Income Tax Information Bulletin #13–Withholding of Adjusted Gross Income Tax on Retirement Pay
7. Income Tax Information Bulletin #16–Use of Federal Form W-2 for Reporting Indiana State and County Taxes Withheld
8. Income Tax Information Bulletin #33–Withholding Requirements for Nonresident Employees
9. Income Tax Information Bulletin #52–Withholding Information for Part-Time Employees and Other Miscellaneous Withholding Requirements
10. Income Tax Information Bulletin #86–Independent Contractors Responsibility for Income Tax Reporting and Withholding
11. Frequently Asked Questions on the DOR website IRS Publication 15 (Circular E), Employer's Tax Guide
12. IRS Examiners' Audit Guide regarding Executive Compensation–Fringe Benefits (dated 2/4/2005)
13. IRS Examiners' Audit Guide for Cash Intensive Businesses (dated 4/2010)

CHAPTER 8 SALES AND USE TAX AUDITS

WHAT TO EXPECT FROM A SALES AND USE TAX AUDIT

The purpose of the sales and use tax audit is to educate the customer and to determine compliance with Indiana's gross retail (sales) and use tax laws. The auditor employs various auditing methods to obtain reasonable assurance of the collection and reporting of sales tax and the payment of use tax on taxable purchases for storage, use, or consumption in Indiana.

The sales and use tax audit is generally completed in conjunction with the withholding and income tax audit, thus other documents will be requested to address all items under audit. This section of the audit manual provides a general overview of the procedures employed by auditors in the examination of transactions for sales and use tax. Specific guidance on the sales and use tax laws and available exemptions can be found in Indiana sales tax information bulletins online at dor.in.gov/6051.htm.

SALES AND USE TAX OVERVIEW

Sales Tax

Sales tax is an excise tax imposed on retail transactions made in Indiana (IC 6-2.5-2-1). Retail sales include, but are not limited to, sales made at retail or wholesale, rental of accommodations, utilities, sales of some software, telecommunications, construction materials (tangible personal property converted into realty), fabricated products, etc.

Use Tax

Use tax is generally a mirror of the sales tax and is due on property purchased for storage, use, or consumption in Indiana (IC 6-2.5-3-2). Any customer that does not pay sales tax on purchases of tangible personal property or a unitary transaction from either an in-state or out-of-state seller must report and pay use tax on such purchases unless:

1. The property was acquired in a retail transaction in Indiana and the state gross retail tax has been paid on the acquisition of that property; or
2. The property was acquired in a transaction that is wholly or partially exempt from the state gross retail tax under any part of IC 6-2.5-5, except IC 6-2.5-5-24(b), and the property is being used, stored, or consumed for the purpose for which it was exempted.

REGISTRATION AND REPORTING REQUIREMENTS

Sales Tax

Any person or business (through an agent, salesperson, or representative) that sells goods or tangible personal property in Indiana must register as an agent with DOR to collect Indiana's sales tax. The sales tax must be separately stated on the sales invoice. As an agent for DOR, the retail merchant is responsible for collecting the sales tax unless the item sold is statutorily exempt (ex. lottery tickets, certain food items, gift cards, etc.) or the business retains an exemption certificate (Form ST-105) for the buyer on file.

Effective Oct. 1, 2018, Indiana law (IC 6-2.5-2-1(c)) requires a seller without a physical presence in Indiana to obtain a registered retail merchant's certificate, collect and remit applicable sales tax if the seller meets either or both of the following conditions in the previous calendar year **or** the current calendar year:

1. The seller has gross revenue from sales into Indiana exceeding $100,000; or
2. The seller has 200 or more separate transactions into Indiana.

Sales into Indiana or sales transactions include any combination of sales of tangible personal property delivered into Indiana, products transferred electronically into Indiana and services delivered in Indiana. The retail merchant reports and pays sales tax on the monthly or annual sales tax return (Form ST-103) submitted in INtax (DOR's online filing program).

Use Tax

Registered retail merchants can remit use tax on the sales/use tax returns (ST-103, ST-103CAR, ST-103MP) filed with DOR. The sales/use tax returns do not have a line for total purchases subject to tax. Therefore, it is important to reflect the total use tax amount due and not the total purchases subject to tax on the sales/use tax return. When a business is not a registered retail merchant, then the use tax is reported annually or monthly on a consumer use tax return (ST-115) or the business' corporate income tax return. Individuals can report use tax on an individual income tax return (IT-40 or IT-40PNR) or on Form ST-115. Only the total use tax amount due and not the total purchases subject to tax is reported on IT-40 and IT-40PNR.

As long as use tax is self-reported in the reporting period during which the item was purchased exempt, only the tax is due. If a customer waits until the Department issues a bill for use tax due, the customer will have to pay penalty and interest on the proposed use tax assessment.

DOCUMENTATION REQUESTS

The auditor provides the customer with a written request for the specific documents needed for the sales and use tax audit. Examples of documentation the auditor requests include:

Sales Tax

- Source Documents such as sales invoices, sales tickets, and register tapes
- Copies of the sales tax returns as filed
- Any sales reports used in preparing the sales tax returns (journals, ledgers, etc.)
- Detailed report of the sales tax accrual account (if applicable)
- Third-party reports such as Credit Card Merchant Reports or IRS Form 1099-K reports
- Any other documentation used in calculating Indiana sales or sales tax and/or used in preparing the sales tax return

Use Tax

- Source documents including all purchase invoices and purchase orders for capital assets, general expenses, purchases charged to a Cost of Goods sold account, prepaid expenses, and inventory purchases
- Detailed report of the use tax accrual account (if applicable)
- Purchase journals and/or detailed general ledger reports of any account with purchase activity including, but not limited to, capital asset, general expense, cost of goods sold, inventory, and prepaid expense accounts
- Any other source document or report used in determining customer's Indiana use tax liability

Other Documentation Requests

- Chart of Accounts
- Financial Statements
- Department, Division, or other Account String Identifier Listings
- Bank Statements
- Any other report or source document needed to verify Indiana sales or use tax

SALES TAX AUDIT PROCEDURES

The auditor reviews the customer's sales reports and records for verification of proper reporting and collection of sales tax on Indiana taxable sales. The customer should prepare to discuss the capture and recording of Indiana sales tax and income taxes. The auditor requests any reports used in preparing the sales tax returns along with the related sales tickets, invoices, register tapes, contracts, and copies of the sales tax returns. The auditor verifies tax was collected on all Indiana sales and any applicable charges such as fabrication labor, shipping charges, etc. The information gathered by the auditor determines the audit plan. Depending on the number of records, the auditor and customer may agree to a sampling method for the review, further discussion on sampling in Chapter 12 of this manual.

During the audit, the auditor traces the transactions back to the sales reports/ journals and to the sales tax returns to ensure any tax collected was reported for the audit/sample period, whichever applicable. The auditor also identifies for further review any sales in which sales tax was not collected (non-taxed or exempt sales).

Exemption Certificates

To support an exempt Indiana sales, the customer must maintain a properly completed exemption certificate, which relieves the seller from liability for collecting the Indiana tax. Form ST-105, General Sales Tax Exemption Certificate, is a multi-use form used by most exempt purchasers. Exempt purchasers, in-state and out-of-state, use this form for most types of exemptions allowed by Indiana. A properly completed streamline sales tax exemption certificate is also an acceptable form of documentation.

The DOR auditor requests to review the exemption certificates for the exempt (Indiana) sales. The auditor will trace these exemption certificates to the reported exempt sales by customer. Each section of the exemption certificate must be complete and the exemption certificate must accurately represent the reason for the purchase for it to be valid. For example, if a purchaser indicates in Section 2 of Form ST-105 it is seeking a blanket exemption for the purchase of “machine lubricants,” thus any purchase other than “machine lubricants” are not properly exempt by that exemption certificate.

Notice of Non-Compliance

When a customer is unable to provide an exemption certificate during the initial fieldwork, the auditor may provide the customer with additional time to obtain documentation by issuing a “Notice of Non- Compliance”, Form AD-14. The Notice of Non-Compliance will identify the number of additional days the customer is extended to obtain sufficient documentation to support the exempt sale. The auditor will also include a special exemption certificate (Form AD-70) for customers to provide to their customers to complete.

The auditor will give consideration to completed and signed special exemption certificates or other proof of exemption submitted to the auditor within the prescribed period.

Sales Tax Adjustments

An adjustment to the reported taxable sales / sales tax is necessary in the following situations:

- Charges on an invoice that were not properly taxed (i.e., shipping charges)
- Unsupported Indiana exempt sales
- Tax that was collected, but not reported

Note: Sales tax erroneously collected cannot be refunded. Sales tax is a tax borne by the customer (buyer) and can only be refunded to the customer (buyer), not the retail merchant.

USE TAX AUDIT PROCEDURES

The auditor reviews purchases to determine compliance with the Indiana use tax laws. In general, all purchases made by the business are within the scope of the audit’s review. In some instances, the auditor may narrow the scope of the use tax review if it is determined certain purchases, such as those made for resale, are exempt from tax per Indiana Code. There are many statutory exemptions available to customers in industries such as manufacturing, public transportation, and agriculture. The auditor will gain an understanding of the business at the beginning of the audit by taking a tour of any business operations in Indiana and completing a pre-audit questionnaire with the customer. In addition to reviewing financial statements, income tax returns, chart of accounts, and any other reports such as Departmental/division listings. This information gathered establishes the audit plan and determines the nature and scope of the records reviewed for use tax.

Typically, the auditor reviews all of the capital asset purchases for the audit period. The customer should prepare to provide a detailed report of the capital asset purchases (asset listing, depreciation schedule, etc.) along with the purchase order and invoice for each capital asset. The auditor reviews these documents to ensure payment of taxes at the time of purchase or the subsequent payment of use tax, when applicable.

Depending on the number of purchases, the auditor examines in detail or by using a sampling method. The auditor also reviews purchase journals, expense accounts and cost of goods sold account detail. In some cases, the auditor reviews asset accounts such as inventory or prepaid expenses. The auditor reviews the purchase invoices to ensure payment of taxes at the time of purchase or remittance of use tax on taxable purchases during the audit or sample period, whichever is applicable.

Use Tax Accrual Account

The auditor tests the reliability of the use tax accrual accounts, by tracing any use tax identified on expense and asset purchases to the use tax accrual account and return where the tax was reported. The auditor traces enough invoices to satisfy the fact that the customer properly accrued, reported, and paid use tax.

For those customers that do not currently accrue use tax, the auditor will educate the customer. There are various methods that can be used to track and remit use tax on taxable purchases where sales tax was not paid at the point of purchase. Audit adjustments may be necessary to assess use tax on purchases that do not qualify for an exemption provided by Indiana Code and where the tax was not paid. Conversely, credits may be granted for taxes paid on purchases that qualify for one of the exemptions identified in the Indiana Code.

ELECTRONIC VS. PAPER RECORDS

The auditor accepts paper or electronic copies of the requested records. Electronic copies are the preferred format for reports such as detailed general ledger reports, sales reports, purchase journals, etc. Other reports such as a chart of accounts listing, Department or division listing are acceptable in a paper format. Further information regarding securely providing electronic records in Chapter 4- Data Safeguards.

CONCLUDING THE AUDIT

Post-Audit Conference

The auditor schedules a post-audit conference after the initial fieldwork is completed. The purpose of the post-audit conference is to discuss and provide work papers for any audit adjustments, follow-up requirements, and to establish deadlines for requested information. The auditor provides information bulletins or other reference material for further explanation of the proposed adjustments. Additional post-audit communication may be necessary to address any issues or concerns before finalizing the audit. For further information on Audit Work Paper presentation, consult Chapter 13 of this manual.

Final Conference

Upon the conclusion of the audit, the auditor schedules the final conference. The final conference may occur at the same time as the post-conference if there is no need to address any issues or gather additional documentation. The final conference is to inform the customer of the conclusion of the fieldwork, discuss the results of the audit, and document that DOR will issue a written report of the findings after final review. The auditor provides the customer with a copy of the DOR Protest Guide and explain the procedures. Further information on the final conference and DOR's protest procedures can be found in Chapter 11 of this manual.

Audit Report and Billing Process

The auditor submits a written report of audit findings to their supervisor for final review and approved billing. The audit bills and the official audit report are mailed to the customer at the address on file and a copy of the audit report is sent to the power of attorney, when applicable.

SALES AND USE TAX REFERENCE MATERIAL

Reference material on DOR's website at dor.in.gov/3330.htm includes, but is not limited to:

- **Sales, Use, and General Tax Information Bulletins** provide nontechnical assistance to the general public on DOR's position related to the application of the sales and use tax laws to specific businesses and circumstances, along with various additional subjects. These serve as a foundation for further investigation and study of the current law and procedures related to the subject mattered covered in the publication.
- **Final Determinations (Letters of Findings, Memoranda of Decisions, Orders Denying Refund)** provide the general public with information about the Department's official position concerning a specific set of facts and issues that arise in a protest. Final Determinations are effective on the date of publication and remain in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.
- **Indiana Code (IC 6) and Regulation** (Indiana Administrative Code, IAC 45)
- **Other Resources** such as Tax Court filings and decisions, access to the Indiana Register, Tax Policy Directives, Newsletters, Filing Statistics, etc.

CHAPTER 9 "GENERAL" INCOME TAX AUDITS

WHAT TO EXPECT FROM AN INCOME TAX AUDIT

The purpose of the income tax audit is to determine whether a customer complies with Indiana's adjusted gross income tax laws and to provide education on the Indiana Code and Administrative Regulations. The auditor will employ various auditing techniques and methods in order to obtain reasonable assurance that the customer is properly reporting their Indiana income. This section of the audit manual provides an overview of the procedures employed by auditors in the examination of individual and corporate income tax returns while addressing specific Indiana modifications and other income tax items reviewed as part of the income tax audit.

The audit may be a complete review of Indiana tax return filings currently in statute (typically the last 3 years) or may be limited to the review of a particular line item on a return such as a credit or deduction. In many cases, an income tax audit occurs in conjunction with a sales and use and withholding tax audit.

INCOME TAX OVERVIEW

Imposition of Individual Income Tax

Indiana imposes a tax upon the adjusted gross income of every resident person, and on that part of the adjusted gross income derived from sources within Indiana of every nonresident person. (IC 6-3-2-1(a))

The term "resident" includes (a) any individual who was domiciled in this state during the taxable year, or (b) any individual who maintains a permanent place of residence in this state and spends more than one hundred eighty-three (183) days of the taxable year within this state, or (c) any estate of a deceased person defined in (a) or (b), or (d) any trust which has a situs within this state. (IC 6-3-1-12)

The term "person" means an individual, trust or estate: provided, that, no corporation shall be considered to be a person. (IC 6-3-1-14)

The term "nonresident" means any person who is not a resident of Indiana. (IC 6-3-1-12)

Imposition of Corporate Income Tax

Indiana imposes a tax on that part of the adjusted gross income derived from sources within Indiana of every corporation. (IC 6-3-2-1(b))

As used in IC 6-3, "corporation" includes all corporations, associations, real estate investment trusts (as defined in the Internal Revenue Code), joint stock companies, whether organized for profit or not-for-profit, any receiver, trustee or conservator thereof, business trusts, Massachusetts trusts, any proprietorship or partnership taxable under Section 1361 of the Internal Revenue Code, and any publicly traded partnership that is treated as a corporation for federal income tax purposes under Section 7704 of the Internal Revenue Code. The term includes life insurance companies (as defined in Section 816(a) of the Internal Revenue Code) and insurance companies subject to tax under Section 831 of the Internal Revenue Code.

Adjusted Gross Income Defined

Adjusted Gross Income derived from sources within Indiana includes (IC 6-3-2-2):

1. Income from real or tangible personal property located in Indiana;
2. Income from doing business in Indiana;
3. Income from a trade or profession conducted in this state;
4. Compensation for labor or services rendered within Indiana; and
5. Income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property to the extent that the income is apportioned to Indiana under this section or if the income is allocated to Indiana or considered to be derived from sources within Indiana under this section.

For an individual, Indiana adjusted gross income is defined as “adjusted gross income” (as defined in Section 62 of the Internal Revenue Code) modified per IC 6-3-1-3.5(a).

For a corporation, Indiana adjusted gross income is defined as “adjusted gross income” as defined Section 63 of the Internal Revenue Code modified per IC 6-3-1-3.5(b).

For periods beginning after Dec. 31, 2018, the addback of riverboat wagering taxes will be reduced by 1/8 of the tax each year from 2019 to 2025, until no addback is required in 2026 and later. This does not affect the addback for other income taxes.

For life insurance companies, estates, and trusts, see “adjusted gross income” defined in IC 6-3-1-3.5 (d)-(f).

Allocation and Apportionment
Corporations or non-resident persons with business income derived from both within and without Indiana shall determine their income from Indiana sources using allocation and apportionment provisions contained in IC 6- 3-2-2.

Who Must File Returns
Resident Individuals IC 6-3-4-1(1) Resident Estates IC 6-3-4-1(4) Resident Trusts IC 6-3-4-1(5) Nonresident Individuals IC 6-3-4-1(2) Nonresident Estates IC 6-3-4-1(6) Nonresident Trusts IC 6-3-4-1(7) All Corporations IC 6-3-4-1(3) All Partnerships IC 6-3-4-10

DOCUMENTATION REQUESTS
The auditor will provide the customer with a written request for the documentation needed for the income tax audit. Some examples of the documentation the auditor may request include the following per tax type:

1. **Individual Income Tax**
   - Federal Income Tax Returns as filed with the IRS - the customer must provide, upon request by DOR, a true and correct copy of any tax return filed with the IRS under IC 6-3-4-6(a).
   - Indiana Income Tax Returns as filed with DOR.
   - Any other state returns filed when claiming credit for taxes paid in another state.
   - Income Transcripts (Forms W-2s, 1099s, K-1s for pass-through income, etc.).
   - Documentation supporting reported exemptions, credits, or deductions.

2. **Corporate Income Tax**
   - Federal Income Tax Returns as filed with the IRS, including all schedules and additional information reported to the IRS - Customers must provide, upon request by DOR, a true and correct copy of any tax return filed with the IRS under IC 6-3-4- 6(a).
   - Pro-Forma Federal Return for entities included on the Indiana Return (if applicable)
   - Indiana Income Tax Returns, as filed, with supporting schedules (including schedules for IN modifications)
   - Other State Income, Franchise, or other returns filed
   - Organizational Chart
   - 10K Report as filed with the SEC (if applicable)
   - Trial Balance Reports
   - Ledgers
   - Apportionment work papers
   - Federal and State Depreciation Schedules
   - Sales Shipped to Report by location

3. **Pass-through Entities**
    - Federal and State (All State) income tax returns of the customer
    - Federal and State (All State) income tax returns for all shareholders or partners
    - Income transcripts for any pass-through income (K-1s, 1099s, etc.)
    - Ledgers, Trial Balance Reports
    - Apportionment work papers
    - Federal and State Depreciation Schedules
    - Sales Shipped to Report by Location

AUDIT PROCEDURES

The auditor performs audit procedures to ensure the customer reported income properly on the Indiana income tax return. Before the fieldwork, the auditor reviews the corporate or individual income returns on file with DOR and compares the information available such as sales tax filings, IRS income transcripts, prior audits, etc. The auditor identifies items on the return that may require further review and verification, including any deductions, credits, addbacks, or other income or expenses. The auditor conducts a pre-audit interview to obtain additional information for the audit plan.

Individual Income Tax

Most individual income tax audits are limited in scope to a specific issue often resulting from an audit of a pass-through entity. Other audits can originate as the result of a crosscheck of information from the IRS or other items identified on a return that require further information. These “desk” type audits are limited in scope and documentation requested by the auditor will be specific to the issue under audit. The auditor may also request IRS transcripts, W-2s, or other documentation to verify income, deductions, and/or credits taken on the return.

Corporate Income Tax

The auditor reviews all state and federal income tax returns of the entity required to file an Indiana corporate income tax return. This includes any returns of the parent corporation, if the pass-through entity is part of a closely held group. The auditor requests the copy of the federal pro-forma return attached to the Indiana corporate return with all supporting schedules. The auditor compares the income and expenses reported on the federal return to financial statements, trial balance reports, ledgers, transfer-pricing studies, or other information used in preparing the return. In addition, the auditor verifies that federal taxable income carries correctly to the Indiana return.

The auditor requests and reviews documentation to verify any addbacks, deductions, and credits taken on the Indiana return. This documentation is not limited to the items listed on the previous page under “documentation requests”. Additional information regarding specific audit procedures for income tax items such as the examination of consolidated or combined filing, intangible expenses addback, apportionment, net operating losses, can be found in Chapter 10 of this manual.

Additional Procedures for Pass-Through Entities

An example of a pass-through entity is a partnership or qualified subchapter S corporation. When auditing a pass-through entity, the auditor verifies that the income of the corporation along with any credits, addbacks, and deductions are properly reported to the shareholder on Form IN K-1.

In addition, the auditor verifies that a composite return was filed on behalf of any non-resident and that income, addbacks, credits or other items properly flow through and are reported or excluded as required.

CHAPTER 10 SPECIFIC INCOME TAX ITEMS

NEXUS

Overview

The term "nexus" refers to the activity a person (or business) conducts, or the presence it maintains, within a particular jurisdiction. To impose adjusted gross income tax on a corporation, individual, or pass-through entity, they must be "doing business" in Indiana. Nexus or "presence" determination applies to the customer and any related corporations, pass-through entity, subsidiary, etc.

Public Law 86-272 – Exception to Nexus

Federal law prohibits any state from imposing a net income tax on income derived within that State from interstate commerce if the business's only activities in that State are the solicitation of orders for the sale of tangible personal property and the orders are approved and filled outside the state. This rule extends only to the shipment of goods across state lines. Once a customer engages in an activity not protected by PL 86-272, interstate commerce protection no longer applies. PL 86-272 only applies to income tax; however, the sales may be subject to sales and use tax.

