



Audit Manual

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Disclaimer

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 is not authorized to support any audit position or used as citation. The controlling statutes, regulations, case law, and departmental publications should guide customers and Indiana Department of Revenue (DOR) auditors in presenting their respective positions when conducting or responding to an audit or investigation.

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

The auditing methods and techniques suggested within serve primarily as administrative guidance, and may not be appropriate, applicable, or necessary for every audit. Auditors will 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.

Chapter 1: Overview

Audit Operations Mission

- Serve Indiana by administering tax laws in a fair, secure, and efficient manner
- Fulfill Indiana Department of Revenue (DOR) statutory and program audit requirements
- Drive customer education and self-compliance
- Secure funds rightfully due the state of Indiana

Purpose of the Audit Manual

This Audit manual's purpose is to inform customers about the process so that they know what to expect if contacted for a DOR audit. While this document may discuss specific procedures to be followed or standard methods and techniques, each audit is unique, and auditors may deviate as circumstances dictate. Such situations will be discussed with managers for guidance as necessary.

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 ensure that tax payments to the state of Indiana are correct. Audits are essential for the efficient administration of self-assessed taxes and for ensuring customers pay the correct amount of tax due as 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, well trained, and treat each customer with professional courtesy and respect. Auditors will need an area to conduct the audit of a customer's records on site, but if the customer cannot accommodate, an alternative audit location may be discussed.

Audits are conducted under authority of and in accordance with IC 6-8.1-3-12.

DOR Resources and Reference Material

Tax Library

Annual reports, tax information bulletins, legal resources, public hearings and other reference materials are available in [DOR's Tax Library](#) or in the Indiana Register by visiting the [Indiana General Assembly website](#).

Subscribe to Updates

[Subscribe to e-mail updates](#) from DOR including the latest updates to DOR publications, notices, news releases, and other important news.

Chapter 2: Audit Operations Division

Authority

The Indiana General Assembly established DOR for the purpose of administering, collecting, and enforcing the taxes placed under its authority (IC 6-8.1-2-1.) DOR is under the control of the governor who shall appoint or employ the commissioner (IC 6-8.1-2-2.) The commissioner may establish various divisions within DOR 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 DOR 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 audit division may:

- Have full prompt access to all local and state official records
- Have access, through the data processing offices of the various state agencies, to information from government and private sources that is useful in performing its functions
- 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
- Employ the use of such devices and techniques as may be necessary to improve audit practices.

Upon request by DOR, a customer must provide DOR a true and correct copy of any tax return that the customer has filed with the United States Internal Revenue Service (IRS). 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

DOR Audit Operations is comprised of dedicated audit professionals located in Indianapolis, [11 Indiana District Offices](#), 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, understanding, and compliance.

Separate groups of auditors are assigned general business tax audits, motor carrier (IFTA/IRP) audits, and other special excise tax audits, such as cigarette tax, alcohol taxes, and fuel excise taxes.

Audit Billing & Support

This group of tax specialists assists the field audit group and other divisions of DOR by performing a wide range of tasks, including customer service, maintenance of customer account information, and correction of improperly filed tax returns to allow for processing.

Computer Audit Specialists

The Computer Audit Specialist (CAS) Group within audit operations helps gather, review, and analyze electronic records. The CAS team is comprised of experienced DOR auditors with a specialization in using applications to perform data analytics on customer records. The CAS assists the auditor in minimizing the number of records reviewed and in improving the effectiveness and efficiency of the audit process by using various software tools and specialized expertise in such areas as statistical sampling and analysis.

Quality Assurance

The Quality Assurance team represents highly experienced auditors who perform a detailed examination of each completed audit to make sure that an accurate and clear audit report summary reaches the customer. They do this by ensuring that all audit case requirements are adhered to, and any adjustments proposed are thoroughly explained, well supported, and justified by statute, regulation, or DOR policy. The Quality Assurance team also serves as an internal control function for audit operations ensuring proper checks and balances to the audit process, and consistency in treatment of taxpayers in similar situations.

Audit Training

The audit training team consists of a training coordinator, a training development specialist, and an ad hoc team of experienced and skilled auditors. This team develops and delivers training modules along with job aids for the entire audit group and for other business units within DOR.

Audit Selection

Generally, customers are selected for an audit based on analysis of data reported on filed tax returns and other information provided to or known to DOR. Information may be derived from external sources, including public sources, as well as the IRS and other governmental agencies. Randomly selected audit leads derived from the analysis are further evaluated to determine whether the circumstances indicate an audit is worthy of assignment.

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 Indiana's tax laws. The [Taxpayer Bill of Rights](#) sets forth the rights and responsibilities for the Indiana Taxpayer.

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 for questions or concerns
- Cooperate with DOR personnel during audits and with resolving filing issues

Right to Representation

Customers may authorize another person to represent them at any time during an audit by submitting a [Power of Attorney](#) (POA) to DOR.

Customers can use [INTIME](#) to submit an electronic Power of Attorney (ePOA) request to streamline the establishment of a POA relationship to grant access to accounts and appoint representatives.

Note the differences between [submitting Form POA-1 and an ePOA via INTIME](#).

DOR will consider an INTIME ePOA equivalent to Form POA-1 for the purpose of discussing tax matters. DOR reserves the right to request Form POA-1 in certain circumstances, but in general will not require Form POA-1 in addition to an approved INTIME ePOA access request. The INTIME ePOA only allows clients to approve access to the accounts currently in INTIME. Form POA-1 may be needed for other tax types.

Step-by-step instructions are available to initiate an INTIME ePOA:

- [Business Customers](#)
- [Tax Practitioners](#)
- [Clients](#)

Once ePOA access has been requested through INTIME and approved by the customer, the customer will be able to see and perform the same actions as the POA.

