

Letter of Findings: 01-20160462
Sales Tax
For the Year 2012-2014

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Restaurant, was unable to meet its burden of establishing that the Department's proposed assessments of additional tax were wrong; Restaurant failed to maintain complete, contemporaneous, accurate records of fuel and convenience store items sales.

ISSUE

I. Sales Tax - Records.

Authority: IC § 6-3-1-3.5; IC § 6-3-2-1; IC § 6-8.1-5-1(c); IC § 6-8.1-5-4; Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, (Ind. Tax Ct. 2007); [45 IAC 15-5-1](#); [45 IAC 3.1-1-66](#); [45 IAC 3.1-1-2](#)(14); [45 IAC 3.1-1-7](#)(6); IRC § 1366; Black's Law Dictionary 394 (9th ed. 2009).

Taxpayer argues that the Department of Revenue overstated the amount of income tax due.

II. Tax Administration—Penalty.

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

Taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

Taxpayer operates restaurants in Indiana. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of the business location. That audit resulted in an assessment of additional sales tax.

As a result, the Department issued Taxpayer an assessment of additional sales tax. Taxpayer disagreed with the assessment of sales tax and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings addresses the assessments of sales tax.

I. Sales Tax - Records.

DISCUSSION

The issue is whether Taxpayer established that the assessments of Indiana sales tax are incorrect on the ground that the Department's audit overstated the amount of convenience store and fuel sales.

As a threshold issue, it is the Taxpayers' responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a

statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

Indiana imposes an adjusted gross income tax on all residents. IC § 6-3-2-1. A taxpayer's Indiana income is determined by starting with the federal income and making certain adjustments. IC § 6-3-1-3.5. Income from an S corporation flows through to the individual shareholder's personal income and is reported by the shareholders on their personal income tax returns. See I.R.C. § 1366. See also [45 IAC 3.1-1-66](#); [45 IAC 3.1-1-2\(14\)](#); [45 IAC 3.1-1-7\(6\)](#).

Simply stated, an S Corporation - such as Taxpayer's restaurant - is "[a] corporation whose income is taxed through its shareholders rather than through the corporation itself." Black's Law Dictionary 394 (9th ed. 2009). Pursuant to IC § 6-3-1-3.5, the Indiana income tax rules piggyback on the federal income tax statutes and regulations. Therefore, the federal rules and case law are generally applicable to determine an individual shareholder's tax liability. Furthermore, any additional income received by the S-Corp as a profit passes through to the individual shareholders as income.

If the Department reasonably believes that a person has not reported the proper amount of tax due, the Department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the Department. IC § 6-8.1-5-1(a). Every person subject to a listed tax must keep books and records so that the Department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. IC § 6-8.1-5-4 (a). A person must allow inspection of the books and records and returns by the Department or its authorized agents at all reasonable times. IC § 6-8.1-5-4 (c). The notice of proposed assessment is prima facie evidence that the Department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is incorrect rests with the person against whom the proposed assessment is made. IC § 6-8.1-5-1(c).

The Department's audit requested copies of complete business records in order to determine if sales tax had been properly collected and remitted. The audit requested "z-tapes, sales invoices, sales journals, and bank statements." Taxpayer only provided copies of bank statements. Taxpayer did not maintain any cash register tapes or other sales records.

The Department's audit reviewed the available records. The Department noted that Taxpayer was previously audited for 2007 and 2008, in which the Department told Taxpayer to keep source documentation, such as sales tickets and register tape 'z reports' are to be kept." The current audit reviewed the records available and noted that:

The taxpayer adjusted the monthly deposits by subtracting amounts they believed not to be subject to the Indiana sales tax, such as game monies, sales to exempt organizations for fund raising, rebate checks that were deposited, transfers from one location's bank account to the other, bad checks, and personal monies deposited in error.

...

Since the taxpayer has reported its sales based simply on the amount of its deposits, audit has no way to verify total sales or taxable sales. Furthermore, the audit has no way to verify that sales tax was charged to its customers since no sales tickets were maintained nor were cash register tapes illustrating tape of sales maintained. Excluding the amounts adjusted by the taxpayer as discussed above, the taxpayer reported its total deposits subject to the Indiana sales tax.

Audit noted that a comparison between the taxpayer's reported sales for sales tax purposes and the reported sales for income tax purposes revealed a discrepancy in each year. The taxpayer's reported total sales for sales tax purposes was more than the total reported sales for income tax purposes.

The audit report did state that it took into account a discrepancy that occurred when Taxpayer transferred money from one bank account to another.

Taxpayer stated that the reason its ST-103, sales and use tax form, and gross receipts are different are because the ST-103 line one improperly included sales tax, but Taxpayer adjusted the income tax return to properly reflect the amount of income. Taxpayer provided forms ST-103 for December 2012-2014, cash reconciliation worksheets

for 2012-2014, bank statements for December 2012-2014, and trial balances for December 2012-2014. The Department wants to note that, Taxpayer's documentation is in support of its own calculation of sales and income tax. As stated in the audit report the cash amounts cannot be verified, since there is no source documentation such as sales tickets and z tapes. These are the same source documents that the Department directed Taxpayer to keep in the prior audit.

In the absence of accurate or complete records, Indiana law requires that the Department issue a proposed assessment based on the best information the Department can obtain. "If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(b). See also [45 IAC 15-5-1](#).

The Department is unable to agree that Taxpayer has made any quantifiably specific objection to the results of the audit. The Department's audit clearly explained that source documentation was required to verify the amount of sales, as did the prior audit. While Taxpayer's calculations do arrive at a lower amount of sales by the S-Corp, and therefore lower income tax to the shareholders, those calculations are not based on source documentation. Therefore, Taxpayer has done nothing to meet their burden establishing that the assessments are "wrong" as required by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protests are denied.

II. Tax Administration—Penalty.

Taxpayer requested that the Department abate the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a negligence penalty if the taxpayer:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

[45 IAC 15-11-2\(b\)](#) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty when "the taxpayer affirmatively establishes that the failure . . . was due to reasonable cause and not due to negligence." [45 IAC 15-11-2\(c\)](#). The taxpayer "must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section." Id. The Department is mindful that "[r]easonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case." Id.

In this instance, Taxpayer has not demonstrated that its actions were reasonable as described in [45 IAC 15-11-2\(c\)](#). Furthermore, Taxpayer has had compliance issues in past. Thus, Taxpayer's request for penalty abatement is denied.

FINDING

Taxpayer's protest of the negligence penalty is denied.

SUMMARY

Taxpayer's protest regarding the income tax is denied. Taxpayer's protest of the negligence penalty is denied.

Posted: 02/22/2017 by Legislative Services Agency
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