Audit Procedures

During the pre-audit interview or audit, the auditor will request information and/or documentation to determine nexus in Indiana. The auditor may ask the customer to complete a nexus questionnaire to obtain this information. Examples of information requested:

- the location and activities of each entity;
- work location and activities of employees performing services in Indiana;
- location of business property (including inventory and assets); and
- other information necessary to determine presence in Indiana for income tax purposes.

Reference Material

Income Tax Information Bulletin #12 - dor.in.gov/files/ib12.pdf

APPORTIONMENT

Overview

Under the Adjusted Gross Income Tax Act, taxable income from a trade or business carried on within and outside Indiana computed using a single-factor formula based on receipts per IC 6- 3-2-2. The sales factor is a fraction where the numerator is the total Indiana receipts during the tax year and the denominator is the total number of receipts for all jurisdictions during the tax year.

Indiana receipts, the numerator factor, must include the following:

- All sales made in Indiana;
- All sales made from Indiana to the U.S. government;
- All receipts from sales of business property in Indiana; and
- All interest, dividend, or other intangible income earned in Indiana.

With partnership income, the relationship between a corporate partner and the partnership controls the reporting of business income. If a unitary relationship exists, the corporate partner includes its "unapportioned" share of the partnership's income along with its own in the computation of business income subject to apportionment. The partner includes its pro rata share of partnership receipts in the apportionment factor.

Non-unitary partnership income and non-business income are excluded from the tax base of apportioned business income. For years beginning prior to Jan. 1, 2016, all sales made from Indiana to a state not having jurisdiction to tax, the activities of the seller (throwback sales) are included in the numerator of the sales factor.

CORPORATION THAT HOLDS INTEREST IN A PARTNERSHIP

An essential part of an audit of a corporation that holds an interest in a partnership is to verify the relationship between the corporate partner and the partnership. The corporation must be able to support the Unitary/Operational or a Non-Unitary/Investment position as reported on the Indiana tax return without regard to ownership percentage. The customer must also demonstrate the income flowing from the partnership was appropriately reported in the method prescribed by the Unitary/Operational or a Non-Unitary/Investment position.

Documentation Requests

The auditor requests the following documents in addition to other standard documents:

- The partnership agreement
- Copies of the partnership State and Federal returns, or K-1's
- Support for all state withholding tax

Definition

The term "Partnership" is defined at IC § 6-3-1-19 as:

(a) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this chapter, a corporation or a trust or an estate. The term also includes a limited liability company (LLC) that is treated as a partnership for federal income tax purposes.

Types of Partnerships and Partners

There are different types of partnerships such as general partnerships (GP), limited partnerships (LP), limited liability partnerships (LLP), and limited liability companies (LLC). NOTE: Holding a minority interest in the partnership does not automatically determine that the nature of the income is investment income. The auditors examine the partner's activities in the partnership. Often a limited partner is a passive investor due to lack of participation in the management.

Audit Procedures

TREATMENT OF FLOW THROUGH INCOME

The auditor examines the partnership agreement to establish a customer's claim of a Unitary or Non-Unitary relationship with the partnership. Some of the items the auditor reviews to verify the relationship are as follow:

- General and limited partners
- Tax Matters Partner
- Voting rights for the Board of Directors and Officers
- Responsibilities for decision making and resolving disputes
- Which partners hold the authority to bind the company in contracts

UNITARY RELATIONSHIP - OPERATIONAL INCOME

When the auditor verifies that the corporate partner participates in the management of the partnership, and a unitary relationship does exist, the income from the partnership is operational income. Operational income or business income is apportionable. The auditor verifies that the pro-rata share of the partnership income is business income attributable to Indiana determined by a single-factor formula. The formula consists of sales of the corporate partner and its share of the partnership's sales factor for any partnership year ending within or with the corporate partner's income year.

NON-UNITARY RELATIONSHIP - INVESTMENT INCOME

When the auditor verifies that the corporation holds an interest in a partnership in which it does not participate in the management, then a non-unitary relationship is established and the income from the partnership is investment income. Investment income is allocable. The auditor verifies that the corporate partner's distributive share of the partnership income is removed from the Federal adjusted gross income as an 'other adjustment - non-unitary partnership income' in arriving at the Indiana taxable business income. The auditor also verifies that the corporate partner's share of the partnership income attributable to Indiana is an added back 'Allocated and Previously Apportioned Income to Indiana'. Refer to 45 I.A.C. 3.1-1-153. Taxation of a corporate partner, also see 45 IAC 3.1-1-106 Partner's distributive share.

COMPOSITE RETURNS

Audit Procedures

In addition to the regular income tax audit procedures, the auditor reviews any composite return filings as part of the income tax audit for a pass-through entity. The auditor verifies all nonresidents were included on the return and the proper computation of tax on the income of nonresidents considering limitations and conditions discussed in Income Tax Information Bulletin #72. The auditor will also verify that any credits (such as the Research Expense Credit, HBI, or EDGE) were properly applied to the computed tax and represented on the K- 1 forms issued to the nonresident (if any of these credits are applied to the non-resident tax liability, the credit should not appear in Part 2 on the Schedule IN K-1).

Reference Material

Income Tax Information Bulletin #72 - dor.in.gov/reference/files/ib72.pdf

COMBINED AND CONSOLIDATED RETURNS

Overview

For affiliated corporations with income derived from sources in Indiana, the default filing position is a separate filing of Indiana corporate income tax return. The affiliated group may elect to file a consolidated Indiana income tax return. The affiliated group may also request or required by DOR to file an IN income tax return on a combined basis.

The Adjusted Gross Income Tax Act provides for an election to file a consolidated return for a qualified affiliated group under IC 6-3-4-14. To file a consolidated return for adjusted gross income tax purposes, the parent corporation must own at least 80% of the voting stock of each subsidiary. The affiliated group may not include any corporation that does not have taxable income or loss derived from Indiana sources. If such an election is made for Indiana tax purposes, the customer must notify DOR by attaching a statement to the return indicating the affiliated corporations electing to file a consolidated return. In addition, a worksheet must accompany the annual return supporting the consolidated adjusted gross income of the participating affiliates.

An election to file a consolidated return for Indiana purposes can be made by filing the consolidated return by the due date; if filed past the due date, a copy of the valid federal extension of time to file must be attached to the return. An election to file a consolidated return cannot be made on a retroactive basis. Once an affiliated group elects to file consolidated for Indiana purposes, the group must follow that election for all subsequent years of filing. If the group wishes to revoke the election in a subsequent tax year, the group must obtain written permission from the Department at least 90 days before the due date of the return.

The State of Indiana permits the filing of a corporate income tax return on a combined basis under certain conditions, if requested by the customer, as the best option to fairly reflect Indiana income. The Department may also require filing on a combined basis if the Department determines that Indiana income tax distortion cannot be corrected by other filing methods or other means of Indiana income apportionment or allocation.

A combined income tax return differs from a consolidated income tax return in that the consolidated return includes only companies that have income derived from Indiana sources (nexus). A combined return must include all unitary domestic affiliated companies, those with income derived from Indiana sources and those without, fairly reflecting income derived from Indiana sources. The combination is limited to “water’s edge,” which means that no foreign corporations, only domestic corporations, are included in the return unless specifically requested by the customer and approved otherwise. The Department may not require combination with foreign corporations.

To file a combined return, the customer must petition the Department within 30 days of the end of its taxable year. The petition must demonstrate that filing separate returns causes a distortion of income derived from Indiana sources. The customer must continue to file on a combined basis until the customer seeks permission to change. The customer includes the income of all the companies in the return and allocates that income amongst the companies that do business in Indiana using a relative apportionment formula.

Consolidated Returns Audit Procedures
The auditor will request the following:

- Copies of the federal income tax returns as filed with the IRS including consolidation schedules
- Apportionment work papers for each company included in the consolidated federal
- Details of all intercompany transactions between the companies included in the federal consolidated income tax return

The auditor examines each member of the affiliated group included in the consolidated federal income tax return to determine if the member has Indiana income tax nexus and derives income from sources within Indiana. Once Indiana income tax nexus is determined, the auditor examines the Indiana income tax consolidation schedule to determine if all companies were properly included or excluded from the Indiana consolidated income tax return. The auditor evaluates possible shifting of income that may result in a distortion of Indiana income, if it cannot be corrected by means of adjustments to Indiana income apportionment or income allocation, then a requirement to file on a combined basis may be considered.

Combined Basis Filing Audit Procedures
The auditor will request the following:

- Copies of the federal income tax returns as filed with the IRS and all details of all intercompany transactions between the companies included in the federal consolidated tax return.
- Proof of the customer's permission to file on a combined basis.
- Intercompany transactions to determine if distortion of Indiana income reported on a separate company or consolidated basis.

A review will also be made to determine if each corporation included on the combined return is a domestic corporation, to determine if the customer meets the "water's edge" criteria if the customer has not previously requested and received approval for inclusion of any foreign corporation in the Indiana combined income tax return. The auditor can request an explanation as to whether filing separately or on a consolidated basis would distort their Indiana income and filing on a combined basis would fairly reflect their income from Indiana sources.

The auditor will look for common officers, marketing, insurance, taxes, legal, and personnel to see if they are truly unitary and acting as one corporation. The relationship between each company is examined to determine if it is unitary using the three unities test of:

1. Unity of use – Centralized corporate functions
2. Unity of operations- Intercompany transactions
3. Unity of control – Greater than 50%

DEPRECIATION ADDBACKS AND DEDUCTIONS

Bonus Depreciation Overview
In general, for federal adjusted gross income, a depreciation deduction is allowed for property used in a trade or business, or property held for the production of income. Per Section 168(k) of the Internal Revenue Code allows an additional first-year depreciation deduction amount on qualified properties (known as Bonus Depreciation) in computing a customer has adjusted gross income. Federal bonus depreciation allows customers to deduct a higher deduction when placed in service and the adjusted basis is reduced by the bonus depreciation before the remaining depreciation deductions are computed for the placed-in-service year and subsequent years.

Indiana customers must add back any federal bonus depreciation amounts claimed when calculating Indiana adjusted gross income. A separate Indiana depreciation schedule must show the assets for which federal bonus depreciation was claimed as if the election had not been made for the remaining life of the assets. The amount of the adjustment between federal and Indiana depreciation deductions can be either an addback or a deduction. This can occur in years subsequent to the year the asset was first acquired due to the fact that the asset's basis for depreciation for Indiana purposes is higher than the asset's basis for federal purposes.

Audit Procedures
The auditor verifies the amounts; either added back to or deducted from Indiana's adjusted gross income for bonus depreciation. Part of the auditor's process of verifying the reported addback/deduction amount is recalculating that amount based on the customer's books and records. The auditor will request all federal and Indiana depreciation schedules relating to that audit period and all supporting source documents for these assets. When a customer has multiple sources of pass-through income affected by bonus depreciation deductions, the customer can report its addback for all sources and all types of depreciation as one amount on its Indiana return. The customer must provide supporting documentation for all depreciation calculations for all assets included.

BONUS DEPRECIATION ADDBACK/DEDUCTION REQUIREMENTS FOR AN INDIVIDUAL
Add or subtract the amount necessary to make the adjusted gross income of any customer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made under Section 168(k) of the Internal Revenue Code to apply bonus depreciation to the property in the year that it was placed in service.
IC 6-3-1-3.5(a)15

BONUS DEPRECIATION ADDBACK/DEDUCTION REQUIREMENTS FOR A CORPORATION
Add or subtract the amount necessary to make the adjusted gross income of any customer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made under Section 168(k) of the Internal Revenue Code to apply bonus depreciation to the property in the year that it was placed in service.
IC 6-3-1-3.5(b)5

Overview - Section 179 Depreciation
Under Section 179 of the Internal Revenue Code, a customer is allowed to elect to expense the cost, or a portion of the cost, of certain qualified depreciable property for the taxable year in which the property is placed in service. The expense deduction under section 179 is allowed for the entire cost or a portion of the cost of one or more items of qualified property. However, this expense deduction is subject to limitations. A customer who elects to expense the cost, or a portion of the cost, must reduce the depreciable basis of the qualified property by the amount of the section 179 Expense deduction. Additionally, the basis of a partnership or S corporation's section 179 property must be reduced to reflect the amount of section 179 expense elected by the partnership or S corporation. This reduction must be made on the basis of partnership or S corporation property even if the partner and shareholder basis limitations prevent a partner or shareholder from deducting all or a portion of the amount of the expense allocated. Any amounts claimed by a customer under section 179 cannot exceed $25,000. However, Indiana does follow (1) the federal phase out thresholds and (2) the federal definitions of property eligible for expensing. The amount of section 179 expense claimed by the customer, in excess of $25,000, in computing federal adjusted gross income must be added back when calculating Indiana adjusted gross income.

Audit Procedures
As part of an audit of an Indiana customer's income, the auditor will verify the amounts, either added back to or deducted from, the Indiana customer's adjusted gross income for section 179 expense. Part of the auditor's process of verifying the reported addback/deduction amount is recalculating that amount based on the customer's books and records. To complete verification, the auditor reviews federal and Indiana depreciation schedules and any source documents (invoices) for these assets.

SECTION 179 DEPRECIATION ADDBACK/DEDUCTION REQUIREMENTS FOR AN INDIVIDUAL
Add or subtract the amount necessary to make the adjusted gross income of any customer that placed Section 179 property (as defined in Section 179 of the Internal Revenue Code) in service in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election for federal income tax purposes not been made for the year in which the property was placed in service to take deductions under Section 179 of the Internal Revenue Code in a total amount exceeding twenty-five thousand dollars ($25,000).
IC 6-3-1-3.5(a)(17)

SECTION 179 DEPRECIATION ADDBACK/DEDUCTION REQUIREMENTS FOR A CORPORATION

Add or subtract the amount necessary to make the adjusted gross income of any customer that placed Section 179 property (as defined in Section 179 of the Internal Revenue Code) in service in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election for federal income tax purposes not been made for the year in which the property was placed in service to take deductions under Section 179 of the Internal Revenue Code in a total amount exceeding twenty-five thousand dollars ($25,000).
IC 6-3-1-3.5(b)(7)

STATE INCOME TAX ADDBACK

Overview

The auditor's goal is the verification of the state income tax addback to federal taxable income. A customer must add back to federal taxable income "an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States." (IC 6-3-1-3.5(b)(3))

Audit Procedures

The auditor will review the customer's federal return to ensure all state taxes are properly added back. This will include certain taxes deducted from Federal Schedules C, C-EZ, E, and/or F (3-digit code: 100). Income, losses, and/or expenses from other schedules and forms may flow through to federal Schedules C, E, and F. For example, partnership income from federal Schedule K-1 (Form 1065) may be included on federal Schedule C. Note: Indiana Code 6-3-1-3.5(c) provides a limitation on the addback of state wagering taxes for taxable years beginning after Dec. 31, 2018 for corporations (and individuals).

Taxes not required being added back

Based on the applicable Indiana statutes, regulations, and case law, and analysis of the specific application of the taxes, DOR determined that taxes may not be required to be added back could include, but not limited to the following:

- Alabama Privilege Tax (Code of Ala. § 40-14A-21)
- Delaware Franchise Tax (8 Del. C. § 503)
- Georgia Net Worth Tax (O.C.G.A. § 48-13-70)
- Illinois Franchise Tax (805 ILCS5/15.35)
- Kansas Franchise Tax (K.S.A. §79-5401)
- Kentucky License Tax (KRS § 136.070) (Repealed January 1, 2006)
- Louisiana Franchise Tax (La. R.S. § 47:601)
- Michigan Business Personal Property Tax (MCLS § 211.8)
- Minnesota Care Tax (Minn. Stat. § 295.50) (Repealed as of Jan. 1, 2020)
- Mississippi Corporation Franchise Tax (Miss. Code Ann. § 27-13-1)
- Nevada Modified Business Tax (Nev. Rev. Stat. Ann. § 363B.010) (Repealed July 1, 2015)
- New York Tax on the Furnishing of Utility Services (NY CLS Tax § 186-a)
- New York Commercial Rent Tax (New York City Administrative Code § 11-701 etseq.)
- North Carolina Franchise Tax (N.C. Gen. Stat. § 105-122)
- North Carolina Utilities Tax (N.C. Gen. Stat. § 105-116) (Repealed July 1, 2014)
- Oklahoma Business Activity Tax (68 Okl. St. § 1215) (Repealed January 1, 2013)
- Pennsylvania Capital Stock-Franchise Tax (72 P.S. § 7601) (Repealed December 31, 2015)
- Pennsylvania Bank and Trust Company Shares Tax (72 P.S. § 7701)
- Pennsylvania Gross Receipts Tax (72 P.S. § 8101)
- Puerto Rico Excise Tax (PR-IRC § 2101)
- South Carolina Utilities Tax (S.C. Code Ann. § 12-20-100)
- Tennessee Franchise Tax (Tenn. Code Ann. § 67-4-2101)

- Washington State Litter Tax (RCW 82.19.010)
- West Virginia Business and Occupation Tax (W. Va. Code § 11-13-1)
- Feed License and Tonnage Fees: Several states including New York, New Jersey, Pennsylvania, Ohio, and Virginia have feed license and tonnage fees. These fees called grain license and tonnage fees in certain states. The DOR considers these fees similar to excise taxes, therefore not added back.

Taxes required being added back

Based on the applicable Indiana statutes, regulations, and case law, and analysis of the specific application of these taxes, DOR determined that taxes required being added back include, but not limited to the following:

- California Franchise Tax (CA Rev & Tax Code § 23101)
- California LLC Fee (CA Rev & Tax Code §17942)
- California LLC Tax (CA Rev & Tax Code §17941)
- Connecticut Business Entity Tax (Conn. Gen. Stat. § 12-2846)
- District of Columbia Unincorporated Business Tax (D.C. Code § 47-1808.01)
- Hawaii Business Excise Tax (Hawaii Revised Statutes § 18-237-13)
- Massachusetts Corporation Excise Tax (Income Tax portion only, MA G.L. Ch. 63 §39)
- Michigan Gross Receipts Tax (MCL § 208.1203)
- Mississippi Corporate Income and Franchise Tax (Income Tax portion only, MS Code § 27-7-5)
- New Hampshire Business Profits Tax (NH Rev Stat § 77-A:1)
- New York Maintenance Fee (New York Tax Law Article 9, § 181.2)
- Ohio Commercial Activities Tax (Ohio Code § 5751.02)
- Oregon Excise Tax (OR Rev Stat § 317.018)
- Puerto Rico Volume of Business Tax also called the Municipal License Tax (Act No. 163- 2013)
- Tennessee Excise Tax (Tenn. Code Ann. § 67-4-207)
- Texas Franchise Tax (TX Tax Code, Ch.171, Subsection A, § 171.002)
- Texas Margin Tax (TX Tax Code, Ch. 171, Subsection C, § 171.101)
- Washington Business and Occupation Tax (WA Rev. Code § 82.04.010)

INTANGIBLE EXPENSES ADDBACK

Overview

Indiana Code 6-3-1-3.5(b)(8) indicates the customer must add back to federal taxable income, to the extent required by IC 6-3-2-20,

A. The amount of intangible expenses (as defined in IC 6-3-2-20) and any directly related interest expenses (as defined in IC 6-3-2-20) for the taxable year that reduced the corporation's taxable income (as defined in Section 63 of the Internal Revenue Code) for federal income tax purposes.

B. Any directly related interest expenses (as defined in IC 6-3-2-20) that reduced the corporation's adjusted gross income (determined without regard to this subdivision). The amount of interest that is considered to have reduced the corporation's adjusted gross income equals:

   a. the directly related interest expense that reduced the customer's federal taxable income (as defined in Section 63 of the Internal Revenue Code); plus
   b. any directly related interest expenses for which a subtraction is allowable under subdivision (15); minus
   c. any directly related interest expenses required to be added back under subdivision (15).

Intangible Expenses

A corporation subject to the AGI tax must add to its taxable income any intangible expenses. It must also add any directly related interest expenses paid, accrued, or incurred with one or more members of the same affiliated group or foreign corporation.

Audit Procedures
Upon audit, the auditor will request:
- Copies of the federal income tax returns as filed with the IRS including consolidation schedules
- Details of all intercompany transactions of all companies in the federal consolidated income tax return

The auditor examines the customer's intercompany transactions and verifies that all related transactions made with a recipient member of the same affiliated group or a foreign corporation involving an intangible expense and any directly related interest expenses have been reported and included on Schedule PIC as required by IC 6- 3-2-20(b). Exemptions to the add back of the deduction claimed by the customer, the auditor examines the documentation of those exceptions and determines if the exceptions meet the requirements of IC 6-3-2-20(c).

The auditor examines interest expenses reported on the customer's federal return and flowing through to an Indiana corporate income tax return to determine if the interest expenses, or any portion thereof, is required to be added back per Indiana Code. The auditor reviews the federal consolidated schedules and copies of loan agreements or other documentation to identify the underlying transaction to determine if any intangible and directly related interest expenses were properly added back as required per 6-3-1-3.5(b)(8).

OTHER ADDBACKS
Charitable Contributions Addback
Indiana Code 6-3-1-3.5(b)(2) requires the customer to add back to federal taxable income "an amount equal to any deduction or deductions allowed or allowable pursuant to Section 170 of the Internal Revenue Code."

Dividends Paid to Shareholders of a Captive Real Estate Investment Trust Addback
Indiana Code 6-3-1-3.5(b)(10) states the customer must add back to federal taxable income "an amount equal to any deduction for dividends paid (as defined in Section 561 of the Internal Revenue Code) to shareholders of a captive real estate investment trust (as defined in section of this chapter)."

Dividends Paid to Shareholders of a Captive Real Estate Investment Trust
Add back the amount of any deduction for dividends paid to shareholders of a captive real estate investment trust (REIT). A captive REIT is defined as a corporation, a trust, or an association:
- considered a REIT under Section 856 of the IRC;
- not regularly traded on an established securities market;
- not organized in a country with a tax treaty with the United States Treasury governing the tax treatment of these trusts; and where more than 50% of the voting power/shares owned/controlled by one entity.