A signed and properly completed Form POA-1 (paper, scanned, or fillable .pdf version) can be submitted to DOR by one of three methods:

- [Submit through INTIME](#)
- By mail, with copy of original:
Indiana Department of Revenue
P.O. Box 7230
Indianapolis, IN 46207-7230
- Fax: 317-615-2605

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 Form POA-1. By law, DOR can accept only an individual's name as a POA representative. Form POA-1 is effective for five years from the date signed on the form. Therefore, customers need to resubmit a POA every five years to continue any DOR communication with the customer's representative. A subsequent POA alone will **not** revoke a prior POA. Revocation of a POA before expiration requires a written and signed notice.

Chapter 4: Auditor Expectations & Responsibilities

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 material error. 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 these functions:

- Review available customer information prior to audit. Information on [pre-audit procedures](#) is available in this manual
- 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 their authorized representative
- Complete a pre-audit questionnaire with the customer and/or their authorized representative
- Tour the business facility
- Determine the initial audit approach based on the nature of the business, recognizing that adjustments may be made to procedures as the audit progresses
- Identify and review returns for any related party to determine validity of shared transactions and whether 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 summary and the audit working papers
- Hold a post-audit conference with the customer (and/or POA) to present the audit findings
- Prepare the audit summary report

Confidentiality

DOR auditors are required to treat customer information with heightened security to ensure the protection of customers' identities and tax information. Auditors will 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

Indiana revenue tax auditors are required to have an appropriate degree in accounting or finance with minimum completed courses in accounting and tax. 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 their 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 and colleagues, in a respectful, honest, and fair manner.

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 perceived 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 or disclosure with the Indiana Office of Inspector General (OIG). See more information in the [Indiana Code of Ethics](#).

Data Safeguards

When a customer provides the auditor with requested data, the auditor will take the necessary precautions to ensure the customer information and data remains confidential and properly protected according to the law, IRS Publication 1075, and DOR established protocol.

Physical Storage

The auditor will store sensitive customer data in a secure location, such as a locked filing cabinet, and 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 secure email system or uploaded through INTIME.

Document Shredding

Original source documents provided during an audit will be returned to the customer. Other paper document copies must be managed by one of these options:

- Returned to the customer
- Shredded
- Placed in a secure receptacle marked for shredding

Chapter 5: General Information

Acronyms

AGI:	Adjusted Gross Income
DBA:	Doing Business As
DFP:	Demand For Payment
DN:	Departmental Notice
DO:	District Office
DOR:	Department of Revenue
ePOA:	Electronic Power of Attorney
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
INTIME:	Indiana Taxpayer Information Management Engine
IRC:	Internal Revenue Code
IRS:	Internal Revenue Service
ITS:	Indiana Tax System
OIG:	Office of Inspector General
NOPA:	Notice of Proposed Assessment
PII:	Personal Identifiable Information
POA:	Power of Attorney
RFI:	Request for Information
SSN:	Social Security Number
TID:	Indiana Customer Identification Number

General Terms

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

Confidential Taxpayer (Customer) Information or Personally Identifiable Information (PII): All information that requires confidentiality and heightened security to ensure the protection of a customer's identity. This includes all federal tax information, state tax return information, SSNs, FIDs, FEINs, full credit card numbers, bank account numbers, mother's maiden name, and medical information. 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

Doing Business As (DBA): An "assumed name" different from the legal registered name of the business.

District Office (DO): DOR has 11 full-service District Offices throughout Indiana, as well as a central office location in Indianapolis at the Indiana Government Center.

Business Tax Application (Form BT-1): 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.

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

INTIME: for tax reporting, payments, account maintenance, and secure messaging.

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 DOR may enter into a written agreement, prior to the expiration of the statute, to extend the time for proposing assessment or for claiming a refund for a reporting period. Under IC 6-8.1-5-2(h), the written agreement must contain:

- The date to which the extension is made
- A statement that the person agrees to preserve the person's records until the extension terminates

Information Document Request (IDR)

Auditors use an Information Document Request (IDR) to request information or documentation 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 a Notice of Non-Compliance. Customers must respond to document requests by the date indicated on all requests.

Electronic vs. Paper Records

The auditor accepts paper or electronic copies of the requested records. Electronic copies are the preferred format for large data files such as detailed general ledger reports, sales reports, purchase journals, etc. Smaller data files or scanned documents could be transmitted through encrypted email message attachments or INTIME e-services upload. Some original source documents may also be gathered in a paper format. The auditor will discuss options with the customer and computer audit specialists to determine the best and most efficient means to transfer the data. Smaller businesses that maintain paper records can generally be reviewed quickly and should not need to provide any records electronically. Information on [data safeguards](#) to securely provide electronic records is available in this manual.

Interest & 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). Refunds of existing overpayments may be requested through INTIME once a logon is created. Refund claims may also be filed through the INTIME, without the need to log in.

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 #100](#) and [#101](#) detail procedures.

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 DOR, through the State Comptroller, issues the refund check. In this scenario, no interest is paid. Only when DOR fails to initiate a refund within 90 days of a claim being filed does interest accrue on a refund.

Audit Generated Assessments and Related Interest Calculations

During an examination when the auditor determines the customer has underpaid a tax and generates a proposed assessment, the customer receives an audit report summary letter and an audit bill (Notice of Proposed Assessment, or NOPA). In this scenario, the amount due is delinquent, and therefore, interest will be calculated on the bill. Indiana Code (IC) 6-8.1-10-1 mandates interest on delinquent tax payments for which DOR has no authority to waive.

Audit Generated Assessment and Penalty

During an audit or examination when the auditor determines the customer has additional tax due, the customer will receive a notice of proposed assessment (NOPA). Depending on the facts and circumstances of the case, additional penalties could apply. Examples of penalties that may apply are as follows:

- Audit assessment due to negligence: 10% of tax due or \$5, whichever is greater
- Underpayment of estimated taxes: 10% per quarter where underpayment occurs
- Failure to file a tax return with preparation by DOR (estimated return prepared): 20% penalty
- Failure to file a tax return; fraudulent intent to evade tax: 100% penalty
- Faulty payment (i.e., bad checks): penalty of \$35 or 100% of payment amount if DOR determines the payment was made fraudulently or with knowledge that the payment was not valid
- Failure to file information return (e.g., W-2): penalty of \$10 for each failure to file a timely return, not to exceed \$25,000 in one calendar year, is imposed
- Failure to include non-resident partners, shareholders, or beneficiaries in a composite return schedule: \$500 and 20% of any amount required to be withheld as composite tax due that is not remitted timely

Trust Taxes

Sales tax, Withholding tax, Food and Beverage tax, and County Innkeeper's tax are examples of "trust" taxes. These taxes have acquired this name because the business acts as an agent for the state and collects the taxes due, holding them in trust until remitted to DOR. The business must file the tax returns and remit the tax due to the state.