OOS Municipal Obligation Interest – Addback
Indiana Code 6-3-1-3.5(b)(13) states the customer must add back to federal taxable income "the amount excluded from federal gross income under Section 103 of the Internal Revenue Code for interest received on an obligation of a state other than Indiana, or a political subdivision of such a state, that is acquired by the customer after Dec. 31, 2011."

Audit Procedures – All Other Addbacks
The auditor examines the customer's federal income tax returns, supporting schedules, and financial records to determine if interest income from municipal investments is excluded as income on the federal return. If excluded, the auditor will verify the interest is added back on the Indiana return. In addition, the auditor examines the federal returns to identify any deductions for charitable contributions, other state income taxes, or other addbacks not specifically mentioned to determine whether properly added back to federal taxable income in arriving at Indiana adjusted gross income.

NET OPERATING LOSSES

Overview

RESIDENT PERSONS

Resident persons are entitled to a net operating loss (NOL) deduction. The amount of the deduction taken in a taxable year may not exceed the customer's unused Indiana NOL carried over to that year. A customer is not entitled to carryback any NOL after Dec. 31, 2011. An Indiana NOL equals the customer's federal NOL for a taxable year, as calculated under Section 172 of the Internal Revenue Code, and adjusted for certain modifications required by IC 6-3-1-3.5. (See the instructions for Schedule IT-40NOL when figuring net operating losses for the correct application of modifications.)

An Indiana NOL carryover is available as a deduction to each of the carryover years following the taxable year of the loss. Effective Jan. 1, 2018, the number of years allowed for carrying over the loss is 20 years. Losses are applied to the earliest taxable years to which the loss may be carried. Any remaining loss amounts after the deduction is taken in a taxable year may be carried over. Indiana NOL carried over are reduced by amounts used to obtain a deduction in a taxable year until the entire amount of the NOL has been used as a deduction or has been carried over to each carryover year allowed per Section 172(b) of the Internal Revenue Code.

CORPORATION; NONRESIDENT PERSONS

Corporations and nonresident persons are entitled to a net operating loss (NOL) deduction. The amount of the deduction taken in a taxable year may not exceed the customer's unused Indiana net operating losses carried over to that year. A customer is not entitled to carryback any NOL after Dec. 31, 2011. An Indiana NOL equals the customer's federal NOL for a taxable year as calculated under Section 172 of the Internal Revenue Code, derived from sources within Indiana and adjusted for certain modifications required by IC 6-3-1-3.5. (For corporations, see Schedule IT-20NOL for correct application of modifications. Nonresident persons should follow the instructions for IT-40NOL.) An Indiana NOL arises when the applicable modifications required exceed the customer's federal adjusted gross income (as defined in Section 63 of the Internal Revenue Code for a corporation and Section 62 for a nonresident person) for the taxable year in which the Indiana net operating loss is determined.

Audit Procedures – Net Operating Losses

The auditor examines the customer's net operating losses and carryforward amounts. The NOL available for carryforward must match the losses generated and reported on the customer's original Indiana income tax returns and that adjustments made to those original NOL amounts to account for:

- Amended Indiana income tax returns that changed the original NOL available for carryforward
- Prior year audit adjustments affecting NOL were not included in the carryforward calculations
- Loss amounts already used and applied in subsequent profit years.

Examining net operating loss calculations also verifies that no foreign source dividends were deducted in calculating the Indiana net operating losses. Net operating losses available for carryforward will be adjusted to account for errors made by the customer and any other income tax audit adjustments. Periods that are out of statute for assessment may still be adjusted to determine proper net operating loss carryforward amounts. A net operating loss schedule will be prepared showing the Indiana net operating loss carryforward amounts available per audit.

OTHER DEDUCTIONS

Net Qualifying Dividends

Net qualifying dividends are special deductions from Schedule C, Federal Form 1120. The deduction reported on Line 2 of Indiana Form IT-20. Qualifying dividends are ordinary dividends that meet specific criteria taxed at the lower long-term capital gains tax rate rather than at the higher tax rate for an individual's ordinary income. To qualify, the payee must own stock for a certain period, generally 60 days for common stock and 90 days for preferred stock. A corporation in the United States or with certain ties also must pay the dividend to the United States.

U.S. Interest from U.S. Government Obligations
Any interest earned from a direct obligation of the U.S. government is exempt from state income taxation and deducted. Examples of U.S government obligations include U.S. savings bonds, U.S. Treasury bills and U.S. government certificates.

For individuals, interest income from government obligations included in Line 1 of Form IT- 40 (Indiana income tax return) can be taken as a deduction on Line 4 of the IT-40 Schedule 2. Any interest income reported from a trust, estate, partnership or S Corporation that is from a government obligation is also deducted on Line 4.

Corporations, S Corporations and Partnerships can deduct the interest income, less related expenses, when determining Indiana adjusted gross income. The 3-digit code for the deduction of interest on U.S. government obligations is 610. On the Indiana corporate income tax return Form IT-20, the deduction is included in the Modifications for Adjusted Gross Income section of the return. The deduction is part of Line 2 on Form IT-20S (S Corporation return) and Form IT-65 (partnership return).

For additional information and guidance, see Income Tax Information Bulletin #19 at dor.in.gov/3650.htm.

Foreign Gross-Up
Per Section 78 of the Internal Revenue Code, a customer is required to add certain foreign taxes to its income. The addition is an amount of foreign taxes paid on a dividend if 1) the customer receives a dividend and 2) claims a foreign tax credit based on the receipt of that dividend.

Dividend "gross-up" (I.R.C. §78) reflects taxes paid by a foreign company, on behalf of a foreign company, to a foreign government. The amount of foreign gross-up to be subtracted is determined by computing the federal foreign tax credit on Form 1118 (Foreign Tax Credit – Corporations). Report the deduction on Indiana corporate income tax return IT-20 under the Modifications for Adjusted Gross Income section of the return. The 3-digit code for the Indiana deduction is 119.

Qualified Patents Income
Indiana allows an exemption from income attributable to qualified patents. The exemption applies to utility or plant patents issued after Dec. 31, 2007 for an invention resulting from a "development process conducted in Indiana." It does not apply to design patents.

The allowable amount included in federal taxable income is a deduction included on the Indiana corporate income tax return Form IT-20, under the Modifications for Adjusted Gross Income section of the return. The 3- digit code for the deduction is 622. For additional information and guidance, see Income Tax Information Bulletin #104 at dor.in.gov/3650.htm.

Qualified Preferred Stock
As of Jan. 1, 2016, this is no longer a required addback. However, if a customer:

- Had losses from the sale or exchange of preferred stock in either Federal National Mortgage Association or Federal Home Loan Mortgage Corporation;
- Treated the loss from the sale or exchange as ordinary income for federal income tax purposes in the year the loss had been incurred; and
- Had any amount previously added back that had not been allowed as a deduction.

The customer can continue deducting the loss not previously allowed as a capital loss. The amount allowable as a capital loss must be computed in accordance with federal limitations on allowable capital losses. See Internal Revenue Code sections 1211 and 1212 for further details on federal limitations.

Prior to Jan. 1, 2016, if the customer treated a loss from the sale or exchange of preferred stock in the Federal National Mortgage Association (established under the Federal National Mortgage Association Charter Act) or the Federal Home Loan Mortgage Corporation (established under the Federal Home Loan Mortgage Corporation Act) as an ordinary loss under Section 301 of the Emergency Economic Stabilization Act of 2008, then the customer should have added back or subtracted the amount necessary to make the adjusted gross income equal to the amount of adjusted gross income that would have been computed had the loss not been treated as an ordinary loss. The deduction is included on the Indiana corporate income tax return Form IT-20 under the Modifications for Adjusted Gross Income section of the return. The 3-digit code for the deduction is 113.

Deferral of Business Indebtedness Discharge and Reacquisition

An amount equal to any income not included in gross income as a result of the deferral of income arising from business indebtedness discharged in connection with a reacquisition after Dec. 31, 2008 and before Jan. 1, 2011, of an applicable debt instrument as provided in Section 108(i) of the Internal Revenue Code, should be added back.

If a deferred amount previously added back, deduct the amount of deferred income recognized for federal purposes in the current period. The 3-digit code for the addback or subtraction is 107. On the Indiana corporate income tax return Form IT-20, the addback or deduction is included in the Modifications for Adjusted Gross Income section of the return. The addback or deduction is part of Line 2 on Form IT-20S (S corporation return) and Form IT-65 (partnership return).

Foreign Source Dividends

A corporation that includes any foreign source dividend in its adjusted gross income for a taxable year is entitled to a deduction from that adjusted gross income. The term “foreign source dividend” means a dividend from a foreign corporation. It includes any amount a customer is required to include in the gross income for a tax year under Internal Revenue Code Section 951 (Subpart F, controlled foreign corporations). The Indiana foreign source dividend deduction is based on “foreign source dividends” after the federal special deductions.

The deduction on Line 12 of Indiana income tax return IT-20 under “Other Adjustments.” The amount of the deduction determined by the percentage of voting stock owned, by the customer, in the foreign corporation. The deduction computed on the Foreign Source Dividend Deduction Worksheet, is included with the IT-20 booklet and return. For additional information and guidance on computing the deduction, see Income Tax Information Bulletin #78 at dor.in.gov/3650.htm.

INCOME TAX CREDITS

Overview

Numerous Indiana tax credits are available for individual, fiduciary, partnership, and corporate customers. In the case of partnerships, limited liability partnerships, S corporations, and limited liability companies, some credits are allocated and passed through to the partners, shareholders, or members of the entity. This section of the manual provides an overview of the credits available to Indiana customers including discussion of the types of credits available, order of application, restrictions, limitations, and basic procedures employed by auditors in reviewing these credits.

Type of Credits

TYPE 1: NONREFUNDABLE CREDITS AND CARRYOVERS

Some of the nonrefundable credits used to reduce specific current-year tax liabilities. The unused portion of the credit cannot be refunded/applied against other outstanding tax liabilities. However, other nonrefundable credits have provisions stipulating that if the credit exceeds the total of the current amount of tax due, the unused portion can carry forward to the customer’s future tax liabilities for the same tax type.

Type 1 Credits:
1-A. Nonrefundable credits for certain charitable contributions made within Indiana
1-B. Nonrefundable credits for qualified investments made within Indiana
1-C. Nonrefundable credits for income and business activities of Indiana customers

TYPE 2: REFUNDABLE CREDITS
Refundable credits have a limited period of time in which they may be claimed to be eligible for refund. Also, at the customer's election, all or a portion of a current year's eligible refund can be carried over toward the next year's income tax liability. However, the Department may reduce or apply an eligible refund toward the customer's other unpaid tax liabilities according to IC 6- 8.1-9-2 and for a debtor's offset of refunds under IC 6- 8.1-9.5.

Type 2 Credits:
2-D. Refundable credits for personal and business activities of Indiana customers
2-E. Refundable credits for estimated and withholding taxes paid to Indiana

A complete listing of the refundable and nonrefundable credits available to Indiana customers is provided in Income Tax Bulletin #59 at www.in.gov/dor/3650.htm.

Order of Application
The available credits applied against the claimant's tax due in the following order:
- Credits classified as nonrefundable credits applied first.
- Those credits with carryover allowances applied second.
- Refundable credits applied last.

The type of tax to which the credit may be applied is also listed. If the credit can be applied against more than one tax type, the additional tax types are listed in the order to be applied.

Restrictions and Limitations
A customer, pass-through entity, shareholder, partner, or member of a pass-through entity cannot be granted more than one tax credit for the same project. This restriction applies to the following credits:
- Community Revitalization Enhancement District Tax Credit (808)
- Enterprise Zone Investment Credit (813)
- Hoosier Alternative Fuel Vehicle Manufacturer Tax Credit (845)
- Hoosier Business Investment Tax Credit (820)
- Industrial Recovery Tax Credit (824)
- Venture Capital Investment Tax Credit (835)

Amount of Credit Available
The amount of credit available to be granted may be limited by the statute creating the credit. The following describes those limitations:
- Unlimited - no limit other than the provisions governing the calculation of an allowable credit up to the amount of tax available to be offset.
- Limited - sum of all approved credits is limited to either the annual amount of the grant money available or the total of all credits that are allowed by the tax credit program.

For filing requirements, eligibility, amount of credit, effective dates, carryback/carryforward application, and other detailed information, see the specific income tax information bulletin issued by DOR or contact the agency administering the tax credit for instructions. Claims for credits should be supported by filing all applicable schedules and forms or by a separate calculation and certification from the appropriate agency of the amounts eligible for credit.

Audit Procedures
The auditor requests the following documentation to support the credits claimed on the Indiana return:

- Certification letters from the agency administering the credit
- Source documents proving eligibility for the credit
- Credit studies prepared by the customer, or the customer's accountant or consultant
- Any other documentation required to be maintained per Indiana Code

The auditor will examine the customer's documentation to verify the customer's eligibility for the credit and the amount claimed. In addition, the auditor will make sure the credits were applied in the order as discussed in this chapter and that all restrictions and limitations were properly adhered to.

Additional information regarding some of the more common credits reviewed as part of an Indiana income tax audit are further discussed below.

Enterprise Zone Employment Expense Credit
The Enterprise Zone Employment Expense Credit is a nonrefundable tax credit established under IC 6-3-3-10. The credit is for employers that hire qualified employees that work 50% or more of their time in an enterprise zone created under IC 5-28-15, perform services for the customer of which 90% is directly related to the conduct of the customer's trade or business that is located in the enterprise zone, and whose qualified employee's principal place of residence is in the enterprise zone in which the employee is employed.

Additionally, employees employed by a customer that is a pass-through entity must have been first employed by the customer after Dec. 31, 1998.

The credit is the lesser of 10% multiplied by the qualified increased employment expenditures of the customer for the taxable year (discussed below) or $1,500 multiplied by the number of qualified employees employed by the customer during the taxable year. Qualified increased employment expenditures are determined by subtracting the base period wages from the total qualified wages paid or payable to qualified employees for a taxable year. For the customer's taxable year in which the enterprise zone is established, the amount by which qualified wages paid or payable by the customer during all of the full calendar months in the customer's taxable year that succeed the date on which the enterprise zone was established exceed the customer's monthly base period wages multiplied by that same number of full calendar months.

Base period wages are:
In the case of a customer other than a pass-through entity, wages paid or payable by a customer to its employees during the year that ends on the last day of the month that immediately precedes the month in which an enterprise zone is established, to the extent that the wages would have been qualified wages if the enterprise zone had been in effect for that year. If the customer did not engage in an active trade or business during that year in the area that is later designated as an enterprise zone, then the base period wages equal zero (0). If the customer engaged in an active trade or business during only part of that year in an area that is later designated as an enterprise zone, then the Department shall determine the amount of base period wages or; In the case of a customer that is a pass-through entity, base period wages equal zero (0).

The amount of credit used by the customer for a particular year may not exceed the qualified state tax liability of the customer. If the customer has credits that exceed the qualified state tax liability for the taxable year, the customer may carry back the credit 3 years or forward 10 years to apply it to any remaining qualified state tax liability of the customer for those years. The customer must apply the current year's credit before any credit carryover or carryback is applied. However, if a credit results from wages paid in a particular zone that terminates in a taxable year that succeeds the last taxable year in which the customer is entitled to use the credit carryover, the customer may use the credit carryover for any taxable year up to and including the taxable year in which the enterprise zone terminates.

Qualified state tax liability includes:
The adjusted gross income tax that is derived from adjusted gross income from sources within an enterprise zone determined in the same manner set forth under IC 6-3-2-2. Insurance premiums tax from insurance premiums derived from sources within an enterprise zone.

Enterprise Loan Interest Credit
The Enterprise Loan Interest Credit is a credit established under IC 6-3.1-7 for customers who make qualified loans to entities located in enterprise zones created under IC 5-28-15. The amount of the credit to which a customer is entitled is five percent (5%) multiplied by the amount of interest received by the customer during the taxable year from qualified loans.

For periods prior to Jan. 1, 2019, a customer is entitled to a credit against the customer's state tax liability if the customer:

- Receives interest on a qualified loan in the taxable year;
- Pays the registration fee charged to zone businesses under IC 5-28-15-5;
- Provides the assistance to urban enterprise associations required from zone businesses under IC 5-28-15- 5; and
- Complies with any requires requirements under the board of the Indiana Economic Development Corporation for the credit.

However, if a customer is located outside of an enterprise zone, the customer is not required to reinvest its incentives within the enterprise zone as specified in (1) above, except as provided in and (3) above.

For periods on or after Jan. 1, 2019, a customer is entitled to a credit against the customer's state tax liability if the customer:

- Receives interest on a qualified loan in that taxable year;
- Provides the assistance to urban enterprise associations required from zone businesses under IC 5-28-15- 5.7(b); and
- Complies with any requirements adopted by the board of the Indiana economic development corporation under IC 5-28-15 for customers claiming the credit under this chapter.

However, if a customer is located outside of an enterprise zone, subdivision (3) does not require the customer to reinvest its incentives under this section within the enterprise zone, except as provided in (2) above.

A customer is entitled to a credit against the adjusted gross income tax, the financial institution tax, or the insurance premium tax for a taxable year if customer receives interest on a qualified loan in that taxable year. The amount of the credit to which the customer is entitled is 5% multiplied by the amount of interest received by the customer during the taxable year from the qualified loans. The credit can be carried forward for 10 years.

The credit must be applied against the customer's adjusted gross income tax liability first, insurance premiums tax liability second, and financial institutions tax liability third.

If a pass-through entity is entitled to a credit but does not have state tax liability against which the tax credit may be applied, an individual who is a shareholder, partner, beneficiary, or member is entitled to the tax credit determined for the pass-through entity for the taxable year multiplied by the percentage of the pass-through entity's distributive income to which the shareholder, partner, beneficiary, or member is entitled.

It is important to note that a pass-through entity and an individual who is a shareholder, partner, beneficiary, or member of a pass-through entity may not claim more than one credit for the qualified expenditure. It is important to note that a pass-through entity, or individual who is a shareholder, partner, beneficiary, or member of a pass-through entity may not claim more than one credit for the qualified expenditure as provided in IC 6- 3.1-1-3.

The credit is not available for loans made after Dec. 31, 2017.

Indiana Research Expense Credit

The Indiana research expense credit was established in 1984 as an incentive for businesses to invest in Indiana. This nonrefundable tax credit is available to any customer that designs, develops, or improves any product, process, technique, formula, or software. IC 6-3.1-4 permits a tax credit for increasing research expenses under Internal Revenue Code (IRC) Section 41 and the regulations in effect on Jan. 1, 2001 with some Indiana exceptions. The applicable standards for the Indiana credit are those standards described in Treasury Decision (TD) 8930 for periods prior to Jan. 1, 2016. For periods beginning on or after Jan. 1, 2016, Indiana recoupled with the current applicable Federal Regulations and law with some Indiana exceptions. Current applicable federal regulations have been amended under TD 9104 and other subsequent Treasury Decisions.

This credit is only for those qualified expenses that occur in Indiana. This credit is available to C Corporation and pass-through entities.

Pass-through entities are defined in IC 6-3.1-4-1 as S Corporations, partnerships, limited liability companies, or limited liability partnerships. Since trusts are not identified as a pass-through entity, taxable trusts may use the credits pass-through to the trust but may not pass any unused credits to the trust's beneficiaries.

For more information regarding this credit, please refer to the Research & Development Handbook published by the Indiana Department of Revenue.

CHAPTER 11 POST-AUDIT AND FINAL CONFERENCE PROCEDURES

POST-AUDIT CONFERENCE

At the conclusion of the audit fieldwork, a post-audit conference will be held with the customer via e-mail, phone, or in a face-to-face meeting. A face-to-face meeting will occur when possible with a follow-up e-mail recounting the discussion and any follow-up appointments agreed to at the meeting.

A post-audit conference by phone is allowable when conducting the post-audit conference in person is not practical due to proximity or necessity. A post-audit conference by mail or email may be conducted after a reasonable effort to conduct the conference in person or by telephone has been made.

The purpose of the post-audit conference is to review and discuss the preliminary results of the audit (or final audit results if applicable); provide explanations, statutory citations, and any relevant reference material for the audit findings; discuss requirements of the customer and auditor; explain the proper procedures to follow in the future; and establish deadlines for any requested information.

INTERIM POST-AUDIT COMMUNICATIONS / CONFERENCES

At any point after the post-audit conference, but before the final conference, it may be necessary to have communications with the auditor. These communications may be completed in-person, by email, or telephone. The method will be determined by the complexity of the issues and volume of documentation provided.

The purpose of this communication is to provide the customer an opportunity to address any issues with the proposed adjustments before the adjustments are finalized. If the customer provides sufficient documentation or clarification the auditor will make adjustments to the proposed assessment.

FINAL CONFERENCE

The final conference will occur at the conclusion of the audit. This conference may occur at the same time as the post-audit conference only if requested by the customer. The final conference may be held in person, by telephone, or via email. At this point, the auditor should have communicated and explained the audit findings

The purpose of the final conference is to provide the customer with the “unofficial” proposed final audit adjustments; discuss any changes from the post-audit results; explain and provide a copy of the DOR Protest Guide; and discuss and review the billing process. The final conference is an indication to the customer the field work is complete and an official report will follow.

At this meeting, the customer will have an opportunity to raise any issues of fact or law and discuss any concerns he/she has with the audit findings. If the customer elects to combine the post-audit conference with the final conference or they elect to waive the final conference, the auditor must confirm this request in writing. If the auditor is unsuccessful in scheduling a conference, the audit will be closed and the Notice of Proposed Assessment related to the final audit determinations will be issued.

ONGOING COMPLIANCE

During an audit, the auditor has an opportunity to educate the customer on the applicable Indiana tax laws. The customer should be aware that tax law changes may impact business operations and that it is the customer’s responsibility to keep up-to-date with these changes. DOR publishes guidelines to assist the customer. DOR’s website, can be found at dor.in.gov.

CHAPTER 12 SAMPLING AND COMPUTER ASSISTED AUDITS

SAMPLING OVERVIEW

Generally, sampling is used when auditing transactional taxes. A transaction tax, the most common of which is Sales and Use Tax, is one for which the tax due is determined based on the facts and circumstances of each individual transaction. A transaction can be reflected as an invoice or receipt, as a line on an invoice or receipt, or by other documentation. The most accurate way for an auditor to verify the tax reported is to review all invoices, receipts, and other documentation. When determined to be appropriate, an auditor may use sampling. This allows the auditor to reach conclusions about a large amount of data by collecting and examining only a portion of the data.

During the audit process, the auditor will determine whether customer records and business activities require the use of sampling. The auditor will develop an appropriate sampling plan and prepare a sampling agreement to be reviewed and signed. The auditor will discuss the sampling method with the customer and gather input from customer regarding the sampling plan. It is important for customer to be in agreement with the sampling method; however, this is not a requirement. The auditor is ultimately responsible for performing adequate tests that ensure the accuracy of the records.

It is recognized in some circumstances the sampling techniques may be unique depending on customer records. This chapter provides guidelines for sampling methodologies that can be deviated from as determined appropriate.

COMPUTER AUDIT SPECIALISTS

The Audit Operations Division has a group of Computer Audit Specialists (CAS) available to assist the auditor. This section specializes in reviewing and analyzing electronic records to improve the audit process.

Unlike paper records, electronic records can be sorted, extracted and summarized as needed to facilitate and expedite the audit process. If sufficient information is contained in an electronic record, the need to locate and retrieve paper copies will be reduced. Electronic records reduce the need for auditors to manually enter data, limit data entry errors, and allow customers easy access to the same information that is reviewed by the auditor. Electronic records are necessary to conduct a statistical sample but may also be used to conduct non-statistical sampling reviews.

Electronic records may be obtained by DOR as provided in IC 6-8.1-4-2(a)(3) and IC 6-8.1-4-2 (a)(6). These sections of the Indiana Code indicate that any books, records, or property of any customer relevant to determine a customer's tax liabilities may be obtained by the Division of Audit.

NON-STATISTICAL SAMPLING

Projections may be used when DOR and the customer consider the resources involved in performing a detailed review and determine a sampling method to be more appropriate or when the records are insufficient to conduct a detailed review. These projections may be accomplished using non-statistical sampling techniques.

Authority

The authority for use of a non-statistical sampling is provided in Indiana Code 6-8.1-4-2(a)(6) which states, "the division of audit may employ the use of such devices and techniques as may be necessary to improve audit practices."

Block Sampling

The form of non-statistical sampling most frequently used by DOR is block sampling. Block sampling involves reviewing contiguous transactions, usually grouped together for a specific period of time. Examples of time periods reviewed for a block sample include:

- Selecting a contiguous 12 month period.
- Selecting 3 months from each audit year.

The number of months reviewed is typically no fewer than 1 month for each audit year (i.e., a 3 year audit should review no fewer than 3months).

Other Non-Statistical Sampling Techniques
Other forms of non-statistical sampling may be used by DOR as determined appropriate. Capital asset purchases and special projects are audited in detail when using a non-statistical sampling technique. Any exception requires prior authorization from the auditor's supervisor.

Items the Auditor May Consider
The following considerations may assist the auditor in determining whether or not sampling is appropriate and if the sample periods are representative:

- Quantity of the records in each year (i.e., number of boxes or file cabinets for sales or vendor invoices).
- How the invoices are filed (i.e., by calendar year, by vendor / supplier, by date, etc.). If filed by calendar year, a one year block sample may be most appropriate. If by date, a sample selecting individual months from each year may be most appropriate.
- How invoices are maintained - paper copies or imaged electronically? Paper invoices filed by year lend themselves to a sampling by calendar year.
- Will records be reviewed onsite or remotely? If records are being reviewed remotely and tax exposure is minimal, selecting months from each year may be preferred.
- Have the business activities and tax payments remained relatively consistent during the audit period? If so a one year block sample may be appropriate.
- Is the activity of the business seasonal? If so, a one year block sample may be appropriate.

If conducting a one year block sample, typically:

- The most recent year will be selected if those invoices are most readily available (i.e., most recent year is onsite and earlier years have been warehoused).
- If more than the most recent year is readily available, reviewing the middle year is also acceptable.
- If invoices are filed by fiscal year, the most recent fiscal year in which all months are included within the audit period will typically be selected.

If selecting one or more months from each year:

- Periods will generally be selected from different parts of the year.
- If monthly activity fluctuates, a low, high and average month will be selected.

For example, if the auditor is conducting a 3 year audit of sales tax for a retail store where over half of its sales occur in November and December, November or December would generally be selected for one of the years. Selecting more than one month from every year would provide the most representative sample.

Projection Methods
When exceptions are identified within a sample, the percentage of error for the sample period is extrapolated over the audit period. For example, an error rate calculated for the sample period is applied to the total amount for the audit period (sales or expenses) to determine the taxable exceptions for the audit period.

DOR typically uses a Ratio Estimate for projecting sample results. The computation for the Ratio Estimate is the total dollars of error over the total dollars reviewed in the sample. This error percentage is applied to the corresponding population amount for sampled and non-sampled periods to estimate the total error. Error percentages are generally not calculated on an account by account basis. Rather, a single error percentage is computed for all accounts. The DOR auditor should give consideration to the appropriate projection base.

- In a sales sample, additional sales tax can generally only be due on exempt sales. Accordingly, the projection base should be exempt sales, not total sales.
- Adjustments to purchases are typically found in Accounts Payable. Accordingly, the projection base would be Accounts Payable balances for the relevant accounts. If it is determined that General Ledger balances are appropriate, activity for each year should be analyzed to determine that the balances from year to year are consistent with business activity. Examples of concerns would be:
    - Significant changes in total activity from one year to the next that are not supported by changes in business activity.
    - Accounts that have significant activity in one year but not another year.
    - Accounts that have positive balances in one year and negative balances in another.

Other projection methods may be used as determined appropriate.

STATISTICAL SAMPLING

Overview

Statistical sampling is a method used to sample transactions where there are a very large number of transactions to be examined and the number of transactions is so voluminous that a detailed examination is impractical. It requires access to both physical and electronic records that are complete. DOR uses a variable sampling plan.

Variable sampling is a statistical plan to project a quantitative characteristic such as a dollar amount.

Definition

Statistical Sampling is defined in the American Institute of Certified Public Accountants Clarified Statement on Auditing Standards (SAS) No. 122, AU-C sec. 530.05, as follows:
An approach to sampling that has the following characteristics:

a. *Random selection of the sample items*
b. *The use of an appropriate statistical technique to evaluate sample results, including measurement of sampling risk*

A sampling approach that does not have characteristics a. and b. is considered non-statistical sampling.

Authority

The authority for using a statistical sampling technique is provided by IC 6-8.1-3-12(b) which states, “The Indiana Department of Revenue may use statistical sampling in order to review a customer’s records more efficiently and accurately.”

Benefits of Conducting a Statistical Sample

- Selecting records from the entire audit period will generally provide more accurate results than selecting sample records from a period that does not extend through the entire audit period.
- Possible time savings in retrieving and review documents.
- Estimation of an appropriate sample size based on statistical principles.
- Efficient manner to accurately determine deficiencies or overpayments of tax.
- Reduced auditor error.
- Measurable sampling risk stated in terms of confidence level and precision.
- Projection of overpayments and underpayments.
- Objective, defensible results.

Characteristics of a Good Sampling Candidate

Characteristics of a good candidate for use of a statistical sampling method may include the following:

- Customers that have a large volume of exempt sales and/or purchase records.
- Customers that do not file invoices by vendor.
- Customers that file invoices of locations being audited with locations not being audited.
- Voluminous refund claims.
- E-Business that does not generate paper records.

Statistical Sampling Audit Procedures

PROCEDURES FOR STATISTICAL SAMPLING REVIEW OF PURCHASES

- The DOR auditor should discuss the possibility of conducting a statistical sample with the customer.
- Once the auditor has discussed statistical sampling with the customer, the auditor will provide the DOR Computer Audit Specialist (CAS) with the customer contact information and any other pertinent details.
- In most cases, the CAS will contact the customer to discuss format of electronic data, types of electronic accounting records needed, sample periods, etc. The DOR auditor may participate in this discussion.
- The CAS summarizes customer electronic records data by account and incorporates the data into an "Account Classifications" worksheet.
- The DOR auditor, with input from the customer, makes a determination of the accounts to be reviewed.
- The CAS selects the stratified random sample and provides the sample selections (pull list) and work papers.
- The auditor should provide the pull list and required work papers to the customer and determine how the records will be reviewed.
- Each invoice in the sample is reviewed to determine the adjustment amount, if applicable. Adjustments are determined in the same manner used for non-statistical sample audits.

Procedures when sales tax is paid on the transaction or use tax payment can be traced to the sample record:

a. No tax paid, record is exempt > adjustment is zero
b. Tax paid, record is taxable > adjustment is zero
c. No tax paid, record is taxable > positive adjustment
d. Tax paid, record is exempt > negative adjustment

If use tax payments cannot be traced to the sample record and sales tax has not been charged (Note: (a) and (b) also apply to a SUTCA)

a. Exempt > adjustment is zero
b. Taxable > positive adjustment
c. An aggregate credit for use tax paid will be applied against tax determined due. The aggregate credit should exclude use tax that the customer has already been provided credit for. For example, if capital assets are reviewed outside the sample and use tax on capital was applied on a transaction by transaction basis.

Negative records for returns, posting errors, discounts, etc.

- CAS performs procedures to match and remove reversing records.
- A detailed listing of unmatched negative records is provided to the auditor.
- No adjustment to pull list record
- Ignore negative record.
- Adjustment to the pull list record.
- Reduce adjustment by corresponding negative amount.

Once the audit adjustments are finalized by the auditor and before submitting the report for further processing by DOR, the CAS verifies the estimator (error estimate) and calculates the precision of the sample and provides this information to the auditor for consideration.

SAMPLING CAPITAL ASSETS

DOR auditors generally do not perform non-statistical sampling reviews of capital assets. However, the auditor may use a statistical sampling technique for review of assets. The CAS will include all capital asset purchases made during the audit period in the population from which the sample is drawn. In most cases, both assets and general purchases will be combined into a single use tax sample. A detailed review of assets may be preferred if it can be quickly completed.

RELATED LEGAL ENTITIES

If the auditor is reviewing two or more related legal entities, the possibility of reviewing the related legal entities under a single statistical sample may be discussed with the customer. The primary benefit of a single statistical sample is that desired precision goals may be achieved through a significantly smaller sample size.

NONRECURRING/EXTRAORDINARY ITEMS

An item is considered extraordinary or nonrecurring in nature if it is unusual and not routine in the normal course of customer business. The most efficient manner of handling nonrecurring transactions is to identify and exclude them before the sample is selected. If the customer is unable to identify nonrecurring transactions before the selection of the sample, then those records will be included with all other items.

In a block sample, a nonrecurring transaction may not be representative of the sample population. If transactions are determined to be nonrecurring, the auditor may remove these transactions from the sample and review them separately.

The design of a statistical sample eliminates the issue of extraordinary transactions skewing the sample results. Stratification and the opportunity for all records in the population to be selected for review addresses the concerns of projecting nonrecurring items that are inherent in block samples. In a statistical sample nonrecurring transactions that are not removed from the sampling frame upfront should remain in the population and the appropriate tax determination should be projected.

MISSING DOCUMENTATION FOR SAMPLE ITEMS

If the customer cannot locate the documentation relating to any sample item, the default position is to consider the item taxable. However, the auditor may use supporting evidence (i.e., other invoices from the vendor) and reasonableness to determine the taxability of the item.

SALES AND USE TAX COMPLIANCE AGREEMENT (SUTCA):

A SUTCA is a program in which statistical sampling is used to determine a taxable rate to be applied to purchasing activity on a go-forward basis (typically three years). Using this rate, the customer can quickly calculate and pay use tax due on included expenses. Capital assets are typically excluded. This method replaces the traditional method of the customer tracking use tax on a purchase-by-purchase basis. Each month a company under a SUTCA determines applicable purchases by computing total purchases for the accounts

included in the agreement. Applicable purchases are then multiplied by the agreed upon taxable rate to calculate the purchases on which tax will be reported.

To enter into a SUTCA, the customer must have or obtain a Direct Pay Permit. When a customer and DOR enter into a SUTCA, DOR agrees to not audit and the customer agrees to not request a refund claim on purchases covered by the agreement.

Once DOR and customer have agreed upon the use tax percentage, the auditor forwards the completed pull list to the CAS. The end product is a signed contract drafted by DOR's Legal Division or Tax Policy. The auditor is not required to write an audit report.

A SUTCA may be done in conjunction with an audit, resulting in additional efficiencies. For an audit, the goal is to determine errors in tax and for a SUTCA, the goal is to determine the percentage of purchases that are subject to tax (taxable rate).

If there is a period between the last SUTCA or audit and the effective date of the new SUTCA in which the statute of limitations has not expired, an investigation report may be conducted to true-up the open period. Typically a true-up is not conducted unless DOR and customer agree to do so at the beginning of the process.

CHAPTER 13 FILED AUDIT WORKPAPERS

Audit work papers are the summaries, schedules, and worksheets compiled by an auditor in the course of conducting the audit. The work papers support the auditor's methods and findings. Therefore, clear, descriptive, and properly prepared work papers are important. The auditor will give the customer copies of his/her work papers and review them with the customer or customer authorized representative at the final conference.

WORK PAPER STANDARDS

The auditor should prepare and provide work papers providing a clear representation of the adjustments in the audit. A minimum of one work paper should be prepared for every applicable tax with the audit periods indicated.

Work papers prepared by the auditor should contain the following information:

- Title heading
- Customer name and control number
- Page number, if multiple pages
- Source of data (generally in the title of work paper)
- Any applicable identifying information for the adjustments (ex. Invoice date, account number, invoice number, dollar amount, etc.)
- Sufficient cross-referencing to create a clear audit trail

CROSS REFERENCING

When carrying summary figures from one schedule to another, the auditor should use cross-referencing whenever possible. Notations should be made under or next to the figures that are transferred to or from a related schedule.

CONTENTS OF WORK PAPERS

The contents of the work papers should be structured so that the customer, audit supervisor, and others who review the work papers can follow the auditor's procedures and understand how and why the determinations were made.

Each tax is to be considered separately. The auditor should create a separate set of schedules for each tax audited. There should be a summary schedule showing the determinations of tax due or a determination that there is no tax assessment. Any projections used in making the determinations are to be supported by subsidiary schedules containing further details, such as a listing of taxable sales or purchases.

The auditor should include subsidiary schedules to substantiate the summary and/or other subsidiary schedules. The information shown on a subsidiary schedule is an analysis of the data shown on the schedule being supported. Subsidiary schedules contain all details essential to the auditor's determinations and the data used to arrive at audit figures, e.g., monthly totals from the sales account, individual sales from the cash receipts journal, lists of individual sales from sales invoices, lists of individual purchases from purchase invoices, etc.

Unless an explanation of the items on a subsidiary schedule is self-evident from column headings, entries in the "description" column, or otherwise noted, the auditor should be sure to include descriptive comments. A subsidiary schedule should show:

- Source of data and a brief description;
- The basis for any estimates;
- Method of calculating percentages;
- Explanation of differences between reported and audited amounts; and
- Any other comments pertinent to the method or reasoning used to arrive at the facts and figures shown on the schedule.

OTHER AUDIT DOCUMENTS

The following documents to be retained in the audit file, separate from the audit work papers:

- All pertinent correspondence to and from the customer and/or its authorized representative;
- Superseded work papers;
- Research material;
- Third-party information; and
- Other data obtained during the audit, such as annual reports, menus, copies of coupons, specials, or advertisements or invoice copies.

In many cases, these miscellaneous documents may have significant bearing on the audit and therefore, should be carefully preserved.

CHAPTER 14 CASH INTENSIVE BUSINESSES

GENERAL INFORMATION

A cash intensive business is one that receives a significant amount of receipts in cash. Cash intensive businesses typically include restaurants, bars, gas stations, convenience stores, grocery stores, car washes and numerous other retail and service-oriented establishments that deal in large percentages of cash transactions.

PRE-AUDIT PROCEDURES

When conducting a cash intensive business audit, the auditor should follow the normal pre-audit procedures completed for all types of audit examinations.

The DOR auditor may also use various available resources to gather information and analyze the returns of a cash intensive business. These resources may include, but are not limited to the following:

- Publically Available Information – Secretary of State Reports, other information obtained from general browser search inquiries (Google, etc.), etc.
- An on-site visit of customer business
- IRS Audit Technique Guides for Cash Intensive Businesses
- Business industry statistics from sources such as BizStats, Beacon, Bureau of Labor Statistics, etc.
- Internally accessible reports including alcohol distributor reports, BMV reports, gasoline distributor reports, etc.
- Accessing Federal Tax Information (FTI) when necessary

It is necessary for the DOR auditor to verify information on the return. Sometimes the pre-Quality Assurance indicates a potential of under-reported income, sales tax, etc. and requires additional inquiry by the auditor. The following are examples of observations that may require further inquiry by the auditor:

- A consistent pattern of losses or low profit percentages
- Observed expenditures that are not supported by the reported income
- Continuation of operations despite reported losses and without correction of the source of the losses
- A Cash T analysis shows a deficit of funds
- Bank balances or liquid assets increase annually despite low net profits or losses
- Increased accumulated assets accompanied by low reported net profits or net losses
- Decreased or low debt accompanied by low net profits or net losses
- Significant difference between gross profit margin and the industry standard
- Low annual sales for the type of business
- Vertical analysis of various expenses relative to gross receipts

ANALYSIS OF BOOKS AND RECORDS

Customers are required to provide documentation to substantiate all figures reported on the filed tax returns. The auditor will request information to verify the reported income and expenses, including all source documents.

A source document is an original record of a transaction. Source documents are a critical part of an audit trail for establishing the authenticity, and tracing the history of a transaction for the purpose of determining that all sales, cash and credit, have been reported to DOR accurately.

Detailed original source documents are the best documents available to validate the amounts reported on tax returns by the customer. Examples of detailed original source documents include guest check tickets or receipts, sales invoices or receipts, entire cash register tape rolls, purchase invoices, deposit slips, credit card receipts, point of sales detailed reports, and bank statements. This list of examples is not all encompassing.

The auditor should document and use all records and documents customer provide to verify the reported amounts and calculate any audit adjustments (if applicable). The auditor should also evaluate the internal controls of the customer and determine answers to the following or similar types of questions to aid in the analysis:

- How is cash handled?
- Is all cash received deposited into a bank account?
- Who has access to the cash?
- What process is used to pay expenses with cash?
- Is additional cash kept on hand in a safe or other location?
- If no cash is kept on hand, how do customer handle cash paying customers?
- Are there other sources of income?
- How are sales handled at the business?
- Is accounting system based on a cash or accrual basis?
- How are retail prices established?
- What is the markup percentage?
- How often and by whom is inventory taken?
- What bank accounts are maintained?
- Who maintains the books?
- Who files the returns?

If all requested records and documents needed to substantiate the amounts reported on a return are provided, a cash intensive business audit will likely proceed as any other audit examination. If the records are determined to be incorrect or indicate insufficient internal control procedures, further review may be necessary.

USING AN INDIRECT AUDIT METHOD

If a customer's records are determined to be incorrect or insufficient (and the returns were prepared on this incorrect or insufficient information), DOR may determine the amount of tax due Indiana by using the best information available (BIA). Sometimes this may require the auditor to use an indirect method for determining the amount of Indiana tax due.

Indirect methods involve the determination of tax liabilities through an analysis of a customer's financial affairs using information from a wide range of sources beyond the customer's declaration and formal books and records. Assessments are often based on circumstantial evidence indicating a reasonable estimate of the customer's correct liability. Some of the factors the auditor may consider in determining if an indirect audit method is appropriate include:

- The customer is unable to provide detailed original source documents to validate the Sales Tax returns filed for the current audit period;
- The customer is unable to validate disparities between tax returns filed, bank deposits, and summary sales records;
- The customer is unable to validate the disparities between audited purchases and reported purchases from the test period;
- The customer fails to provide complete purchase invoices for the test period selected;
- The auditor identifies cash paying customers that are not included in reported gross receipts;
- There are gaps in customer records or records are missing;
- Reported payroll is insufficient to support the business;
- The auditor observes that there are more employees working at the business than are on the payroll;
- The expenses reported on the corporate tax returns include personal expenses paid by the business.

The decision to use an indirect audit method depends not only on the inadequacy of the records, but also on the auditor's analysis of the internal records. The auditor will include specific findings in the audit report of insufficiencies in the records or internal controls.

Indirect methods available for use to substantiate reported tax return amounts include but are not limited to:

- Bank deposit analysis
- Vertical analysis
- Source and application of funds
- Cost of goods sold analysis
- Percentage mark-up analysis
- Industry Ratios
- Comparative analysis
- Inventory analysis
- 1099K data
- Cash T account
- Net worth
- Third-party verification

The auditor will use the most accurate method available based on the records provided and internal controls in place by the customer.

CHAPTER 15 REFUND CLAIM PROCESSING

OVERVIEW

Refunds claims can originate from the filing of an amended tax return, an audit, or a refund claim filed by the customer for overpaid taxes on Form GA-110L (Claim for Refund). The Refund group reviews claims submitted by customers on Form GA-110L for various tax types such as sales tax, withholding tax, income tax, and others. This group also reviews claims for exempt utilities on a Form ST-200 (Utility Sales Tax Exemption Application).

REFUND CLAIM PROCESSING / REVIEW PROCEDURES

When a refund claim is submitted to DOR on Form GA-110L, a DOR team member will review the claim to ensure the following information is accurate.