Bankruptcy does not relieve liability for non-remittance of trust tax. [More information on each tax type](#) is available.

Responsible Officer

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 Form ROC-1 or by logging in to the [INTIME](#) account to update the information.

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. DOR is not precluded from conducting an audit during a bankruptcy proceeding. Audit results may require bankruptcy claims being amended.

Chapter 6: Pre-Audit Preparation

Preliminary Review of Customer Records and Tax Returns

Pre-Audit preparation is the first step in conducting an 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 information including:

- Customer's contact information and entity type
- Returns filed with DOR
- Prior audit files including any related protest final determinations or settlement agreements
- Publicly available information such as SEC filings, corporate web pages, Secretary of State reports, etc.
- Any refund claims filed in the recent past
- Customer-provided IRS returns

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 a preliminary audit plan that includes:

- The tax types and periods under audit
- The preliminary approach to auditing each tax
- With respect to larger Sales and Use tax audits, the potential sample period 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 or fee type(s) and period(s) to be audited. The letter will also provide the customer with the auditor and supervisor contact information and next steps. Audit periods and tax types may change as the actual audit progresses based on the facts and circumstances present.

Initial Contact: Phone Call or Email

The auditor follows up on the letter with a phone call or email. This discussion should address the customer's initial questions and concerns while establishing an appointment for the pre-audit interview and 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, depending 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

Prior to the start of the audit, the auditor must conduct an initial interview with the customer. The interview can be in person, via 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 understanding of the business, the auditor will request information such as a chart of accounts, departmental listing, organizational chart, list of responsible officers, etc. 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 interview may include a discussion of availability of records and sampling options.

Discussing Customer's Records and Recordkeeping Systems

The auditor will discuss the customer's records and recordkeeping systems to learn such things as:

- The location and volume of the records to be examined and how those records are filed/stored
- The availability of federal income tax returns, excise tax returns, financial statements, corporate minutes, and depreciation schedules
- The customer's internal processes for producing, handling, recording, source documents and the system for identifying, recording, and reporting taxes

Discussing Customer's Accounting Practices

The auditor may discuss the customer's accounting practices such as:

- Internal controls 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
- Systems used for recording transactions and financial posting

Other Items Addressed in Initial Interview:

If, during the pre-audit interview, the customer indicates being audited by the IRS but did not report the results to DOR, the auditor may adjust the customer's returns accordingly as part of the audit. Taxpayers may be advised to file amended returns to report modifications to federal taxable income or federal adjusted gross income, as required by Indiana statutes, to preserve rights for claiming refunds or appealing assessments related to RAR adjustments.

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 & 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](#) is available.

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, employers are responsible for withholding Indiana state and local (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.

Common areas of review during a Withholding tax audit:

- Verification of individuals treated as contract workers, as opposed to employees
- Withholding of local (county) income tax for all employees living or working in Indiana

State Form WH-4

The withholding agent is required to retain a completed Form WH-4, Employee's Withholding Exemption and County Status Certificate, from each employee. 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 should be withheld. Employees should update their WH-4 by Jan. 1 of each year if their county of residence or county of principal employment changes and at any time the total exemptions change.

How to Figure State and County Income Tax

[Departmental Notice \(DN#1\)](#) is updated each year on Sept. 1 and Dec. 1 with 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 rates.

When Form WH-4 indicates that an employee was a resident of an Indiana county, the employer must withhold local (county) income tax on payments made to the employee using the [tax rate for that county](#). However, if Form WH-4 indicates an employee was not a resident of an Indiana county, then the employer must look to the county of principal employment or workplace and withhold payments made to the employee using that county's tax rate. The county of residence and the county of principal business (or employment) is effective as of Jan. 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 Jan. 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 Jan. 1), the employer will not be required to withhold any county tax for that employee for that tax year.

For any employee who fails to submit a WH-4 or for whom a WH-4 is not retained by the employer, the DOR auditor will presume the employee is subject to county tax in either their county of address record or the county where the customer location is.

For tax years beginning on or after Jan. 1, 2024, an employee who lives outside Indiana but works in Indiana no more than 30 days in a calendar year is not subject to Indiana adjusted gross income tax or local income tax on wages paid. This exception does not apply to employees who were residents of an Indiana county on Jan. 1 of the tax year.

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 it with DOR.

Reciprocal agreements do not affect local (county) taxation. The employer must withhold local tax if the county of principal employment of the nonresident employee is in Indiana, at the county rate listed in [DN #1](#).

Documentation Requests

The auditor will provide the customer with 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 or journals
- A complete listing of employees, their principal work location, and county of residence as of Jan. 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 analyze 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 registers, work logs, etc. to verify wages or other compensation
- Perform an analysis on 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.

Withholding Tax Reference Material

- [Departmental Notice #1](#) – How to Compute Withholding for State and County Income Tax
- [Departmental Notice #5](#) – Reporting Employee Taxes Withheld
- [Departmental Notice #16](#) – Withholding of Tax on Riverboat Gaming Winnings
- [Income Tax Information Bulletin #13](#) – Withholding of Adjusted Gross Income Tax on Retirement Pay
- [Income Tax Information Bulletin #16](#) – Use of Federal Form W-2 for Reporting Indiana State and County Taxes Withheld
- [Income Tax Information Bulletin #33](#) – Withholding Requirements for Nonresident Employees
- [Income Tax Information Bulletin #52](#) – Withholding Information for Part-Time Employees and Other Miscellaneous Withholding Requirements
- [Income Tax Information Bulletin #72](#) – S Corporation, Trust, and Partnership Mandate to File a Composite Return on Behalf of Nonresident Shareholders and Partners
- [Income Tax Information Bulletin #86](#) – Independent Contractors Responsibility for Income Tax Reporting and Withholding
- [Information Bulletin #88B](#) – Tax Withholding for Race Teams
- [IRS Publication 15 \(Circular E\)](#) – Employer's Tax Guide
- [IRS Examiners' Audit Guide](#) regarding Executive Compensation – Fringe Benefits
- [IRS Examiners' Audit Guide](#) for Cash Intensive Businesses
- [Withholding income tax](#)

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 determine compliance with Indiana's gross retail (Sales) and Use tax laws and to educate the customer where necessary. 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](#) on DOR's website.