- Customer's name;
- Customer's address;
- Customer's identification number with location number, federal identification number or social security number (if an individual);
- Type of tax the refund claim is for (each tax type requires a separate GA-110L); Sales tax for exempt utilities requires a completed ST-200 (Utility Sales Tax Exemption Application) form. If previously approved and predominant, the ST-109 form (Indiana Utility/Communication Sales Tax Exemption certificate) or copy of the letter from DOR with the percent allowed (if not predominant) should be attached to the refund claim;
- The period of the claim (each year/period should be listed separately);
- The amount of the claim (listed per corresponding year/period);
- Signature of the customer. The refund claim should be signed by the customer (if an individual), an authorized representative (e.g., an officer of the corporation or a partner/shareholder of a partnership/S Corporation), or a representative authorized by the customer on a POA-1(Power of Attorney) form;
- Explanation of the claim with supporting documentation. A detailed explanation of why the refund is due and all the supporting documentation to verify the validity of the claim.
- Timeliness of the claim- IC 6-8.1-9-1 (a) provides the general statutory period within which a claim for refund may be filed. The prerequisite for obtaining a refund is that the customer must file the claim with the Department within three years after the latter of the following:
    1. The due date of the return;
    2. The date of the payment; or
    3. In the case of a return filed for the state gross retail or use tax, the gasoline tax, special fuel tax, or motor carrier fuel tax, the end of the calendar year that contains the taxable period for which the return is filed.

There are two exceptions to the general three-year time period in which a claim for refund must be filed:

- Refunds of adjusted gross income tax or financial institutions tax as the result of a modification of a customer's federal income tax liability by the Internal Revenue Service (IRS) must be filed by the latter of (1) the due date for the refund otherwise provided by IC 6-8.1-9-1(a) or (2) 180 days after a final determination regarding the modification.
    - A final determination means an action or decision by a customer, the IRS, the United States Tax Court, or any other United States Federal Court concerning any disputed tax issue that is final and conclusive, and cannot be reopened or appealed by a customer or the IRS as a matter of law.
    - Any extended statute of limitations does not apply to a tax return (or amended tax return) filed by the customer without any action by the IRS. This includes amended returns filed by a customer to report adjustments made by the IRS if a federal tax refund is not available for that taxable year (e.g., the federal return reports a net operating loss but the Indiana return reports a gain) AND a federal tax refund could not have been obtained for that taxable year even if the federal return had reported tax due.

If an agreement to extend the statute of limitations for assessment is entered into under IC 6-8.1-5-2 (h), the statute of limitations for filing a refund claim is extended to the same date to which the Department may assess additional tax.

If any of the above information is missing or the year/periods are not listed separately, the reviewer will contact the customer to obtain the missing information. The reviewer will use the contact information at the bottom of the form to contact the customer so this information should be accurate.

If the refund claim is missing any supporting documentation or information, a rejection letter will be mailed. The letter will outline the items needed to resolve the missing or inaccurate data and it will provide a deadline. If the items requested in the outline are not corrected before the deadline, the refund claim will be rejected. The customer will receive a rejection letter and the customer will have to file a new refund claim. If a refund claim is rejected, this does not extend the three years statute of limitation on the refund, which began on the original due date of the return. Additional information regarding the refund process can be found in General Tax Information Bulletin #100 at dor.in.gov/reference/files/gb100.pdf.

If a refund claim is determined to be invalid in full or in part, the claim will be denied. Some reasons a claim can be invalid are: out of statute, no supporting documentation, duplicate claims and other miscellaneous items. The customer will receive a refund denial letter with an explanation stating the reason(s) for such denial. If the customer disagrees with the denial, the customer has 60 days from the date the refund denial letter is mailed to file a request with the Department for an administrative hearing. Administrative hearing procedures can be found in General Tax Information Bulletin #100. When a refund claim is denied, the customer cannot resubmit the claim without new or different reason(s).

If a refund claim is granted in full or in part, the Department will check to see if there are any missing returns or tax liabilities. If there are outstanding tax liabilities, the Department will apply the refund to these first before refunding the money to the customer. The customer will receive a letter stating where the credits were allocated. Please see General Tax Information Bulletin #101 at dor.in.gov/reference/files/gb101.pdf, for more information. If the Department grants the claim for refund in full, payment of the claim is sufficient notice of the Department's decision. If there are missing returns, the Department may hold the refund until the missing returns are filed.

UTILITY STUDY REVIEW PROCEDURES (FORM ST-200)

A DOR team member will examine the customer's ST-200 to ensure the following information is included and accurate:

- The legal name on the ST-200 is the same as the name on the utility bill(s) provided (except for farmers, the name can be different, if the farmer is leasing the land from another farmer);
- The meter location address on the ST-200 is the same as the service address on the utility bill(s);
- The meter number on the ST-200 is the same as the meter number on the most current utility bill;
- Narrative explaining the business operations and activity qualifying for an exemption. If the customer operates a farm, is a manufacturer or restaurant, a utility study (listing the equipment and power rating) is required; if a nonprofit, no utility study is needed;
- At least one utility bill should be attached for each ST-200 application
- If the utility bill does not have all of the necessary information on it, a screenshot from the customer's online account or documentation on the utility company letterhead must be provided.

If a utility is determined to be predominantly (more than 50%) consumed for excepted (exempt) use, the utility will qualify for a 100% exemption and DOR will issue a Form ST-109 (Indiana Utility/Commission Sales Tax Exemption). The ST-109 will be issued to the utility company and the customer. An ST-109 will not be issued for any utility not predominantly (under 50% exempt) consumed for excepted (exempt) use. For a partial exemption or utility consumed in research and development, the customer will be required to file a refund claim each year to recover taxes paid on the exempt usage. The refund claim should indicate the determined exempt percent. The customer will receive a letter stating the approved exempt percentage after the utility study is reviewed and approved.

SUPPORTING DOCUMENTATION

A refund claim must be submitted with an explanation for the refund and any documentation that supports the reason for requesting the refund. The most common types of refunds requested include sales tax (both utility and non-utility) and withholding tax. Examples of supporting documentation for these tax types are listed below. A refund claim of other tax types can must be submitted with supporting documentation such as amended returns, worksheets to show the breakdown of food and beverage tax or county innkeeper's tax, and any other documentation that customer may have to support the requested refund.

SALES TAX (NON-UTILITY)

- Invoices showing sales tax was paid if requesting a refund of sales tax paid in error;
- For use tax paid in error, a spreadsheet or journal which shows items for which use tax was accrued that ties to the amount of use tax remitted on the ST-103;
- Exemption certificate showing the customer is exempt;
- Contracts for items such as software and warranties;
- Sales spreadsheets that show a breakdown of taxable/nontaxable;
- Proof of payment in refunds where sales tax is requested for sales tax charged to an exempt customer, along with the exemption certificate from the customer;
- Any other documentation

SALES TAX (UTILITY)

- A completed ST-200 for each utility meter with the supporting bills. The utility bills need to include the billing name of the customer, mailing address, meter number, account number and meter location if different than the mailing address. The name and address must match the address registered with DOR for that location. If the bills do not have all of this information, something from the utility company or the customer's online account detail must be provided;
- Completed utility usage study. The production and non-production equipment should be listed separately (preferably on two different worksheets).

WITHHOLDING

- Payroll journals;
- W-2s filed;
- Returns;
- WH-4s;
- Any other documentation;
- Amended returns with supporting documentation;

To check the status of customer individual refund claim, the customer will need the exact amount of the refund claim, the year and the customer's social security number. Customer can check the status of customer refund claim online at dor.in.gov/4339.htm, by automated phone at (317) 233-4018, or by contacting a customer service representative at (317) 232-2240. Please allow 45 days for processing before contacting the Department regarding the status of customer refund claim.

INTEREST AND PROTEST PROCEDURES

If the refund process takes longer than 90 days (starting from the postmark date) the Department will apply interest to the amount of the refund. The interest rates can be found in Departmental Notice #3, dor.in.gov/files/dn03.pdf.

To protest a proposed assessment or denial of a claim for refund, the customer has 60 days from the date issued to file a protest, which must be in writing. The protest letter should detail the reason(s) for customer protest and it must be signed and dated. A protest submission form (State Form 56317) is also required when filing a protest. Refer to DOR's Appeals webpage at http://www.in.gov/dor/5691.htm for more information about the protest process (Protest Guide), various options to resolve a protest (including fast-track settlement), links to required forms, answers to frequently asked questions, and a link to a searchable database of final determinations, revenue rulings and Information Bulletins.

Written protests should be mailed to:
Indiana Department of Revenue Attn:
Legal Division, MS 102
100 N. Senate Avenue, Room N248
Indianapolis, IN 46204

CHAPTER 16 – AUDIT AND COMPLIANCE SUPPORT

LIMITED SCOPE / DESK AUDIT PROCEDURES

A limited scope audit is a type of audit in which the field activity is less extensive than a complete audit of a tax or fee type. These audits focus only on a specific area of concern. Most limited scope audits do not require a customer's onsite visit thus called "desk audits." The desk audits are performed at DOR's main office in Indianapolis or at one of the district offices.

Common reasons to perform a limited scope audit includes:

- Verification of customer filed refund claims;
- Review of a single item on the return – Example: specific credit or deduction on an income tax return;
- Determination of the exempt nature of a purchase;
- Limited customer adjustments when a full-scale audit is not necessary or practical.

The auditor sends a letter indicating the specific item under review as part of the limited scope audit. This letter indicates the documentation required for the audit and specifies a period for which this information must be provided. The auditor can schedule a date for an interview to obtain information regarding the specific area of concern. Lastly, the letter will inform the customer of the consequences for failing to provide the requested information by the deadline indicated.

Based on the information provided, the auditor reviews the documentation and makes a determination. Actions that may be taken by DOR include:

1. Accepts the documentation as sufficient evidence and proposes no adjustment to the return as filed;
2. Adjusts the return, recalculating the tax/fee, and issues a proposed assessment for any additional tax due.

QUALITY ASSURANCE AND BILLING

Procedures Issuing the Audit Report

After the final conference, the auditor prepares a written report of the findings. The audit report will provide a thorough explanation for each of the audit adjustments. The auditor includes any relevant factual support and indicates the statutory basis for each adjustment. The report accompanied by the audit work papers are submitted to the auditor's supervisor for approval. The supervisor forwards the audit report to DOR's Quality Assurance team for further review. Chapter 13 of this manual further details audit work paper presentation.

Internal Quality Assurance

Once the auditor completes an audit file, the file passes through various stages in the review process. When the file is assigned to a Quality Assurance team member, the reviewer performs a detailed examination of each completed audit report. Reviewers are provided a procedural checklist to guide the review process through each audit. Audits are reviewed for mechanical accuracy and agreement with Department records as well as for completeness to ensure contents are adequate and comply with current procedures and guidelines.

Audit reports are reviewed for correct application of tax law and Departmental policies, procedures, and guidelines, as well as professionalism in content and presentation. Supporting documents and worksheets are reviewed to ensure conclusions are sound and corroborated. The reviewer must determine, on each audit file, that the auditor has reached sound conclusions, computed the correct amount of tax due, has documented all adjustments and findings properly, and has followed all guidelines established for assembling and submitting the completed audit file.

NOTICE OF PROPOSED ASSESSMENTS

Once the limited scope desk audit or field audit report has been fully reviewed and approved for processing, the file is submitted to the Audit Billing Division for processing. The billing division will generate the audit bills and official audit report. A hard copy of the final audit report along with a cover letter will be mailed to the customer via the United States Postal Service. An electronic copy of the audit report and cover letter will also be e-mailed to the Power of Attorney via DOR's secure e-mail, if applicable.

In addition to the audit report and cover letter, DOR will issue a notice of proposed assessment (bill) for each year in the audit period that will include any applicable penalties and interest.

Penalty is generally 10% of the assessed tax and the interest rate varies per year. Refer to Departmental Notice #3 at https://www.in.gov/dor/files/dn03.pdf for further information on calculating interest. Both limited scope audits and field audits that result in an assessment of tax will result in bills being issued. Questions regarding the Proposed Assessment can be directed to auditbilling@dor.in.gov, by phone at (317) 232-3425, or mail to:

Indiana Department of Revenue
Attn: Audit Division, Audit Support and Compliance MS 104
100 N Senate Avenue, Room N241
Indianapolis, IN 46204

The customer must reply by the due date on the bill. If they do not respond by the due date, the law requires the Department to start collection efforts and they will lose their protest rights. If the bill is not paid 60 days, the bill moves to the next stage, Demand Notice for Payment.

PROTEST PROCEDURES

To protest a proposed assessment or denial of a claim for refund, the customer has 60 days from the date issued to file a protest, which must be in writing. The protest letter should detail the reason(s) for customer protest and it must be signed and dated. A protest submission form (State Form 56317) is also required when filing a protest. Refer to DOR's Appeals webpage at dor.in.gov/5691.htm for more information about the protest process (Protest Guide), various options to resolve a protest (including fast-track settlement), links to required forms, answers to frequently asked questions, and a link to a searchable database of final determinations, revenue rulings and Information Bulletins.

Written protests should be mailed to:
Indiana Department of Revenue
Attn: Legal Division, MS 102
100 N. Senate Avenue, Room N248
Indianapolis, IN 46204

AUDITOR SURVEY

DOR is always looking for ways to improve service to our customers. Included with the audit report will be instructions on how the customer or representative can provide feedback on the audit experience. Customer feedback is a critical part of DOR's continual improvement in fulfilling its vision of becoming the premier tax administrator in the nation. Please take a moment when the customer receives the audit report to provide us with customer feedback.

OPTIONS TO PAY THE AUDIT BILL

Customers may pay by in person, by phone, online or by mail. Checks and money orders should be made payable to the Indiana Department of Revenue and mailed to:

Indiana Department of Revenue
Attn: Audit Division, Audit Support and Compliance, MS 104
100 N. Senate Avenue
Indianapolis, Indiana 46204

DOR also offers several payment plan options for both individuals and businesses. Generally the amount of tax due must be more than $100 for individuals and $500 for businesses to establish a payment plan. The payment plan options can be found on our website at dor.in.gov/6389.htm.

DOR also offers “fast track” settlement options, see the DOR Protest Guide at dor.in.gov/files/dor-protest-guide.pdf for more information.

DORpay can be found at dorpay.dor.in.gov. Instructions on how to pay through DORpay can be found at dor.in.gov/files/dorpay-guide.pdf.

INtax can be found at dor.in.gov/4336.htm.

CHAPTER 17 OTHER TAXES AND FEES

There are several other taxes and fees administered by DOR. The audit procedures, including pre-audit and post-audit, are similar to the procedures discussed in the previous chapters. Some of the more common other taxes and fees administered by DOR are highlighted in this chapter.

FOOD AND BEVERAGE TAX (FAB)

General Information

In counties or municipalities that have adopted a food and beverage tax, businesses that sell food and beverages must register for both sales tax and FAB. The FAB rate is 1% of the gross retail income received from taxable food and beverage transactions (Marion County and the Historic Hotel's rate is 2%). In instances where both a county and a municipality within the county have adopted the FAB tax, the total taxable transaction inside the municipality is 2%.

The food and beverage tax applies to any transaction in which food or beverage is furnished, prepared, or served by a retail merchant for consumption at a location or on equipment provided by the retail merchant in a county or municipality that adopts the tax.

Taxable transactions include:

- Food sold and served by a retail merchant that is performing catering activities;
- Food sold at a deli counter in a grocery store that is cooked or heated on the premises of the retail merchant;
- Transactions in which the seller provides eating utensils, including plates, knives, forks, spoons, glasses, cups, napkins, or straws.

Transactions not subject to tax include:

- Sales of food that is only cut, repackaged, or pasteurized by the seller.
- Sales of eggs, fish, meat, and poultry requiring cooking by the consumer.
- Sales of food and beverages if the transaction is exempt from the sales tax (for example, the customer is a charitable organization and the purchase is for the organization's charitable purpose).
- Foods that are subject to sales tax but were not mixed or heated by the seller (candy, soft drinks, etc.) are exempt from food and beverage tax. This exemption applies if the foods are (1) not intended for consumption on the customer's premises; and (2) not served by the seller off the seller's premises.

Collection and Remittance of the Tax

The food and beverage tax is imposed, paid, and collected in the same manner as the sales tax. The filing of the return and the remittance of the tax collected are due 30 days after the end of the month in which the transaction occurs. The return for the food and beverage tax is a separate return from the sales and use tax return. A retailer that is required to collect and remit the tax may file a consolidated food and beverage tax return if the retailer operates multiple locations in the same county. A separate return is required to be filed by the retailer if the retailer has locations in different adopting counties.

FAB Reference Material

General Tax Information Bulletin #203 - dor.in.gov/reference/files/gb203.pdf

Departmental Notice #21 - dor.in.gov/3618.htm

Current FAB Tax Rates and Effective Dates - dor.in.gov/3613.htm

ENHANCED PREPAID WIRELESS TELECOMMUNICATIONS FEE

General Information

Also known as Wireless Prepaid Phone Cards & Services (WPC), IC 36-8-16.6 provides an enhanced prepaid wireless telecommunications service charge be collected from users of prepaid wireless telecommunications services by sellers and remitted to the Indiana Department of Revenue by the sellers. All retail merchants in Indiana who sell prepaid wireless telephone services (through the sale of a prepaid phone or prepaid phone card) must collect $1 per sales transaction (effective July 2015).

The fee, known as the Prepaid 911 Enhancement Fee, will ensure Indiana complies with 911 requirements set down by the Indiana General Assembly. This is the result of an Indiana law (IC 36-8- 16.6-14) passed during the 2010 legislative session.

Please note that this fee should not be included in any sales tax calculations. In addition, retail merchants may keep 1% of the transaction fee to cover collection efforts for this new law.

Collection and Remittance of the Fee

A seller is required to collect the charge from the consumer with respect to each retail transaction and to disclose to the consumer the amount of the charge. The seller may separately state the amount of the charge on an invoice, a receipt, or a similar document that the seller provides to the consumer. If the seller does not separately state the amount of the charge on an invoice, a receipt, or a similar document, the seller is still required to remit to the Department the charges collected from the consumer.

Retail merchants must remit all fees collected to the Indiana Department of Revenue on or before the date they are required to file their Indiana sales tax, following the date of the transaction. The seller shall report and remit the charges collected using the Department's online tax filing program (INtax). A seller can register for INtax by going to dor.in.gov/4336.htm.

A seller can deduct 1% of the enhanced prepaid wireless charges collected from consumers if the seller reports and remits the charges collected in a timely manner.

Reference Material

General Tax Information Bulletin #210 - dor.in.gov/reference/files/gb210.pdf

MOTOR VEHICLE RENTAL EXCISE TAX (MVR)

General Information

A motor vehicle rental excise tax; also known as the auto rental excise tax, is imposed on rentals of passenger motor vehicles and trucks for periods of less than 30 days. The rental of a trailer is not subject to this tax. The tax is equal to 4% of the gross retail income received by the retail merchant (6% for the Marion County Supplemental Auto Rental Excise Tax). The person renting the vehicle is liable for the tax. The retail merchant is required to collect the tax and remit it to the Department. The tax must be separately stated from the amount paid for the rental. Trucks which have a declared gross weight of over 11,000 pounds are exempt. The rental of a passenger motor vehicle or truck by a funeral director is exempt from the auto rental excise tax if the rental is part of the services provided by the director for a funeral. (Also refer to Indiana Code: IC 6-6-9; IC 6-6- 9.7)

Vehicles rented by entities exempt from the sales tax are not exempt from the auto rental excise tax, or the Marion County Supplemental Auto Rental Excise Tax. Entities that are not exempt include state or local governments (IC 6-2.5-5-16), and nonprofit organizations (IC 6- 2.5-5-25).

Whether registering customer vehicle for the first time or renewing customer registration, customer will pay an annual excise tax and a registration fee. Passenger vehicles and recreational vehicles have separate vehicle excise tax rates. The excise tax amount is based on the vehicle class and age. The age of a vehicle is determined by subtracting the model year from the calendar year that the vehicle is due to be registered. The class of a vehicle is based on the vehicle value as determined by the manufacturer's original retail price.

Customers living in certain counties and municipalities will also pay a county and municipal vehicle excise tax or wheel tax.

Collection and Remittance of the Tax
A separate return must be filed for each business location. Consolidated reporting is not allowed as each location's tax collections are to be credited to the location's taxing district. A monthly return must be filed even though no tax is due.

Reference Material
Sales Tax Information Bulletin #47 - dor.in.gov/reference/files/sib47.pdf

BMV Excise Tax Fee - https://www.in.gov/bmv/2624.htm

BMV Vehicle Application Checklist - in.gov/bmv/files/Vehicle_Excise_Tax_Surtax_Refund_App_Packet.pdf

Departmental Notice #38 - https://www.in.gov/dor/reference/files/dn38.pdf

COUNTY INNKEEPER'S TAX (CIT)

General Information
All counties are authorized to impose an innkeeper's tax under IC 6-9-18 or through specific enabling statutes throughout IC 6-9. Not all counties have adopted the innkeeper's tax and most adopting counties administer this tax themselves. The majority of Indiana's 92 counties have imposed an innkeeper's tax. Fifty-five counties have used the uniform innkeeper's tax statute under IC 6-9-18.

In general, the uniform innkeeper's tax statute provides that the fiscal body of a county may impose an innkeeper's tax on those engaged in the business of renting or furnishing, for periods of fewer than 30 days, any room or rooms, lodgings, or accommodations in any hotel, motel, boat motel, inn, college or university memorial union, college or university residence hall or dormitory, or tourist cabin located in the county. The county innkeeper's tax is in addition to the state sales tax.

Accommodations can include:
- Rooms in hotels, motels, lodges, ranches, villas, apartments, houses, bed and breakfast establishments, vacation homes or resorts.
- Gymnasiums, coliseums, banquet halls, ball rooms, arenas or other similar accommodations regularly offered for rent.
- Cabins, cottages, tents or fixed trailers. Houseboats and other craft with overnight facilities.
- Space in camper parks and trailer parks where spaces are regularly offered for rent for periods of less than 30 days.

The Department provides a list of counties that have adopted the county innkeeper's tax in the table located in the Departmental Notice #40 (rates vary by county). Customers may also contact customer county auditor's office to learn if the county innkeeper's tax will apply to customer business.

Collection and Remittance of the Tax
Innkeeper's taxes are imposed and administered in the same manner as the sales tax. For example, transactions not subject to sales tax, such as where there is no consideration exchanged for the room, also are not subject to innkeeper's tax. Indeed, all of the provisions related to rights, duties, liabilities, procedures, penalties, definitions, exemptions, and administration of sales tax under IC 6-2.5 are applicable to the imposition and administration of the innkeeper's tax except to the extent those provisions are in conflict or inconsistent with specific provisions enacted under the innkeeper's tax statutes or the requirements of a county treasurer.

Innkeeper's taxes may be collected either by the Indiana Department of Revenue (Department) or by the county that enacted the tax. If the tax is paid to the Department, the innkeeper will need to register online with the Department by completing a Form BT-1 (Business Tax Application) and remitting innkeeper's taxes monthly via INtax, the Department's online filing and payment portal. More information related to INtax is available online at dor.in.gov/4336.htm.

Innkeeper's taxes collected at the county level must be paid monthly and reported on forms approved by the county treasurer.

Reference Material
For additional information regarding County Innkeeper's tax and the current rates, please visit our website at dor.in.gov/3469.htm.

WASTE TIRE MANAGEMENT FEE (TIF)

General Information
If a customer sells tires for self-propelled vehicles, the customer must collect an Indiana tire fee of $0.25 per tire in addition to sales tax. All tires mounted on self-propelled vehicles are subject to the tire fee, except for tires for garden tractors propelled with less than 25-horsepower motors. A tire mounted on a farm tractor; an implement of agriculture; a semitrailer; or equipment used in transportation, manufacturing, agriculture, construction, or mining is subject to the tire fee.

The fee is also imposed on each new tire mounted on a vehicle at the time the vehicle is sold, and any spare tire that is included with the vehicle. Purchases by governmental units and nonprofit organizations are not exempt from the tire fee.

Collection and Remittance of the Fee
The fee imposed shall be collected by the person selling the new tire to the ultimate consumer of the tire or vehicle. The statute does not apply to the sale of used or retreaded tires.

The law requires the tire fee to be remitted at the same time as the sales tax. If a customer is required to file by the 20th of the month through electronic funds transfer, the customer is also required to remit the tire fee by the 20th of the month through electronic funds transfer.

The customer that is remitting the tire fee is entitled to retain 1% of the amount collected as compensation for filing and remitting the fee.

The tire fee is to be remitted using Form TF-103 and returns can be filed by using INtax. This form is required to be filed with the remittance of the tire fee unless the payment is remitted through electronic funds transfer and then only a quarterly recap is required to be filed.

Reference Material
Indiana Code: IC 13-11-2-231; IC 13-11-2-245; and IC 13-20-13-7

General Tax Information Bulletin #208 - dor.in.gov/reference/files/gb208.pdf

CHAPER 18 SPECIAL TAXES

The Special Tax Group, a group within Audit Operations, completes the audit of special taxes. The audit procedures, including pre-audit and post-audit, are similar to the procedures discussed in previous chapters. This chapter covers information regarding the taxes administered and audited by the Special Tax Group.

CONTACT INFORMATION

Special Tax & Support Administration Phone Number: (317) 615-2544

FIREWORKS PUBLIC SAFETY FEE (FPS-103)

Overview

Indiana enacted a Fireworks Public Safety fee during the 2006 session of the Indiana General Assembly (see Indiana Code IC 22-11-14). The fee was set at 5% of the gross retail income of fireworks sold in Indiana. The fee became effective for all transactions occurring in Indiana after May 31, 2006.

Definition

Indiana Code IC 22-11-14-1 sets forth definitions for “Consumer firework” and “Special fireworks” among other definitions covered in the code. Additional items subject to the fireworks public safety fee include but are not limited to dipped sticks, wire sparklers, cylindrical fountains, cone fountains, illuminating torches, wheels, ground spinners, flitter sparklers, snakes or glow worms, smoke devices, and trick noisemakers.

Registration

The Act requires any person selling consumer fireworks, special fireworks, or novelties and trick noisemakers at retail to collect the public safety fee. The Act requires all retailers that are selling consumer fireworks to register with the state fire marshal. The entities that register with the state fire marshal will automatically register with DOR and will receive the forms necessary to remit the public safety fee.

A registered resident wholesaler, manufacturer, importer, or distributor is not prohibited from selling consumer fireworks at retail if the consumer fireworks are to be used on the property of the purchaser, or on the property of another person who has given permission to the purchaser to use the consumer fireworks.

A retailer who is selling items listed in IC 22-11-14 -8(a), will be required to collect the public safety fee. All wholesalers, manufacturers, importers, and distributors are required to provide a list to the state fire marshal of all retailers to whom they have sold or will sell these items.

A retailer selling items listed in IC 22-11-14-8(a) from a temporary stand must obtain a fireworks stand retail sales permit from the state fire marshal. These retailers are required to collect and remit the public safety fee to DOR. The Department of Revenue will provide required forms, upon request, for the remittance of the fee.

Collection and Remittance of the Fee

The public safety fee is a charge imposed on the retail sale of fireworks in Indiana. The purchaser of fireworks in a retail transaction is liable for the public safety fee, and shall pay the fee to the retailer as a separate line item. The retailer collects the public safety fee as an agent for the state.

The public safety fees collected in trust for the state makes an individual retailer, an employee, officer, partner in a partnership or member of a limited liability company personally liable for the payment of the public safety fee to the state. The public safety fee is due twenty (20) days after the end of the month in which the public safety fee was collected. A person who knowingly or intentionally fails to collect or remit the public safety fees due commits a Class D felony.

Record Keeping Requirements

Customers are required to maintain a record of each fireworks sale for a period of four (4) years past the date of the return. The following source documents to support customer's Fireworks Public Safety Fee include:

- All sales records consisting of cash register receipts and daily "Z" tape totals.
- Recaps of daily, monthly and annual sales records by location and register.
- Purchase invoices.
- Physical inventories maintained at a minimum annually.
- Bank statements, financial statement, trial balances, general ledgers and account details.
- Copies of monthly FPS & sales and use tax returns.
- Copies of federal and state income returns

Audit Procedures

The auditor reviews filed returns, ledger reports, source documents and any other documentation needed to ensure the fee was properly collected on all retail sales of items listed in IC 22-11-14 -8(a), and the fees collected were properly reported and remitted to DOR.

Reference Material

More information on Fireworks Public Safety Fee is available at dor.in.gov/3989.htm. Nontechnical information is available in General Tax Information Bulletin #209 at dor.in.gov/reference/files/gb209.pdf.

AVIATION FUEL EXCISE TAX (AVF-150)

Overview

Indiana instituted the Aviation Fuel Excise Tax effective July 1, 2013 to replace state gross retail tax on aviation fuel (see Indiana Code IC 6-6-13). In addition, effective July 1, 2013, the aviation fuel was no longer subject to the Indiana gross retail (sales) tax of 7%. The tax rate as of July 1, 2013 was set at $.10 per gallon. Effective July 1, 2017 the tax rate increased to $.20 per gallon (see IC 6-6-13-6).

Definitions

Indiana Code IC 6-6-13 sets forth definitions for "Retailer", "Aviation fuel" among other definitions.

"De-Fueling" refers to when aviation fuel companies will remove fuel from an aircraft and refund the customer for the cost of the fuel removed. To reduce reported metered gallons sold on the AVF-150 tax return, the retailer must maintain documentation that the fuel was dispensed to and removed from the same aircraft within a reasonable period of time.

Documentation must show that the aviation fuel excise tax was charged, paid and later refunded to the customer.

Registration Requirements

Every retailer of aviation fuel is required to register with the Department. The retailer shall complete Form AVF-1 (Registration). Form AVF-1 is available online at dor.in.gov/3512.htm.

Collection and Remittance of the Tax

A retailer shall add the per-gallon amount of excise tax to the selling price of each gallon of aviation fuel sold by the retailer so that the ultimate consumer bears the burden of the tax.

The retailer is required to remit to DOR the aviation fuel excise taxes imposed on transactions that occurred during a particular month to the Department on or before the fifteenth (15) day of the following calendar month. The tax shall be remitted by electronic funds transfer (EFT). A retailer who properly remits the aviation fuel excise tax shall be allowed to retain one and six tenths percent (1.6%) of the taxes collected to cover the cost of collecting, reporting, and timely remitting of the aviation fuel excise taxes.

Each retailer is required to report monthly the number of gallons of aviation gasoline and jet fuel sold by the retailer, along with the number of gallons of exempt fuel sold. The monthly report of taxable and exempt sales shall be filed electronically through Form AVF-150.

A person who knowingly fails to collect or timely remit the aviation fuel excise tax is liable for the uncollected tax plus a penalty equal to one hundred percent (100%) of the uncollected tax. Other penalties such include felony prosecution and civil fines if the failure to file was deemed intentional.

Exemptions from Aviation Fuel Excise

The sale of aviation fuel is exempt from the excise tax if the aviation fuel is placed into the fuel supply tank of an aircraft owned by the United States government, the State of Indiana, the Indiana Air National Guard or a common carrier of passengers or freight. Exemptions also exist for wholesale to wholesale transactions.

An exemption certificate (AVF-105 Aviation Fuel Excise Fuel Tax Exemption Certificate) must be retained for each customer for which exempt sales are claimed.

Record Keeping Requirements

Aviation fuel dealers must maintain records to support all gallons sold and placed into aircraft, including exemptions certificates. It is recommended that the customer maintain the following documentation in support of their reported Aviation Fuel Excise Tax:

- Purchase invoices/purchase journals Sales invoices/sales journals
- Sales tax exemption certificates
- Aircraft de-fueling records including any refunds of fuel or aviation excise taxes. Documentation of own aviation gasoline or jet fuel consumption.
- Physical inventory reading of each aviation gasoline and jet fuel bulk tank at the beginning and ending of each month. The reading should be recorded and converted into gallons along with the date when it was taken.
- Inventory readings from electronic meter inventory system
- Tank and/or tanker truck meter readings in support of disbursed gallons beginning and ending monthly totalizer meter readings for each bulk tank

Audit Procedures

The auditor reviews the filed returns, inventory reports, purchase invoices, disbursement logs, or other documentation. After review, the auditor ensures:

1. the excise tax was properly collected on the retail sale of aviation fuel,
2. a properly completed aviation fuel exemption certificate (form AVF-105) was provided for aviation sales where the tax was not collected, and
3. the excise taxes collected were properly reported and remitted to DOR.

Reference Material

General Tax Information Bulletin #207 - dor.in.gov/reference/files/gb207.pdf

GASOLINE AND OIL INSPECTION FEE (MF-360)

Overview

Indiana implemented the Gasoline Tax in 1923 (see Indiana Code IC 6-6-1.1 and Indiana Administrative Code 45 IAC 12). Effective July 1, 2018 this motor fuel excise tax rate was increased from $.28 to $.29 per gallon. Gasoline Tax funds are used to construct, maintain and expand the Indiana highway system and for traffic policing and safety. The Oil Inspection Fee of $.01 per gallon is collected on gasoline as well as certain special fuel products (see IC 16-44-2). Monies collected from the Oil Inspection Fee is deposited into the underground storage tank excess liability trust fund.

Definitions

Kerosene: Includes all light fuel oils both dyed and clear that are sold under various names (i.e., #1 diesel, #1 heating oil, #1 fuel oil, #1 stove oil, etc.) and are used off road, for heating, etc.

Terminal: A fuel storage facility that can receive and disperse fuel via pipeline or marine vessel. Must also have a rack from which fuel is removed for placement into a tank truck or tank transport truck. Must be registered as a qualified terminal by the Internal Revenue Service.

#1 Special Fuel: This includes all light fuel oils both dyed and clear that are sold under various names (i.e., #1 diesel, #1 heating oil, #1 fuel oil, #1 stove oil, etc.) and are used off road, heating, etc. Not included is #1 clear diesel fuel used to propel motor vehicles on public highways and #1 dyed diesel if used to propel motor vehicles on public highways by a Licensed Dyed Fuel User.

Bulk Plant: Commonly known as a "jobber" or "wholesaler." A fuel storage facility, other than a terminal, that is primarily for redistribution of fuel by motor vehicles. These vehicles typically have a capacity of no more than 5,400 gallons.

Rack: A dock, platform, or an open bay with a series of metered pipes and hoses for delivering special fuel from a refinery or terminal into a motor vehicle, rail car or marine vessel. Licensed distributor – Means a person holding a valid distributor's license issued by the administrator.

Imposition

A license tax is imposed on the use of all gasoline used in Indiana. The distributor shall initially pay the tax on the billed gallons the distributor receives in this state, less deductions authorized by the Indiana Code. Gasoline is considered received when it is withdrawn from an in-state refinery or terminal for sale or use in this state or transfer to a destination in this state, unless the destination is another in-state refinery or terminal. The distributor shall then add the per gallon amount of the tax to the selling price of each gallon of gasoline sold in this state and collect from the purchaser so the consumer bears the ultimate burden of the tax.

Gasoline, kerosene and #1 special fuel are subject to an inspection fee on all gallons received for sale or use in Indiana. The distributor shall initially pay the fee on the billed gallons of all gasoline, kerosene and # 1 special fuel the distributor receives in this state, less any deductions authorized by the Indiana Code. The distributor shall then add the per gallon amount of the tax to the selling price of each gallon of gasoline sold in this state and collect from the purchaser so the consumer bears the ultimate burden of the tax.

Collection and Reporting Requirements

The Gasoline Tax and Oil Inspection Fee is collected by the licensed gasoline distributor as an agent for the state. In the case of a corporate or partnership distributor, every officer, employee, or member of the employer who in that capacity is under a duty to collect the tax, is personally liable for the tax, penalty, and interest. To determine the tax liability under this chapter, each distributor shall electronically file a MF-360 Consolidated Gasoline Monthly Tax Return with the administrator by the 20th day of each calendar month. This report is submitted via the Fuel Tax EDI system or the web based INtax program (see http://www.in.gov/dor/3762.htm). The tax/fee due is also remitted electronically.

An uncanceled license issued by the administrator to do business as a gasoline distributor is required for a person to receive gasoline in Indiana without paying gasoline tax to their supplier. A "supplier" means a distributor or person who sells gasoline. To obtain a gasoline distributor license, a Form FT-1 (Fuel Tax License Application) is filed with the Department, along with a current financial statement and a $100 registration fee. The Department may require an applicant to file with the administrator a surety bond, a letter of credit, or a cash deposit in an amount of not less than two thousand dollars ($2,000) nor more than a three (3) month tax liability for the applicant as estimated by the administration. In order to maintain a permanent gasoline distributor license, a person must distribute at least five hundred thousand (500,000) gallons of gasoline during the year.

Exemptions
The following transactions are exempt from Gasoline Tax and Oil Inspection Fee.

- Gasoline, kerosene and #1 special fuel exported from Indiana to another state, territory, or foreign country.
- Gasoline, kerosene and #1 special fuel sold to the United States or an agency or instrumentality thereof.
- Gasoline, kerosene and #1 special fuel sold to a post exchange or other concessionaire on a federal reservation within Indiana; however, the post exchange or concessionaire shall collect, report, and pay to the administrator any tax permitted by federal law on gasoline sold.
- Gasoline, kerosene and #1 special fuel used by a licensed distributor for any purpose other than the generation of power for the propulsion of motor vehicles upon the public highways.
- Gasoline, kerosene and #1 special fuel received by a licensed distributor and thereafter lost or destroyed, except by evaporation, shrinkage, or unknown cause, while the distributor is still the owner.

Recordkeeping Requirements
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 section include all source documents necessary to determine the tax, including but not limited to purchase/sales invoices, purchase/sales journals, bills of lading and delivery tickets. A person must retain the books and records that support the reported information for three (3) years from the date the final payment of gasoline tax/oil inspection fee liability was due.

Audit Procedures
The auditor will review the filed returns, sales and purchase documentation, logs, or other documentation needed to ensure 1) the excise tax was properly collected on gasoline sales by the distributor, and 2) the excise taxes collected were properly reported and remitted to DOR.

Reference Material
More information regarding Gasoline Tax/Oil Inspection Fee is available at dor.in.gov/3649.htm.

Departmental Notices #19, #36 and #43 provide nontechnical assistance to the general public and can be found at dor.in.gov/3618.htm.

SPECIAL FUEL TAX AND OIL INSPECTION FEE (SF-900)
Overview
Special Fuel Tax funds are used to construct, maintain and expand the Indiana highway system and for traffic policing and safety (see Indiana Code IC 6-6-2.5 and Indiana Administrative Code 45 IAC 10). Effective July 1, 2018, the motor carrier surcharge was repealed and the special fuel tax rate was increased from $.26 to $.47 and adjusted for inflation to $.48. The rate is published in Departmental Notice #43. Beginning July 1, 2005 an Oil Inspection Fee of $.01 per gallon is collected on clear diesel used to propel motor vehicles on public highways (see IC 16-44-2). This clear diesel includes all clear #1 and #2 special fuel and kerosene if blended at the rack. Also, subject to the Oil Inspection Fee is #1 and #2 dyed diesel fuel if used to propel motor vehicles on public highways by a License Dyed Fuel User. Monies collected from the Oil Inspection Fee are deposited into the underground storage tank excess liability trust fund.

Special fuel tax licensees include Licensed Supplier, Permissive Supplier, Importer, Exporter, Blender, Dyed Fuel User and Transporter.

Definitions
Special Fuel: All combustible gases and liquids that are suitable for the generation of power in an internal combustion engine; or used exclusively for heating, industrial, or farm purposes other than for the operation of a motor vehicle. Special fuel includes low sulfur #1 and #2 clear diesel, high sulfur dyed diesel, low sulfur dyed diesel, dyed #1 diesel, kerosene and clear/dyed biodiesel.

Received: The removal from any refinery or terminal in Indiana, or the entry into Indiana of any special fuel for consumption, use, sale, or warehousing, except for transfers in bulk into or within a terminal in Indiana between registered suppliers.

Terminal: A fuel storage and distribution facility that is supplied by pipeline or marine vessel, and from which special fuel may be removed at a rack and that has been registered as a qualified terminal by the Internal Revenue Service for receipts of taxable motor fuels free of federal motor fuel taxes.

Supplier: A person that imports or acquires immediately upon import into Indiana special fuel by pipeline or marine vessel from within a state, territory, or possession of the United States into a terminal or that imports special fuel into Indiana from a foreign country, or that produces, manufactures, or refines special fuel within Indiana, or that owns special fuel in the pipeline and terminal distribution system in Indiana, and is subject to the general taxing or police jurisdiction of Indiana, and in any case is also registered under Section 4101 of the Internal Revenue Code for transactions in taxable motor fuels in the bulk distribution system. A terminal operator shall not be considered a supplier merely because the terminal operator handles special fuel consigned to it within a terminal.

Permissive Supplier: Any person who does not meet the geographic jurisdictional connections to Indiana required of a supplier, but who holds an inventory position in a federally qualified terminal located outside of Indiana and who is registered under Section 4101 of the Internal Revenue Code.

Importer: Any person, other than a supplier, who sells or purchases special fuel from out-of-state and delivers into Indiana.

Exporter: Any person, other than a supplier, who purchases special fuel in Indiana for the purpose of transporting or delivering the fuel to another state or country.

Dyed Fuel User: A person that qualifies for the federal diesel fuel tax exemption under Section 4082 of the Internal Revenue Code to operate motor vehicles on the highways with dyed fuel in the fuel supply tank.

Blender: A person that mixes one (1) or more petroleum products, with or without another product, excluding biodiesel or blended biodiesel, if the product obtained by the blending is capable of use in the generation of power for the propulsion of a motor vehicle, an airplane, or a motorboat.

Transporter: The person and its agent, including the driver that transports special fuel.

Terminal Operator: The person who by ownership or contractual agreement is charged with the responsibility and physical control over the operation of the terminal.

Imposition

A license tax of $0.26 per gallon is imposed on all special fuel sold or used in producing or generating power for propelling motor vehicles in Indiana. The licensee shall initially pay the tax on the billed gallons that are received for sale or use in this state, less deductions authorized by the Indiana Code. Special Fuel is considered received when it is withdrawn from an in-state refinery or terminal for sale or use in this state or transfer to a destination in this state, unless the destination is another in-state refinery or terminal.

Number 1 (#1) and #2 clear special fuel, kerosene blended at the rack and dyed #1 and #2 special fuel used by Dyed Fuel Users is subject to an inspection fee on all gallons received for sale or use in Indiana. The licensee shall initially pay the fee on the billed special fuel gallons the licensee sold, received or used in this state, less any deductions authorized by the Indiana Code. The licensed supplier, permissive supplier or importer shall then add the per gallon amount of the tax to the selling price of each gallon of special fuel sold in this state and collect from the purchaser so the consumer bears the ultimate burden of the tax.

Collection and Reporting Requirements

The Special Fuel Tax and Oil Inspection Fee is collected by the licensed supplier/permissive as an agent for the state. In the case of a corporate or partnership distributor, every officer, employee, or member of the employer who in that capacity is under a duty to collect the tax, is personally liable for the tax, penalty, and interest. A licensed importer must obtain an import verification number from the Department before the special fuel entering Indiana. The special fuel tax is remitted by the licensed importer within three (3) days of the nonexempt special fuel entering into Indiana or the time that a valid import verification number was assigned by the Department, whichever is earlier.

An uncanceled license issued by the administrator to do business as a special fuel licensee is required for a person to receive special fuel in Indiana without paying special fuel tax to their supplier. To obtain a special fuel tax license, a Form FT-1 (Fuel Tax License Application) is filed with the Department, along with a current financial statement and a registration fee, if applicable. The registration fee depends on the type of license being requested. The license application is available online at dor.in.gov/3512.htm. The Department may require an applicant to file with the administrator a surety bond, a letter of credit, or a cash deposit in an amount of not less than two thousand dollars ($2,000) nor more than a three (3) month tax liability for the applicant as estimated by the administration.