Examples of common areas of review during a Sales and Use tax audit:

- Retention of exemption certificates from customers to support reported exempt sales
- Records provided by marketplace facilitators to support excluded sales, where Sales tax is collected by the facilitator
- Collection of Sales tax on taxable items and at the correct tax rate
- Charges for services performed on items sold prior to delivery to the purchaser, such as shipping and handling charges or alterations
- Proper application of statutory exemptions for sales or purchases made

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.

Retail sales made in Indiana are presumed to be subject to Indiana sales tax, which is to be collected by the merchant unless the purchaser provides the merchant with a valid exemption certificate or direct pay permit. All reported exempt sales must be supported by proof of exemption.

Use Tax

Use tax is usually described as 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 (or pays less than the required Indiana Sales tax due) on purchases of tangible personal property or a bundled transaction from either an in-state or out-of-state seller must report and pay Use tax on such purchases unless:

- 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
- 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 (i.e., lottery tickets, certain food items, gift cards, etc.) or the business retains an exemption certificate (Form ST-105 or SST exemption certificate) or a direct pay permit for the buyer on file.

Effective Oct. 1, 2018, Indiana law (IC 6-2.5-2-1(d)) 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 receives gross revenue from sales into Indiana exceeding \$100,000, including sales that are not subject to Sales tax or are considered tax exempt, within the previous calendar year or within the current calendar year.

The retail merchant reports and pays Sales tax on the monthly or annual Sales tax return (Form ST-103 or equivalent) submitted on [INTIME](#) or through Streamlined Sales Tax procedures.

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. It is therefore necessary for the customer to retain a record of purchases upon which Use tax is reported. When a business is not a registered retail merchant, then the Use tax is reported as needed on a consumer Use tax return (ST-115) or through [INTIME](#). Use tax may also be reported on the business's Corporate Income tax return. Individuals can report Use tax on an Individual Income tax return (IT-40 or IT-40PNR), on Form ST-115, or through [INTIME](#).

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 DOR 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 (point of sale system records)
- 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 Form 1099-K reports
- Any other documentation used in calculating Indiana sales or Sales tax and/or used in preparing the Sales tax return
- Exemption certificates or direct pay permits collected from customers evidencing exempt sales

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(s), 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. If sales are made through a marketplace facilitator and reported as excluded sales, appropriate records documenting this will be requested and reviewed. The auditor requests any reports used in preparing the Sales tax returns along with the related sales tickets, invoices, register tapes, contracts, and summaries 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 quantity of records, the auditor and customer may agree to a sampling method for the review. Further information on sampling is in [Chapter 15](#) of this manual.

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

Exemption Certificates and Direct Pay Permits

To support an exempt Indiana sale, the customer must maintain a properly completed exemption certificate or direct pay permit issued by DOR, 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. Indiana is also a full member of the Streamlined Sales Tax (SST) agreement and accepts the SST Certificate of Exemption.

Direct pay permits may be used by purchasers who have been approved by DOR to pay Use tax directly to the department and not to vendors.

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 in order for it to be valid.

Notice of Non-Compliance

When a customer is unable to provide an exemption certificate or other proof of exemption 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 extended to obtain sufficient documentation to support the exempt sale. The auditor will also include a special exemption certificate (Form AD-70) for merchants to provide to their customers to complete.

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

Sales Tax Adjustments

An adjustment to the reported taxable sales/Sales tax is necessary in these 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
- Items presumed to be statutorily exempt in error

Sales tax (and other trust taxes) 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 to the retail merchant.

Use Tax Audit Procedures

The auditor reviews the customer's 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 quantity 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 details. 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.

Purchases made from sellers in other states may have Sales tax collected at a rate and amount less than is due to Indiana. If this is the case, the auditor will compute the amount of Indiana Use tax due, allowing credit for amounts paid to other states. No such credit is allowable for local Sales taxes paid in other jurisdictions, however.

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 tax return where the amount was reported. The auditor traces enough invoices to confirm the fact that the customer properly accrued, reported, and paid Use tax.

The auditor will educate customers who do not currently accrue Use tax on the various methods 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. For larger businesses, the auditor may suggest the customer initiate a [Sales & Use Tax Compliance Agreement \(SUTCA\)](#) to more efficiently report Use tax on monthly returns.

Sales and Use Tax Reference Material

- Reference material on [DOR's tax library](#) webpage includes, but is not limited to:
 - [Sales and Use 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.
- [Indiana Code](#) (Title 6) and Regulations ([Indiana Administrative Code](#), Title 45)
- Final Determinations (Letters of Findings, Memoranda of Decisions, Orders Denying Refund) provide the general public with information about DOR'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.
- Other Resources such as Tax Court filings and decisions, access to the Indiana Register, Newsletters, Filing Statistics, etc.

Chapter 9: 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 applicable Indiana adjusted gross income or financial institutions 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 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 open by the statute of limitations (typically the last three years) or may be limited to either a shorter time frame or the review of a particular line item on a return such as a credit or deduction. Credits or deductions with carry forward provisions may be reviewed well past the general three-year look-back period. In many cases, an income tax audit occurs in conjunction with a Sales and Use and Withholding tax audit.