To determine the tax liability under this chapter, each special fuel tax licensee with the exception of the terminal operator and transporter shall electronically file a SF-900 Consolidated Special Fuel Monthly Tax Return with the administrator by the 20th day of each calendar month. This report is submitted via the Fuel Tax EDI system or the web based INtax program (see dor.in.gov/3762.htm). The tax/fee due is also remitted electronically. The terminal operators submit an informational only FT-501 tax return by the 20th day of each calendar month. On this tax return, receipts into and disbursements from the customer's terminal(s) are reported. Both gasoline and special fuel products are detailed on the Terminal Operator's Monthly Return. The transporters submit an informational only SF-401 tax return by the 25th of each calendar month (see dor.in.gov/3512.htm for more information). On this return, shipments from customer Indiana owned terminals and shipments into Indiana from out-of-state owned terminals are reported. Both gasoline and special products are detailed on the Transporter's Monthly Return (see dor.in.gov/3512.htm for more information).

Exemptions

The following transactions are exempt from Special Fuel Tax and Oil Inspection Fee:

- Gallons sold to other licensed suppliers via rail or pipeline – reported on schedule 6
- Gallons disbursed on exchange with other licensed suppliers – reported on schedule 6X
- Exports- reported on schedules 7, 7A and 7B
- Gallons sold to United States Government including Post Exchanges/Federal Reservations – reported on schedule 8
- Gallons of dyed fuel sold for off road use such as agricultural or heating oil use or train use– reported on schedule 10

Recordkeeping

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 section include all source documents necessary to determine the tax, including but not limited to purchase/sales invoices, purchase/sales journals, bills of lading and delivery tickets. A person must retain the books and records that support the reported information for three (3) years from the date the final payment of special fuel tax/oil inspection fee liability was due.

Audit Procedures

The auditor will review the filed returns, sales and purchase documentation, logs, or other documentation needed to ensure 1) the excise tax was properly collected on special fuel sales by the licensed distributor as applicable, and 2) the excise taxes collected were properly reported and remitted to DOR.

Reference Material

More information regarding Special Fuel/Oil Inspection Fee is available at dor.in.gov/3649.htm.

Departmental Notices #19, #36 and #43 provide nontechnical assistance to the general public and can be found at dor.in.gov/3618.htm.

General Tax Information Bulletin #300 provides nontechnical assistance to the general public and is available at dor.in.gov/reference/files/gb300.pdf.

GASOLINE USE TAX (GUT) (GT-103 AND GT-103DR)

Overview

Indiana implemented the Gasoline Use Tax on July 1, 2014 to replace the prepaid sales tax and the regular at- the-pump sales tax on gasoline (see Indiana Code IC 6-2.5-3.5). The Department will determine the gasoline use tax rate by calculating a monthly statewide average retail price per gallon of gasoline (excluding tax) multiplied by 7%. Due to this computation, the gasoline use tax rate may change on a monthly basis. The Department publishes the monthly gasoline use tax rate in Departmental Notice #2 at dor.in.gov/3618.htm.

Definitions

Distributor: A person who is the first purchaser of gasoline from a refiner, terminal operator or supplier regardless of the purchase location.

Refiner: A person who manufactures or produces gasoline by any process involving substantially more than blending of gasoline.

Terminal Operator: Stores gasoline in tanks and equipment used in receiving and storing gasoline from pipelines pending bulk wholesale reshipment. A terminal operator may also store gasoline at a boat terminal transfer that is a dock, a tank or equipment or contiguous to a dock or tank including equipment used in unloading gasoline from a ship or barge, transferring the gasoline to a tank pending wholesale reshipment.

Qualified Distributor: Licensed under the Gasoline Tax Code IC 6-6-1.1 and holds a valid gasoline use tax permit issued under the Gasoline Use Tax Code IC 6-2.5-3.5-17.

Collection and Reporting Requirements

The Gasoline Use Tax is collected when a refiner, terminal operator or qualified distributor sells gasoline to a nonqualified distributor or retail merchant. The refiner, terminal operator or qualified distributor must collect and remit the tax from the nonqualified distributor or retail merchant to the Department. The Gasoline Use Tax is also imposed on distributors (other than qualified distributors) who import gasoline from outside Indiana for shipment into and sale or use in Indiana. A distributor importing gasoline into Indiana must obtain a permit from the Department as outlined in Gasoline Use Tax Code IC 6-2.5-3.5-17. Finally, if a refiner, terminal operator or qualified distributor transfers gasoline to a location for purposes of retail sale, that refiner, terminal operator or qualified distributor is subject to the Gasoline Use Tax upon transfer.

Each refiner, terminal operator or qualified distributor that collects gasoline is required to remit Gasoline Use Tax via the Department's online tax filing system, INtax. Payments are made bi-monthly with the first payment due on the 25th day of the month for all gasoline sold from the 1st through the 15th day of the month. The second payment is due on the 10th day of the following month for all gasoline sold from the 16th through the last day of the month. To determine the tax liability, the qualified distributor completes a GT-103 tax return. This return is submitted via the INtax system. Also, a monthly GT-103DR recap is submitted detailing the number of gallons of gasoline sold or shipped during the preceding month. This return is submitted via the Fuel Tax EDI system or the web based INtax program (see dor.in.gov/3762.htm).

Exemptions
The exemptions provided in IC 6-2.5-5 apply to the Gasoline Use Tax and include the following:

- Sales from a refiner or terminal operator to a qualified distributor
- Sales to another licensed distributor for resale only
- Sale to nonprofit organizations
- Sales to companies in public transportation
- Sales to persons engaged as farmers to be used directly in productions of agriculture products for sale
- Sales to a contractor for exempt projects (such as public schools, government or nonprofits)
- Sales to Indiana Government Units (agencies, cities, towns, municipalities, public schools, and state universities)
- Sales to the United States Federal Government
- Sales for export

Distributors, refiners and terminal operators that want to receive gas in Indiana without paying the gasoline use tax and distributors importing gasoline into Indiana must have a valid permit from the Department to collect Gasoline Use Tax payments from purchasers and recipients of gasoline. To obtain a gasoline use tax permit, a Form FT-1 (Fuel Tax License Application) is filed with the Department, along with a current financial statement, $100 registration fee, current financial statement and a surety bond. The bond is in an amount of not less than two thousand dollars ($2,000) nor more than a three (3) month tax liability for the applicant as estimated by the administration. An exception to the bond requirement is for established distributors who are current and compliant with all fuel and listed taxes and who have had their Gasoline Distributor's bond released due to good standing with the Department.

Recordkeeping Requirements
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 section include all source documents necessary to determine the tax, including but not limited to purchase/sales invoices, purchase/sales journals, bills of lading and delivery tickets and ST-105 exemption certificates. A person must retain the books and records that support the reported information for three (3) years from the date the final payment of gasoline use tax liability was due.

Audit Procedures
The auditor will review the filed returns, sales and purchase documentation, logs, or other documentation needed to ensure 1) the gasoline use tax was properly collected on sales to unlicensed distributors or retail merchants, and 2) the excise taxes collected were properly reported and remitted to DOR.

Reference Material
More information regarding Gasoline Use Tax is available at dor.in.gov/5081.htm.

Departmental Notice #27, Departmental Notice #43, and Sales Tax Information Bulletin #83 provide nontechnical assistance to the general public and can be found at dor.in.gov/3618.htm and dor.in.gov/6051.htm.

PETROLEUM SEVERANCE TAX (MF-600)
Overview
In 1947 Indiana enacted an excise tax on all petroleum products severed and taken from the land (see Indiana Code IC 6-8-1 and Indiana Administrative Code 45 IAC 6-1). Petroleum products include crude oil and gas. The tax rate is the greater of 1% of the value of the petroleum or $.03 per 1,000 cubic feet for natural gas and $.24 per barrel for oil. Petroleum Severance funds are deposited into the oil and gas fund and are used by the Department of Natural Resources for purpose of administering IC 14-37 for research pertaining to exploration for, development of and wise use of petroleum resources in Indiana.

Definitions

Petroleum: All hydrocarbons produced at a well in a liquid or gaseous state.

Natural Gas: Refers to petroleum that maintains a gaseous state at atmospheric conditions. Oil – is petroleum that maintains a liquid state at atmospheric conditions.

Barrel of Oil: Refers to 42 United States gallons of oil at 60 degrees Fahrenheit. Producer – is a person engaged in severing petroleum directly from the land.

Owner: A person receiving or entitled to receive a proportionate share of petroleum or a proportionate share of the proceeds of the sale of petroleum after production by an operator, and without limitation of the foregoing, includes the owners of royalties, excess royalty, overriding royalty, mineral rights, or working interest.

Value: The price paid or offered to be paid for petroleum of a like grade or gravity in the field or pool in which such well is located, and, if no such price to be paid or offered, then as determined pursuant to the rules of the Department.

Collection and Reporting Requirements

An excise tax is imposed on the owner and producers of petroleum products for the removal of all such products from the land in Indiana. The responsibility for the payment of the tax is upon any person purchasing such petroleum products or having such petroleum products in their possession. It is a lien on the petroleum for the tax, penalties and interest. Any person purchasing or having possession of petroleum products that the tax has not been paid is personally liable for the reporting and payment of the amount of the lien of the tax and other charges.

The responsibility for the reporting and paying of the Petroleum Severance Tax is applied to all purchasers and those having possession of petroleum products after being severed from the ground. To determine the tax liability under this chapter, the owner, producer or purchaser shall electronically file an MF-600 Petroleum Severance Tax Return with the administrator within 30 days after the last day of the calendar month being reported. This report is submitted via a paper return and mailed along with the tax due to the Department at the address on the return.

Registration Requirements

To register for Petroleum Severance Tax, a Form FT-1 (Fuel Tax License Application) is filed with the Department. There is no fee, bond or financial statement requirement. On the application, the customer estimates the annual number of barrels that will be purchased or gathered from the land.

Recordkeeping Requirements

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 section include all source documents necessary to determine the tax, including but not limited to sales/purchase invoices, sales/purchase journals, and production documents. A person must retain the books and records that support the reported information for three (3) years from the date the final payment of petroleum severance tax liability was due.

ALCOHOL EXCISE TAX – BEER, CIDER, LIQUOR, WINE PRODUCERS (ALC-M)

Overview

Indiana enacted an excise tax on all alcoholic products sold or made available for sale in Indiana (see Indiana Code IC 7.1-4 and Indiana Administrative Code 45 IAC 7). The intent was to (1) protect the economic welfare, health, peace and morals of the people of this state, (2) regulate and limit the manufacture, sale and possession and use of alcohol and alcoholic beverages and provide for the raising of revenue. The excise tax is assessed on a monthly basis with the tax rate determined by the type of product. A portion of the revenue proceeds go into the general fund, the remainder is distributed to cities and towns based on population.

Definitions

Beer: An alcoholic beverage obtained by fermentation of an infusion or decoction of barley malt or other cereal and hops in water.

Hard Cider: An alcoholic beverage that is made from the normal alcoholic fermentation of the juice of sound, ripe apples and contains at least one-half of one percent of alcohol by volume and not more than seven percent of alcohol by volume.

Farm Winery: General requirements Sec. 4. In order to be considered a "farm winery" within the meaning of this title and to be eligible to receive a farm winery permit, a wine-making establishment shall not annually sell more than one million (1,000,000) gallons of wine in Indiana, excluding wine shipped to an out-of-state address.

Liquor: An alcoholic beverage containing alcohol obtained by distillation. The term also means a wine that contains 21% or more of alcohol reckoned by volume.

Primary Source of Supply: Refers to the source of a product sold to a wholesaler as coming from 1) a distiller of the alcoholic beverage; 2) a producer of the alcoholic beverage; 3) a vintner of the alcoholic beverage; 4) a rectifier of the alcoholic beverage; 5) an importer in the United States of the alcoholic beverage; 6) an owner of the alcoholic beverage at the time it becomes a marketable product; 7) a bottler of the alcoholic beverage; 8) a brewer of the alcoholic beverage; or 9) an agent specifically authorized to make sales to an Indiana wholesaler by a person listed in the above eight categories.

Rack: Means transferring product from one container to another such as from fermenter to a bright tank or kegs.

Rectifier: Means a person who colors, flavors or otherwise processes already existing alcoholic beverages by distillation, blending, percolating or other process.

Small Winery: Means a commercial winemaking establishment that produces table wine in an amount allowed by Indiana Code (less than 100,000 gallons).

Table Wine: Means a wine that is produced without rectification or fortification and whose alcohol content does not exceed 14%.

Vintner: Refers to a wine producer who does not grow his own grapes.

Wine: An alcoholic beverage obtained by the fermentation of the natural sugar content of fruit, fruit juice or other agricultural products containing sugar, including necessary additions to correct defects due to climatic, saccharine, and seasonal conditions, and also the alcoholic fortification of the beverage. This term includes hard cider, except for alcoholic beverage tax purposes. The term does not mean an alcoholic beverage that contains 21% or more, of absolute alcohol reckoned by volume.

Collection and Reporting Requirements

Customer registration for Alcohol Excise Tax is done by contacting the Alcohol and Tobacco Commission (ATC) at 317-232-2430. The ATC then notifies the Department of a new licensee. The Department then adds them to the list of active alcohol taxing units.

Beer Excise Tax: A brewer or beer wholesaler is liable for the beer excise tax on the sale or gift, or withdrawal for sale or gift, of beer or flavored malt beverage to a person within Indiana. In the case of a beer wholesaler receiving beer or flavored malt beverage from a brewer outside of Indiana, the beer wholesaler, not the brewer, is liable for the beer excise tax imposed upon the transaction. In the case of a wine wholesaler receiving, selling or giving flavored malt beverage within Indiana, the wine wholesaler, not the brewer is liable for the beer excise tax imposed upon the transaction.

Liquor Excise Tax: A distiller, rectifier, wholesaler or other liquor permit holder is liable for the excise tax on the sale, gift or the withdrawal for sale or gift, of liquor and wine that contains 21% or more, of absolute alcohol reckoned by volume.

Wine Excise Tax: A wine wholesaler or producer is liable for the excise tax on the wine manufactured and sold or gifted, or withdrawn for sale or gift with the exception of hard cider within this state.

Hard Cider Excise Tax: This tax is imposed upon the manufacture and sale or gift or withdrawal for sale or gift of hard cider within Indiana.

Customers are required to file monthly excise tax returns which are specific to their respective product. The returns are due on or before the 20th day following the month in which the liability for the tax accrues. Payment of the excise tax due shall accompany the return. The Department shall allow a discount of 1.5% of the amount of excise tax otherwise due for the accurate reporting and timely remitting of the excise tax imposed.

Type	Form
Cider Wholesaler	ALC-W
Wine/Liquor Wholesaler	ALC-W
Beer Wholesaler	ALC-W
Farm Winery	ALC-FW
Direct Wine Seller	ALC-DWS
Brewer/Distiller/Rectifier/Vinter	ALC-M
Primary Source Supplier (Beer)	ALC-PS
Primary Source Supplier (Wine/Liquor)	ALC-PS

Related Schedules	Form
Wine/Liquor Whlsl. Purchasers Sch.	ALC-W-S
Wine/Liquor Taken Out of Bond	ALC-W-S
Wine/Liquor Returned to Winery/Distillery	ALC-W-S
Exempt Wine and Liquor Sold	ALC-W-S
Report of Wine/Liquor placed in Bond	ALC-W-S
Beer Rec'd from out of state Source	ALC-W-S
Beer Returned to Brewer/Importer	ALC-W-S
Sale to U.S. Govt. for out of state use	ALC-W-S
Beer Whlslr. Pur. Report of Beer Rec'd	ALC-W-S Form Indiana Brewer
Small Winery Excise Tax Schedule	ALC-FW-S
Direct Wine Seller Excise Tax Schedule	ALC-DWS-S
Brewer/Distiller/Rectifier/Vinter Excise	ALC-M-S Tax Schedule

Alcohol Excise Tax Rates	
Beer	11.5 cents per gallon
Hard Cider	11.5 cents per gallon
Wine	$0.47 per gallon
Liquor	$2.68 per gallon

The wine excise tax shall apply to wine that contains less than twenty-one percent (21%), of absolute alcohol reckoned by volume. The wine excise tax also shall apply to an alcoholic beverage that contains 15% or less of absolute alcohol reckoned by volume, mixed with either carbonated water or other potable ingredients, or both, and sold in a container filled by the manufacturer or bottler, and which is suitable for immediate consumption directly from the original container. An alcoholic beverage that is subject to the wine excise tax shall not be also subject to the liquor excise tax.

Exemptions

Beer Excise Tax: A wholesaler within Indiana who receives beer or flavored malt beverage upon which the beer excise tax has been paid shall be entitled to a refund of the amount of the tax on all tax-paid beer or flavored malt beverage shipped from Indiana by the wholesaler for sale outside of Indiana or sold within Indiana under circumstances exempting the beer or flavored malt beverage from the excise tax. The Department shall promulgate rules and regulations governing the form of application for and the evidence required to establish the right to a refund. Sales or withdrawals of alcoholic beverages for sale to the United States government, its agencies, and instrumentalities, including military facilities, are exempt from alcoholic beverage excise tax; however, sales to individuals, private stores, or concessionaires located upon federal areas are not exempt.

Liquor Excise Tax: The liquor excise tax shall not apply to the sale for delivery outside this state, or the withdrawal for sale for delivery outside this state, of liquor and wine that contains more than 21 % of absolute alcohol reckoned by volume. The liquor excise tax shall not apply to the sale or withdrawal for sale of wine to a pastor, rabbi or priest for sacramental or religious purposes only.

Wine Excise Tax: The wine excise tax shall not apply to the sale or withdrawal for sale of wine to a pastor, rabbi or priest for sacramental purposes.

Recordkeeping Requirements

Beer Excise Tax (Brewer/Wholesaler): Must make a true duplicate invoice showing the date of the delivery, the amount and value of the shipment and the name of the purchaser. The brewer/wholesaler must retain a copy of said invoice for two years.

Liquor, Wine and Cider Excise Tax: All sales of alcoholic beverages made by a primary source supplier to a liquor wholesaler shall at the time of the sale be accompanied by an invoice that must show the following: 1) the name and address of the seller and purchaser; 2) the date of disposition; 3) the name or names of each brand sold; 4) the number of packages, if any; 5) the number of cases by size of bottle; 6) the quantity of each kind of alcoholic beverage sold. The primary source of supply shall send a copy of the invoice to the Department and the Commission (ATC) at the time of the sale.

Various Alcoholic Beverage Permit Holders: The Alcoholic Beverage Wholesaler point of taxation is on gallons received. The Farm Winery point of taxation is when product is removed from bond. The Direct Wine Sellers and Indiana Brewer/Distiller/Rectifier/Venter point of taxation is on sales. The Primary Source Supplier point of taxation is when product is shipped. The customer must maintain purchase, sales and productions documentation to support total, exempt and taxable gallons reported on the various excise tax returns outlined above. Those records will include:

Sales Records

- individual sales invoices
- weekly, monthly and/or quarterly summaries

All sales must be accompanied by an invoice that must show the following:

- name and address of the seller and purchaser
- date of disposition
- name or names of each brand sold
- number of packages
- number of cases by size of bottle
- quantity of each kind of alcoholic beverage sold

Production Records

- daily production reports
- weekly, monthly and/or quarterly summaries

All production records must show the following:

- date of production
- name of brand produced
- quantity of each kind of alcoholic beverage produced

Inventory Records

- record the amount of alcoholic beverage in inventory at the beginning and ending of each month

A reconciliation of the gallons produced should be completed each month.

- General Ledger
- Accounts Payable
- Accounts Receivable

Financial Statements or Trial Balances

Copy of monthly Indiana Alcohol Excise Tax Returns Copy of quarterly Federal Excise Tax Returns

The production, sales, reconciliation and any other records that support the reported information should be maintained for at least three (3) years from the date the final payment of tax liability was due.

If transactions occur after the tax return is submitted, the proper method for reporting is to amend the return.

Reference Material

Information regarding special alcohol excise tax types are included in the following sections of the Indiana Code:

Beer Excise Tax	Indiana Code IC7.1-4-2
Liquor Excise Tax	Indiana Code IC7.1-4-3
Wine Excise Tax	Indiana Code IC7.1-4-4
Hard Cider Excise Tax	Indiana Code IC7.1-4-4.5
Malt Excise Tax (repealed 7/19)	Indiana Code IC7.1-4-5

FARM WINERY TAX (ALC-FW)

Definition

Farm Winery: To be considered a “Farm Winery” within the meaning of this title and to be eligible to receive a farm winery permit, a wine making establishment shall not annually sell more than one million (1,000,000) gallons of wine in Indiana, excluding wine shipped to an out-of-state address.

Audit Procedures

Procedures for auditing Farm Winery Tax are the same as for auditing Alcohol Excise Tax which is covered in Alcohol Excise Tax section.

ALCOHOLIC BEVERAGE WHOLESALER EXCISE TAX (ALC-W)

Definition

Alcoholic Beverage Wholesaler: Anyone engaged in the business of purchasing for resale at wholesale, or importing alcoholic beverages into Indiana for sale within the state.

Imposition

A beer excise tax shall be levied against all Indiana beer wholesalers receiving beer or flavored malt beverage from a brewer located outside of Indiana intended for resale in Indiana. The beer wholesaler, not the brewer, is liable for the beer excise tax imposed on the transaction. In the case of a wine wholesalers receiving, selling, or giving flavored malt beverage from a brewer within Indiana, the wine wholesaler, not the brewer, is liable for the beer excise tax imposed on the transaction.

A liquor excise tax shall be levied against any permittee who holds a liquor wholesaler's permit, a dining car liquor permit, a dining car wine permit, a boat wine permit or a wine wholesaler's permit for wine that contains more than 21% of absolute alcohol reckoned by volume. The tax applies whether the sale or gift, or withdrawal for sale or gift, is to a person authorized to purchase or receive it or not. However, the same article shall be taxed only once for liquor excise tax purposes.

A wine excise tax shall be paid by the holder of a wine wholesaler's permit, a direct wine seller's permit, a dining car permit or a boat wine permit on the alcoholic beverage to which the tax is applicable and which has been manufactured or imported by the permit holder into this state. However, the same article shall be taxed only once for wine excise purposes (IC 7.1-4-4-3).

Reporting Requirements

The holder of a beer, cider, liquor and/or wine wholesaler permit(s) shall file a monthly Alcoholic Beverage Wholesaler's Excise Tax Return (ALC-W) and any related schedules with the Department on or before the 20th day of the month following the month in which the liability for the tax accrues. Payment of the excise tax due shall accompany the return. A return must be filed even if there is no activity within Indiana during the reporting period.

Customer registration for excise tax for wholesaler permits for beer, wine, or liquor is done by contacting the Alcohol and Tobacco Commission (ATC) at 317-232-2430. The ATC then notifies the Department of a new licensee. The Department then adds them to the list of active alcohol taxing units. Along with the application (or renewal), the applicant must remit an annual permit fee of two thousand dollars ($2,000.00), or one hundred dollars ($100.00) if the applicant is applying for or renewing a wine wholesaler's permit and intends to sell less than twelve thousand (12,000) gallons of wine and brandy in a year, or if they are renewing their license, must certify to the commission that they sold less than twelve thousand gallons (12,000) of wine and brandy in the previous year.

Tax Rates

The excise tax rates on alcohol for wholesalers are the same as for alcohol producers and are listed in the Alcohol Excise Tax manual.

Reference Material

Information regarding Alcohol Excise Tax is available at dor.in.gov/5162.htm and dor.in.gov/3733.htm.

RESIDENT & NON-RESIDENT CIGARETTE TAX (CIG-M):

Overview

Indiana enacted a cigarette excise tax with the intent of levying it on all cigarettes sold, used, consumed, handled or distributed within this state, and to collect the tax from the person who first sells, uses, consumes, handles or distributes the cigarettes. It is further the intent and purpose that whenever any cigarettes are given for advertising or any other purpose whatsoever, they shall be taxed in the same manner as if they were sold, used, consumed, handled, or distributed in this state. The liability for the excise tax imposed shall be conclusively presumed to be on the retail purchaser or ultimate consumer, pre-collected for convenience and facility only. When such taxes are paid by any other person, such payment shall be considered as an advance payment and shall be added to the price of the cigarettes and recovered from the ultimate consumer or user.

Distributors, wholesalers, or retailers may state the amount of the tax separately from the price of such cigarettes on all price display signs, sales or delivery slips, bills, and statements which advertise or indicate the price of such cigarettes. Full details of the Indiana Cigarette Tax code can be found in the Indiana Code IC 6-7-1.

Definitions

Cigarette: Any roll for smoking made wholly or in part of tobacco, irrespective of size or shape and irrespective of tobacco being flavored, unadulterated, or mixed with any other ingredient, where such roll has a wrapper or cover made of paper or any other non-tobacco material. The definition in this section shall not be construed to include cigars.

Distributor: Every person who sells, barters, exchanges, or distributes cigarettes in the state of Indiana to retail dealers for the purpose of resale, or who purchases cigarettes directly from a manufacturer of cigarettes, or who purchases for resale cigarettes directly from a manufacturer of cigarettes, or from a wholesaler, jobber, or distributor outside the state of Indiana who is not a distributor holding a registration certificate.

Retailer: Every person, other than a distributor, who purchases, sells, offers for sale, or distributes cigarettes, to consumers or any person for any purpose other than resale, irrespective of quantity or amount, or the number of sales.

Collection and Reporting Requirements

All taxes levied, assessed and imposed shall be paid and the payment evidenced by the purchase of stamps and by affixing the same to the individual packages and duly cancelling these stamps.

Cigarettes sold in Indiana must bear an Indiana cigarette tax stamp on the package verifying the payment of the Indiana cigarette tax. Stamps are sold to licensed distributors by the Department on Form CT-4A. The distributors are responsible for affixing the tax stamps to the cigarettes that they distribute in Indiana.

Each distributor shall obtain from the Department a registration certificate (CIG-1A). Application for a registration certificate shall be made in writing upon forms prescribed by the Department and shall be signed and verified by the distributor. The registration application must be submitted along with an annual application fee of five hundred dollars ($500.00). In addition, a distributor must concurrently file a bond or a letter of credit:

1. In a form and with a surety or financial institution approved by the Department;
2. In the amount of one thousand dollars ($1,000.00)
3. Naming the state as protected by the bond
4. Conditioned upon payment of taxes, damages, fines, penalties, or costs adjudged against the holder of the registration certificate by reason of the violation of any of the provisions of the law.

All registration certificates shall be personal, nontransferable, and valid for one (1) year from the issuance date unless suspended or revoked by the Department. If a business is transacted at two (2) or more locations by one distributor, a separate registration certificate shall be required for each location where he operates as a distributor. Each certificate will be numbered, show the name and location address of the distributor and must be posted in a conspicuous place at the location for which it was issued. If a distributor relocates his business, a new certificate will be issued upon request and return of the original registration and the Department will issue an amended registration free of charge. Any registration issued by the Department may be surrendered back to the Department at any time before its expiration, and the Department shall refund an amount of money on a pro rata basis to the remaining period of the license with no refund to exceed four hundred dollars ($400.00).

Cigarette Tax Rates

The following rates are imposed and shall be collected and paid upon the sale, exchange, bartering, furnishing, giving away, or otherwise disposing of cigarettes within the state of Indiana.

On cigarettes greater than three pounds per thousand, the rate is $0.6612 per individual cigarette. Cigarettes longer than 6 1/2 inches and weighing more than three pounds per thousand shall be taxed as a separate cigarette.

Remittance of Cigarette Tax

Distributors are required to file monthly "Cigarette Distributor's Monthly Returns" (CIG-M) on or before the fifteenth (15) day of the month following the month in which the activity occurs. Payment of any excise tax due shall accompany the return. **A return must be filed even if there is no activity within Indiana during the reporting period.**

Other schedules required to be filed with the CIG-M return include The CIG-IS which is used to detail the beginning inventory of cigarettes (unstamped and non-Indiana stamped cigarettes), adjustments to inventory during the reporting period and the physical ending inventory of cigarettes at the close of the reporting period. The CIG-TS schedule which is used to detail all transactions related to the taxed (stamped) and untaxed (unstamped) purchases, sales and credit adjustments of cigarettes. The CIG-SS schedule which is used to report the beginning inventory of unaffixed tax stamps, increases (purchases) and decreases (adjustments) in stamp inventory of unaffixed stamps at the close of the reporting period, and a physical ending inventory of unaffixed stamps at the close of the reporting period as well as the total stamps affixed.

All reports required to be filed must be filed in an electronic format prescribed by the Department. All taxes required to be remitted under this tax must be remitted in an electronic format prescribed by the Department (see dor.in.gov/5168.htm for electronic filing instructions).

Exemptions

The state of Indiana does allow certain sales to be exempt from the Cigarette Excise Tax, these include sales exported out of Indiana, sales to the federal government, sales to native American Indian tribes, sales to the

United States military, research sales other than for marketing purposes and sales between wholesalers and distributors as regulated by the various state's legislation or regulatory body.

Recordkeeping Requirements

Every distributor of cigarettes shall keep and preserve for three (3) years records and invoices, showing the purchase and sale of cigarettes. Such distributors shall also keep separate invoices, and records of stamps purchased. All these records, invoices, and stock of cigarettes and unused stamps on hand shall be open to inspection by the Department at all reasonable times. However, all distributors within fifteen (15) days after the first day of each month, shall file with the Department a report of all drop shipment sales made by them to other distributors within the state during the preceding month, which report shall give the name and address of the distributor, the kind and quantity of the sales, and their dates of delivery. Further, every distributor engaged in interstate business shall, within ten (10) days after the first day of each month, file with the Department a report of all such interstate sales made during the preceding month, which report shall give the name and address of the person to whom sold, the kind and quantity of the sales, and their dates of delivery.

All drop shipments made by manufacturers of cigarettes within the state of Indiana must be shipped and billed through a regularly licensed distributor licensed by the state of Indiana.

Anyone who recklessly fails to keep the required records, falsifies the records or fails to safely preserve the records for a period of three (3) years in such a manner as to insure permanency and accessibility by the Department; commits a Class C misdemeanor.

Stamping vs. Non-Stamping Distributors
Distributors either, purchase cigarettes directly from manufacturers and stamp the cigarettes themselves, or they purchase them already stamped from another distributor. Since non-stamping distributors do not purchase and affix the Indiana tax stamp to packs of cigarettes, they pay their tax directly to their supplier which is another distributor. The tax returns filed by non-stamping distributors are for informational purposes.

Resident Distributors vs. Non-Resident Distributors
There is a distinction between a stamping distributor located in the state and one located outside of the state. Both have to purchase Indiana tax stamps from the Department but some of the reporting requirements are different. An in-state distributor has to account for all cigarettes they purchase; both stamped and unstamped as well as the Indiana stamps purchased. An out of state distributor only has to account for the cigarette sales into Indiana, the Indiana stamped cigarettes, and the Indiana tax stamps.

MSA Compliance
Licensed distributors file the CT-19 informational return, Monthly Report of Cigarettes Stamped and Roll- Customer-Own Tobacco Purchased, to meet the Master Settlement Agreement requirements. This form is used to record the number of cigarettes reported as sticks that were stamped during the period by brand family and brand name. In Indiana, the number of ounces of “Roll Customer Own” (RYO) purchased by brand along with the conversion of the RYO ounces to units is also reported.

The data filed with Indiana DOR is shared with the Indiana Attorney General’s office.

This return, CT-19, is compared to the Distributor’s reported CIG-M, Cigarette Distributor’s Monthly Return, along with the related CIG-M schedules of stamp inventory, stick inventory, sales, and purchase transactions for each month (CIG-SS, CIG-IS, and CIG-TS).

The MSA Compliance portion of the Cigarette audit includes analyzing the reported cigarette purchases and sales for accurate stick count. The brands reported by the distributor are compared to the brands listed on the Participating Brand Directory and the Non-Participating Brand Directory as listed on the Indiana Attorney General’s website at https://www.in.gov/attorneygeneral/2342.htm.

From these Directories, the audit will verify reported purchases and sales of brands as either listed, delisted, or unlisted as well as a verification of the quantity of NPM cigarettes sold during the reporting period. This review is done to confirm the accuracy of the reported sales quantities of “Non-Participating Brand/Manufacturers”, NPM’s, reported during the audit period. The verification of the NPM brands is important as the reported amounts on the CT-19 are used by the Attorney General’s office to calculate the Non-Participating Manufacturer’s escrow payment. Any delisted or unlisted brands discovered on audit are reported to the Attorney General, as well.

The Cigarette audit report will include a section discussing the findings of the Distributor’s MSA Compliance.

Audit Procedures

The auditor will review the customer's records in order to make a determination as to the accuracy of the originally reported figures on the previously filed tax returns for the taxes under audit. An example of the records to be reviewed include but are not limited to:

- Copies of the CIG-M and related returns filed for the audit period,
- All books and records used to prepare those returns including worksheets and schedules,
- Bank statements and cancelled checks,
- All purchase and sales invoices,
- Inventory records for all tobacco products,
- Copies of state and federal audit reports for the audit periods,
- Documentation supporting exempt sales including delivery records, sales invoices and tobacco returns filed with other states,
- Purchase and sales journals, general ledgers and other supporting schedules
- All documentation used to file the CT-19 Monthly Report of Cigarettes Stamped and Roll-Customer- Own Tobacco Purchased.

Inventory

Another component of the field work includes a physical inventory which is taken in conjunction with the month end inventory. This will be scheduled in advance to avoid conflicts and will hopefully be done in conjunction with the customer's actual physical month end inventory. The inventory count will be conducted to verify the number of unaffixed Indiana stamps currently held in inventory as well as a physical review of stamped and unstamped product to determine its legal status for resale in Indiana. The inventory will also be done to count the number of cigarettes with particular attention given to NPM brands.

Reference Material

More information regarding Cigarette Tax is available at dor.in.gov/3518.htm. Departmental Notices #8 and #36 provide nontechnical assistance to the general public and can be found at dor.in.gov/3618.htm.

Also, more information on the Indiana Tobacco Enforcement along with a copy of the Indiana MSA Agreement and the updated lists of participating and non-participating manufacturers can be found at http://www.in.gov/attorneygeneral/2342.htm.

A list of the licensed Indiana Cigarette & Other Tobacco Products (OTP) distributors can be found at dor.in.gov/4880.htm.

RESIDENT & NON-RESIDENT OTHER TOBACCO PRODUCTS (OTP) TAX (OTP-M)

Introduction

Indiana enacted an excise tax on "Other Tobacco Products (OTP) with the intent of levying it on all OTP sold, used, consumed, handled or distributed within this state (see Indiana Code IC 6-7- 2). The liability for the excise tax imposed shall be conclusively presumed to be on the retail purchaser or ultimate consumer, pre-collected for convenience and facility only. When such taxes are paid by any other person, such payment shall be considered as an advance payment and shall be added to the price of the tobacco product and recovered from the ultimate consumer or user. Distributors, wholesalers, or retailers may state the amount of the tax separately from the price of such tobacco product on all price display signs, sales or delivery slips, bills, and statements which advertise or indicate the price of such tobacco products. Full details of the Indiana Other Tobacco Products Tax can be found in the Indiana Code 6-7-2.

Definitions

Distributor: Refers to a person who:

1. manufactures, sells, barters, 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 by Indiana.

Retail Dealer: Refers to a person engaged in the business of selling tobacco products to ultimate consumers.

Moist snuff: Any finely cut, ground, or powdered tobacco that is not intended to be:

1. smoked; or
2. placed in the nasal cavity.

Tobacco product: Refers to:

1. any product made from tobacco, other than a cigarette, that is made for smoking, chewing or both; or
2. snuff, including moist snuff.

Wholesale price: Refers to the net price shown on an invoice and at which the manufacturer of the tobacco products sells tobacco products other than moist snuff to distributors, excluding any discount or other reduction that is not shown on the invoice.

Registration Requirements

Each distributor, including a person that sells tobacco products through an Internet website, must obtain a license from Indiana before it distributes tobacco products in Indiana. The Department shall issue licenses which are valid for one (1) year unless revoked or suspended by the Department and the licenses are not transferable. An applicant for a license must submit proof to the Department of the appointment of an agent for service of process in Indiana if the applicant is:

1. an individual whose principal place of residence is outside Indiana; or
2. a person other than an individual that has its principal place of business outside of Indiana.

To obtain or renew a license, a person must:

1. submit, for each location where it intends to distribute tobacco products, an application that includes all information required by the Department;
2. pay a fee of twenty-five dollars ($25.00) at the time of the application; and
3. at the time of the application, post a bond, issued by a surety company approved by the Department, in an amount of not less than one thousand dollars ($1,000.00) and conditioned on the applicant's compliance with the Indiana code.

If a business is transacted at two (2) or more locations by one (1) distributor, a separate license must be obtained for each place of business. Each license must be numbered, show the name and location address of the distributor and must be posted in a conspicuous place at the location for which it was issued. If the Department determines that a bond provided by the licensee is inadequate, the Department may require a new bond in the amount necessary to fully protect the state.

A distributor that relocates his business shall return his license, and the Department shall issue a new license with the updated address information, free of charge.

The Department may revoke or suspend an issued license for any violations of this law by the licensee, or may not issue a license to an applicant within six (6) months after the revocation of that applicant's license.

Collection and Reporting Requirements

The distributor of the tobacco products, including a person that sells tobacco products through an Internet web site, is liable for the tax imposed. The tax is imposed at the time the distributor:

1. brings or causes the product 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.

An unlicensed wholesaler/retailer purchasing tobacco products through a catalogue or other media from a person not licensed as an Indiana distributor must register as a distributor and pay the tax on the wholesale price of the other tobacco product or, if purchasing moist snuff, pay the tax based on the number of ounces. A wholesaler/retailer failing to register and comply with the law commits a class B misdemeanor. However, the offense is a class D felony if it is committed with the intent to evade the tax imposed or to defraud the state.

The Indiana General Assembly finds that the tax rate on smokeless tobacco should reflect the relative risk between such products and cigarettes.

All purchase and sales invoices should indicate whether the OTP excise tax has been assessed and/or who is responsible for the assessment, collection and remittance of the OTP excise tax.

For a non-resident licensed OTP distributor to take an exemption for product shipped to an Indiana distributor, they must verify that the Indiana customer holds a current OTP license. This verification can be in the form of requesting and retaining a copy of the Indiana customer's current OTP license or verifying the current license status on the Indiana state website at dor.in.gov/4880.htm, which is updated monthly.

The Department shall credit or refund to a distributor the tax paid on the tobacco products that are shipped out-of-state, returned to the manufacturer or destroyed by the distributor in the presence of an employee or agent of the Department (IC 6-7-2-14).

OTP Tax Rates:

A tax is imposed on the distribution of tobacco products in Indiana at the rate of:

1. 24% of the wholesale price of tobacco products other than moist snuff; or
2. for moist snuff, $0.40 per ounce, and a proportionate tax at the same rate on all fractional parts of an ounce. If the calculated for a fractional part of an ounce carried to the third decimal is greater than four (4), the amount of the tax shall be rounded to the next additional cent.

Distributors are required to file monthly "Other Tobacco Products Distributor's Excise Tax Returns" (OTP-M) on or before the 15th day of the month following the month in which the activity occurs. Payment of any excise tax due shall accompany the return. **A return must be filed even if there is no activity within Indiana during the reporting period.**

Other schedules required to be filed with the OTP-M return include the OTP-M-S Transaction Schedule detailing purchases made by an Indiana based licensed distributor or sales into Indiana by an out of state licensed distributor. Any product returned to the distributor that is intended for resale should be reported as a negative transaction. This schedule should also include all subsequent transactions involving the product such as the customer name, address and product and invoice number(s), as well as other required information involving the transactions.

All reports required to be filed must be filed in an electronic format prescribed by the Department. All taxes required to be remitted under this tax must be remitted in an electronic format prescribed by the Department (see dor.in.gov/5168.htm for electronic filing instructions).

Exemptions
The state of Indiana does allow certain sales to be exempt from the OTP Excise Tax, including sales exported out of Indiana. This exemption would only be reportable by an Indiana resident distributor. All products reported as exemptions must have been reported as a receipt at one time.

The sale of tobacco products to the United States or an agency or instrumentality thereof is also exempt from the Indiana OTP excise tax.

Recordkeeping Requirements
All licensed distributors 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, receipts, and canceled checks.

a. A person must retain the books and records described above, and any state or federal tax return that the person has filed:
    1. for an unlimited period, if the person fails to file a return or receives notice from the Department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return; or
    2. in all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the Department consents to earlier destruction.

In addition, if the limitation on assessments is extended beyond three (3) years for a particular tax liability because of failure to file, the person must retain the books and records until the assessment period is over.

- A person must allow inspection of the books and records and returns by the Department or its authorized agent at all reasonable times.
- A person must, on request by the Department, furnish a copy of any federal returns that he has filed.

Anyone not complying with the record keeping requirements commits a Class C misdemeanor.

MSA Compliance
Licensed distributors file the CT-19 informational return, Monthly Report of Cigarettes Stamped and Roll- Customer-Own Tobacco Purchased, to meet the Master Settlement Agreement requirements. This form is used to record the number of cigarettes reported as sticks that were stamped during the period by brand family and brand name. In Indiana, the number of ounces of "Roll Customer Own" (RYO) purchased by brand along with the conversion of the RYO ounces to units is also reported.

The data filed on the CT-19 with Indiana DOR is shared with the Indiana Attorney General's office.

This return, CT-19, is compared to the Distributor's RYO as reported on the OTP-M return along with the OTP- M-S schedule of sales and purchase transactions for each month of RYO.

The MSA Compliance portion of the OTP audit includes analyzing the reported RYO purchases and sales for accurate stick (converted) count. The brands reported by the distributor are compared to the brands listed on the Participating Brand Directory and the Non-Participating Brand Directory as listed on the Indiana Attorney General's website at https://www.in.gov/attorneygeneral/2342.htm.

From these Directories, the audit will verify reported purchases and sales of brands as either listed, delisted, or unlisted as well as a verification of the quantity of NPM RYO units sold during the reporting period. This review is done to confirm the accuracy of the reported sales quantities of "Non-Participating Brand/Manufacturers", NPM's, reported during the audit period. The verification of the NPM brands is important as the reported amounts on the CT-19 are used by the Attorney General's office to calculate the Non-Participating Manufacturer's escrow payment. Any delisted or unlisted brands discovered on audit are reported to the Attorney General, as well.

The OTP audit report will include a section discussing the findings of the Distributor's MSA Compliance.

Audit Procedures

The auditor conducts the audit of the records in order to make a determination as to the accuracy of the originally reported figures on the previously filed tax returns for the taxes under audit. An example of the records to be reviewed include but are not limited to:

- Copies of the OTP-M and related schedules filed for the audit period
- All books and records used to prepare those returns including worksheets and schedules
- Bank statements and cancelled checks
- All purchase and sales invoices,
- Inventory records for all tobacco products
- Copies of state and federal audit reports for the audit periods
- Documentation supporting exempt sales including delivery records, sales invoices and tobacco returns filed with other states
- Purchase and sales journals, general ledgers and other supporting schedules
- All documentation used to file the CT-19 Monthly Report of Cigarettes Stamped and Roll-Customer- Own Tobacco Purchased

Reference Material

More information regarding Other Tobacco Product Tax is available at dor.in.gov/3518.htm.

Departmental Notice #36 and General Tax Information Bulletin #206 provide nontechnical assistance to the general public and can be found at dor.in.gov/3618.htm and dor.in.gov/6886.htm.

Information on the Indiana Tobacco Enforcement along with a copy of the Indiana MSA Agreement and the updated lists of participating and non-participating manufacturers can be found at http://www.in.gov/attorneygeneral/2342.htm.

A list of the licensed Indiana Cigarette & Other Tobacco Products (OTP) distributors can be found at dor.in.gov/4880.htm.

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