Documentation Requests

The auditor will provide the customer with a written request for the documentation needed for the income tax audit. The auditor may request the following documentation by tax type:

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
- Income transcripts (Forms W-2s, 1099s, K-1s for pass-through income, etc.)
- Schedule C and supporting records of income and expenses
- Documentation supporting reported exemptions, credits, or deductions

Corporate Income Tax and Financial Institutions 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

Pass-through Entities

- Federal and State (all state) income tax returns of the customer
- 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
- Calculation of amounts reported as composite tax for non-resident partners, shareholders, members, or beneficiaries.
- Pass Through Entity Tax (PTET) and credit reporting

Audit Procedures

Prior to 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 or a business operated as a sole proprietorship. Other audits (or desk examinations) 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 and Financial Institutions 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 parent corporation returns, if the entity is part of an affiliated group. The auditor may request a 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, and other information used in preparing the return. In addition, the auditor verifies that federal taxable income carries correctly to the Indiana return.

Indiana imposes a Financial Institutions Franchise tax on businesses defined as a financial institution and operating in the state of Indiana. This tax is reported on Indiana Form FIT-20 and is governed by IC 6-5.5. Affiliated companies doing business as financial institutions in the state must file Indiana returns on a combined basis. Auditors will review FIT-20 filing, federal returns, and business records to determine compliance with filing requirements and tax calculation.

Additional Procedures for Pass-Through Entities

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

In addition, the auditor verifies that a composite return was filed on behalf of any nonresident and that income, addbacks, credits, or other items properly flow through and are reported or excluded as required. Beginning with tax year 2022, the audit will also verify Pass Through Entity tax (PTET) and credits reported.

The auditor may perform further review of individual or corporate returns that report the pass-through income, deductions, add-backs, and credits to verify that K-1 data was consistent. Individual taxpayers audited in conjunction with pass-through entities are also subject to review of basis calculations to determine appropriate handling of income and losses.

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 entities, subsidiaries, disregarded entities, or other affiliates.

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 during the course of the audit, the auditor will request information and/or documentation to determine the nexus in or outside Indiana. The auditor may ask the customer to complete a nexus questionnaire to obtain this information. Requested information includes:

- Location and activities of each entity
- Work location and activities of employees performing services in Indiana
- Location of business property (including inventory and assets)
- Other information necessary to determine presence in Indiana for income tax purposes

Reference Material

- [Income Tax Information Bulletin #12](#)

Apportionment

Overview

Under the Adjusted Gross Income Tax Act, taxable income from a trade or business carried on within and outside Indiana is 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 number of Indiana receipts during the tax year and the denominator is the total number of receipts for all jurisdictions during the tax year.

Indiana receipts must include:

- All sales made in Indiana
- All sales made from Indiana to the U.S. government
- All receipts from sales of business property in Indiana
- All interest, dividends, or other intangible income earned in Indiana
- All receipts for services consumed in Indiana (market-based sourcing of service receipts)

With partnership income, the relationship between a corporate partner and the partnership determines the reporting of business income. If a unitary relationship exists, the corporate partner includes its “unapportioned” share of the partnership’s income and required modifications 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; non-unitary partnership income and non-business income derived from Indiana sources are allocated directly to be included in Indiana taxable income.

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

In addition to other standard documents, the auditor requests these documents:

- The partnership agreement
- Copies of the partnership state and federal returns, and K-1s
- Support for all state withholding of composite tax

Definition

The term “Partnership” is defined at IC § 6-3-1-19 as “...any entity subject to the requirements of Subchapter K of the Internal Revenue Code.” This could include formal or informal entities, including 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).

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.

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. To verify the relationship, the auditor may request and review information related to:

- 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 contract

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 with which a non-unitary relationship is established, the income from the partnership is treated as allocated investment income. The auditor verifies that the corporate partner's distributive share of the partnership income is removed from the federal taxable income, by reporting on Schedule F attached to the corporate tax return, 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 reported as Indiana non-unitary partnership income on Schedule F. The partner's distributive share reported should be inclusive/net of Indiana modifications as reported to the partner on IN K-1. [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 Form IN K-1 issued to the nonresident (if any of these credits are applied to the nonresident composite tax liability, the credit should not appear in Part 2 on the Schedule IN K-1).

Withholding on Distributions to Non-resident Partners or Shareholders

Every partnership and S 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 state of residence. If their county of principal business or employment on Jan. 1 is in an Indiana county, then county income tax must also be withheld. For tax years beginning on or after Jan. 1, 2023, this requirement also applies to trusts and estates with non-resident beneficiaries.

Pass Through Entity Tax

Beginning with tax year 2022, Indiana statutes allow for an election by a pass-through entity (partnership or S corporation, or LLC that reports as either of those) to report tax due at the entity level. Auditors will verify that appropriate elections and forms have been filed with DOR, and that PTET is computed accurately. Additionally, auditors will verify that any amount of PTET expensed on the federal return is added back as a modification on the Indiana return (as a tax based on income and levied at the state level).

Election to report PTET does not eliminate the requirement for withholding and reporting of composite tax due on behalf of nonresident shareholders or partners.

Reference Material

- File on behalf of nonresident shareholder/partner: [Income Tax Information Bulletin #72](#)
- Procedures arising from partnership adjustments: [Income Tax Information Bulletin #72A](#)
- Pass Through Entity Tax: [Income Tax Information Bulletin #72B](#)
- [PTET Instructions and FAQs](#)

Combined and Consolidated Returns

Overview

For affiliated groups of corporations not doing business as financial institutions with income derived from sources in Indiana, the default filing position is a separate filing of Indiana Corporate Income tax return for each entity. The affiliated group may elect to file a consolidated Indiana income tax return. The affiliated group may also request to file an Indiana income tax return on a combined basis with all members of a unitary group.

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 (Schedule 8-D) 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 original or extended 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, and all entities which qualify must be included in the consolidated return. 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 DOR at least 90 days prior to 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. DOR may also require filing on a combined basis if DOR 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. DOR may not require combination with foreign corporations.

To file a combined return, the customer must petition DOR 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, use a relative apportionment formula.

Consolidated Returns Audit Procedures

The auditor will request:

- 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 return
- 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 through intercompany transactions that may result in a distortion of Indiana taxable income. If Indiana income cannot be corrected by means of adjustments to income, apportionment, or income allocation, then a requirement to file on a combined basis or other adjustments may be considered.

Combined Basis Filing Audit Procedures

The auditor will request:

- 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 on the Indiana combined income tax return. The auditor can request an explanation as to whether filing separately or on a consolidated basis would cause distortion of their Indiana income and filing on a combined basis would fairly reflect their income from Indiana sources.

The auditor will look at each affiliate 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 tests of unity:

- Unity of use – centralized corporate functions
- Unity of operations- intercompany transactions
- 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. 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 federal taxable income. Federal bonus depreciation allows customers to deduct a higher expense amount when an asset is 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 in accordance with IC 6-3-1-3.5. 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.

Section 179 Depreciation Overview

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. 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 bonus depreciation and 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.

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)) It is important to note that many taxes levied by states are not net income taxes but are, nonetheless, "based on or measured by" income or receipts. All such taxes are required to be added back to federal taxable/adjusted gross income in determining Indiana adjusted gross income.

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. 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.

IC 6-3-1-3.5(c) provides a limitation and phase-out on the addback of state wagering taxes for taxable years beginning after Dec. 31, 2018, for corporations and individuals.

Auditors will evaluate the calculation of any state tax expense deducted on the federal return to determine whether it is based on income and should be added back on the Indiana return. Auditors may request copies of other states' tax returns for this and other purposes.

Intangible Expenses Addback

Overview

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

IC 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).

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 among 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 are verified by examining the documentation of those exceptions and determining 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 expense, 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

IC 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

IC 6-3-1-3.5(b)(9) 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)."

OOS Municipal Obligation Interest - Addback

IC 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, following definition of "adjusted gross income" for corporations provided at IC 6-3-1-3.5(b.)

Net Operating Loss

Overview

Resident Persons

Resident persons may be 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. 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.

Corporations: Non-resident Persons

Corporations and nonresident persons may be 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. 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.

Financial Institutions

Entities filing the FIT-20 as financial institutions are entitled to deduct net operating losses and net capital losses incurred by a member of a group filing an Indiana combined return. For an affiliated group filing a combined FIT return, the calculation of the allowable deduction is limited by the relevant members' ratio of Indiana receipts. The instruction booklet for the FIT-20 return details the computation of the allowable deductions.

Audit Procedures: Net Operating Losses and FIT Net Capital 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 include 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 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 or other adjustments not authorized by Indiana statutes 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 beyond the statute of limitation 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.

Similarly, when examining the financial institutions tax returns, the auditor will confirm any capital loss deductions computed and the allowable carryover.

Other Deductions

Net Qualifying Dividends

Net qualifying dividends are special deductions from Schedule C, Federal Form 1120. The deduction is 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.

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 from 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. 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](#)

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. For additional information and guidance, see [Income Tax Information Bulletin #104](#).

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 was previously added back, deduct the amount of deferred income recognized for federal purposes in the current period. 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 is reported on Line 12 of Indiana Corporate Income tax return IT-20. The amount of the deduction is determined by the percentage of voting stock owned by the taxpayer in the foreign corporation. The deduction is computed on the Foreign Source Dividend Deduction Worksheet, which must be included with the IT-20 return to support the deduction.

For additional information and guidance on computing the deduction, see [Income Tax Information Bulletin #78](#).

Federal Gross Repatriated Dividends

The addback is the amount necessary to make the dividend equal to the gross deemed dividend reportable for federal tax purposes. If a deduction was claimed under IRC section 965(c), the addback required will equal the amount on federal Form 965, Part II. The total amount included in Indiana adjusted gross income equals the gross amount of dividends reported prior to any deduction under IRC Section 965(c). This income, after the add-back and after any deduction for Section 78 gross-up related to the deemed dividend, is treated as a foreign source dividend.

Other Modifications Required

The Indiana General Assembly frequently revises the definition of "adjusted gross income" which then requires changes, additions, or deletions of modifications (addbacks or deductions) required or allowed. During the course of an audit, the auditor will apply the specific modifications in effect for the tax year(s) under audit. Corporate customers should carefully review the annual instruction booklets published by DOR, as well as relevant Information Bulletins and other publications.

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. During an audit, the auditor will examine and verify any credits claimed, including any non-refundable credits that have carryover application to future periods.

A complete listing of the refundable and nonrefundable credits available to Indiana customers is provided in [Income Tax Bulletin #59](#).

Order of Application

The available credits applied against the claimant's tax due in the following order:

- Credits classified as nonrefundable credits applied first
- 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.

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

Documentation the auditor requests 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

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.

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 who 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 Corporations and pass-through entities. It is feasible for a sole proprietor, perhaps reporting as a single member LLC, to claim a research expense credit. Auditors will review all documentation in support of qualifying research expenses claimed on Schedule IT-20REC.

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 pass-through entities, taxable trusts may use the credits passed through to the trust but may not pass any unused credits to the trust's beneficiaries.

For more information regarding this credit, refer to the [Research Expense Credit Handbook](#).

Chapter 11: Other Taxes and Fees

There are several other taxes and fees administered by DOR. During the course of an audit, the DOR auditor will verify compliance with various miscellaneous taxes required. These taxes are generally specific to certain business activities and may be applicable in only certain local jurisdictions. The audit procedures, including pre-audit and post audit, are similar to the procedures discussed in the previous chapters.

Food and Beverage Tax (FAB)

In counties or municipalities that have adopted a Food and Beverage tax (FAB), 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 Orange County Historic Hotel District'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.

Reference Material

- [General Tax Information Bulletin #203](#)
- [Current FAB Tax Rates and Effective Dates](#)

Enhanced Prepaid Wireless Telecommunications Fee

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 DOR 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.

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 law.

Reference Material

- Information on [Prepaid Wireless Service Charge](#)
- [General Tax Information Bulletin # 210](#) – Enhanced Prepaid Wireless Telecommunications Service Charge

Heavy Equipment Rental Excise Tax (HRT)

The Heavy Equipment Rental (HRT) excise tax is imposed upon the rental of all personal property from a retail merchant that meets the requirements of IC 6-6-15-2(3)(A) and from a location in Indiana for a period of 365 or fewer days or for a rental contract with no specified end date. The tax is imposed at a rate of 2.25% on gross retail income received by the retail merchant for the rental and is in addition to the Sales tax.

When auditing a subject business, the auditor will verify that HRT is correctly computed, collected, and remitted by the merchant.

Reference Material

[General Tax Information Bulletin #211](#) – Heavy Equipment Rental Excise Tax

Motor Vehicle Rental Excise Tax (MVR)

A Motor Vehicle Rental (MVR) 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 DOR. 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 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).

Reference Material

[Sales Tax Information Bulletin #47](#) - Auto Rental Excise Tax, Marion County Supplemental Auto Rental Excise Tax, and Vehicle Sharing Excise Tax

County Admissions Tax (CAT)

Sports and entertainment venues in certain locations are required to collect and remit County Admissions (CAT) tax. The tax is added to the price of tickets and is required to be collected from the consumer and remitted to the department. When auditing a business entity involved in this activity, the auditor will verify the tax is computed, collected, and remitted in accordance with Indiana statutes and regulations.

County Innkeeper's Tax (CIT)

All counties are authorized to impose an County Innkeeper's tax (CIT) under IC 6-9-18 or through specific enabling statutes throughout IC 6-9. Not all counties have adopted CIT and most adopting counties administer this tax themselves. The majority of Indiana's 92 counties have imposed CIT. 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, ballrooms, 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

DOR provides [a list of counties](#) (rates vary by county) that have adopted the County Innkeeper's tax. Customers may also contact customer county auditor's office to learn if the county innkeeper's tax will apply to customer business.

Reference Material

[General Tax Information Bulletin #204](#) - County Innkeeper's Taxes

Waste Tire Management Fee (TIF)

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 Tire 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.

Reference Material

[General Tax Information Bulletin #208](#) - New or Replacement Tires on Vehicles

[Indiana Code](#): IC 13-11-2-231; IC 13-11-2-245; and IC 13-20-13-7.

Chapter 12: Special Taxes

The Special Tax Group, a unit within Audit Operations, completes the audit of “special” taxes, primarily excise taxes imposed on tobacco, alcohol, and fuel. 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.

Fireworks Public Safety Fee (FPS-103)

Overview

Indiana enacted a Fireworks Public Safety (FPS) fee during the 2006 session of the Indiana General Assembly (see 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.

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

[General Tax Information Bulletin #209](#) - Fireworks Public Safety Fee

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 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).

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](#) – Aviation Fuel Excise Tax

Gasoline and Oil Inspection Fee (MF-360)

Overview

Indiana implemented the Gasoline Tax in 1923 (see Code IC 6-6-1.1 and Indiana Administrative Code 45 IAC 12). 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.

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

- [Gasoline Tax/Oil Inspection Fee](#) information and forms
- [Departmental Notice #43](#) - Rates for the Gasoline License Tax and Special Fuel License Tax

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.

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

- Information and forms for [Special Fuel/Oil Inspection Fee](#)
- [Departmental Notice #36](#) - Electronic Filing and Payment Mandates
- [Department Notice #43](#) - Rates for the Gasoline License Tax and Special Fuel License Tax

Gasoline Use Tax (GT-103 and GT-103DR)

Overview

Indiana implemented the Gasoline Use Tax (GUT) 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). DOR will determine the GUT rate by calculating a monthly statewide average retail price per gallon of gasoline (excluding tax) multiplied by 7%. Due to this computation, the GUT rate may change on a monthly basis. DOR publishes the monthly GUT rate in [Departmental Notice #2](#).

Audit Procedures

The auditor will review the filed returns, sales and purchase documentation, logs, exemption certificates, 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

- Information and forms for [Gasoline Use Tax](#)
- [Departmental Notice #43](#) – Rates for the Gasoline License Tax and Special Fuel License Tax
- [Sales Tax Information Bulletin #83](#) – Gasoline Use Tax

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.

Alcohol Excise Tax – Beer, Cider, Liquor, Wine Producers

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. Returns must be filed by distributors (wholesalers), farm wineries, out-of-state Direct Wine Sellers, Indiana-based brewers, distillers, rectifiers and vintners, and primary source suppliers.

Farm Winery Tax (ALC-FW)

Definition

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

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).

Reference Material

Information regarding Alcohol excise tax is available at:

- [INTIME guide for Alcohol, Cigarette and Other Tobacco Products](#)
- [Electronic Filing for Alcohol](#)
- [Alcohol Tax Forms](#)
- [Indiana Tax Handbook for New & Small Business Owners](#)

Information regarding specific Alcohol excise tax types can be found in these sections of the [Indiana Code](#):

- Beer Excise Tax: IC 7.1-4-2
- Liquor Excise Tax: IC 7.1-4-3
- Wine Excise Tax: IC 7.1-4-4
- Hard Cider Excise Tax: IC 7.1-4-4.5
- Malt Excise Tax: IC 7.1-4-5

Resident & Non-Resident Cigarette Tax (CIG-RM; CIG-NRM)

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 or heating 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 or other tobacco products.

Distributor: Every person who sells, barter, 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 to any person for any purpose other than resale, irrespective of quantity or amount, or the number of sales.

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 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. While both must purchase Indiana tax stamps from DOR, some of the reporting requirements are different. An in-state distributor must 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 (MSA) 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 Your Own" (RYO) tobacco 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). Beginning July 1, 2022, the CIG-M schedules were replaced with CIG-RM (for residents) and CIG-NRM (for non-residents) schedules.

The MSA Compliance portion of the Cigarette audit includes analyzing the reported cigarette purchases and sales for accurate stick count, which includes a physical inventory of products. 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](#).

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 ("Non-Participating Brand/Manufacturers") cigarettes sold during the reporting period. This review is done to confirm the accuracy of the reported sales quantities of 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. Examples of the records to be reviewed include but are not limited to:

- Copies of the CIG-RM or CIG-NRM (or CIG-M for periods prior to July of 2022) and related returns and 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 cigarette 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 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 on [Cigarette, E-Cigarette & Other Tobacco Products Tax](#)
- Departmental Notices [#8](#) and [#36](#) are available in [DOR's Tax Library](#) and provide nontechnical assistance to the general public.
- Information Bulletin [#205](#) is available on DOR's [General Tax Information Bulletins](#) page
- Information on [Indiana Tobacco Enforcement](#), the Master Settlement Agreement (MSA), and updated lists of participating and non-participating manufacturers is available.
- List of [licensed Indiana distributors](#) of Cigarette, Other Tobacco Products and Electronic Cigarette retail dealers

Other Tobacco Products Tax (OTP and OTP-M)

Overview

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 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 IC 6-7-2.

Closed System Cartridge Tax (CSC)

Overview

Like the OTP tax, the Closed System Cartridge tax (CSC) is collected by **distributors** on the wholesale price of specified taxable products (tobacco products, alternative nicotine products, closed system vape cartridges, or a combination of these).

The Closed System Cartridge tax was effective beginning July 1, 2022, and is imposed by IC 6-7-2. Detailed descriptions of the products subject to these taxes and relevant instructions can be found in [General Tax Information Bulletin #206](#).

Definitions

Distributor

Refers to a person who:

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

Taxable Product

"Taxable product" means tobacco products, alternative nicotine products, or closed system cartridges, or any combination thereof.

Retail Dealer

Refers to a person engaged in the business of selling taxable products to ultimate consumers, including a retail merchant that meets one (1) or both of the economic thresholds under IC 6-2.5-2-1(d).

Moist Snuff

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

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

Alternative Nicotine Product

Alternative nicotine product means a noncombustible product containing nicotine that is intended for human consumption, whether chewed, absorbed, dissolved, or ingested by any means. The term does not include cigarettes (as defined in [IC 6-7-1-2](#)), tobacco products, closed system cartridges, consumable material, open system containers (as defined in [IC 6-7-4-5](#)), vapor products (as defined in [IC 6-7-4-8](#)), or any product regulated as a drug or device by the United States Food and Drug Administration

Tobacco Product

Refers to any product containing, made, or derived from tobacco that is intended for human consumption, or is likely to be consumed, whether chewed, smoked, heated, absorbed, dissolved, inhaled, snorted, sniffed, or ingested by any other means, or any component, part, or accessory of a tobacco product. The term includes, but is not limited to cigars, pipe tobacco, chewing tobacco, moist snuff, snus, and other similar kinds and forms of tobacco. The term does not include cigarettes, closed system cartridges, consumable material, open system containers, vapor products, alternative nicotine products or any drugs, devices, or combination products authorized for sale by the Food and Drug Administration.

Closed System Cartridge

Closed system cartridge means a sealed, prefilled, and disposable container of consumable material in which the container is inserted directly into a vapor product, and is not intended to be opened or accessible through customary or reasonably foreseeable handling or use.

Consumable Material

Consumable material means any liquid solution or other material used in a closed system container that is depleted as the vapor product is used.

Wholesale Price

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

Reporting

All Other Tobacco Products (OTP), moist snuff, alternative nicotine products, and closed system cartridges are reported on the OTP-M return and related schedules at wholesale price. Resident and Nonresident distributors report on the same form.

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](#).

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 taxable 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

- Information on [Other Tobacco Product Tax](#)
- [Departmental Notice #36](#) and [General Tax Information Bulletin #206](#) are available in [DOR's Tax Library](#) and provides nontechnical assistance to the general public.
- Information on [Indiana Tobacco Enforcement](#), the Master Settlement Agreement (MSA), and updated lists of participating and non-participating manufacturers is available.

- List of the licensed [Indiana Cigarette & Other Tobacco Products \(OTP\) distributors](#)

Electronic Cigarette Tax (ECG)

Overview

The Electronic Cigarette Tax (ECG) is collected by the **retailer** of open system containers, consumable materials (commonly called e-liquid or vape juice, e.g.), and vapor products associated with these containers.

This tax was effective beginning July 1, 2022, and is imposed by IC 6-7-4. Detailed descriptions of the products subject to these taxes and relevant instructions can be found in [General Tax Information Bulletin #206](#). Retail businesses of various types could be subject to the electronic cigarette tax; any business, including a remote seller, that sells open container vaping systems and/or e-liquid is subject to this tax. As a result, an ECG audit may be done in conjunction with audits for Sales tax or other tax types.

Definitions

Open System Container

Open system container means all containers of consumable material for intended use in a vapor product and for which the container is intended to be refillable. The term does not include closed system cartridges (as defined in [IC 6-7-2-0.5](#)).

Retail Dealer

Retail Dealer means a person engaged in the selling of consumable material, vapor products, or both to ultimate consumers.

Vapor Product

Vapor product means any of the following:

- A device, such as an electronic cigarette, that employs a mechanical heating element, battery, or electronic circuit, regardless of shape or size, that can be used to produce vapor from consumable material that may or may not be sold with the device.
- Any open system container of a consumable material in a solution or other form that is intended to be used with or in a device described in subdivision (1).

The term "vapor product" does not include closed system cartridges (as defined in [IC 6-7-2-0.5](#)).

A retail dealer is responsible for collecting the tax as a separate added amount to the consideration in the transaction. The person who acquires consumable material or vapor products in a retail transaction is liable for the tax on the transaction.

The electronic cigarette tax is collected in addition to the Sales tax. In other words, the merchant collecting the electronic cigarette tax must also impose and collect Sales tax on the transaction for products subject to the electronic cigarette tax. Further, Sales tax is imposed on the electronic cigarette tax collected on the transaction.

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. Examples of the records to be reviewed include but are not limited to:

- Copies of the ECG-103 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 electronic cigarette products
- Copies of state and federal audit reports for the audit periods
- Purchase and sales journals, general ledgers and other supporting schedules
- Point-of-Sale system records such as z-tapes to reconcile sales and tax collected

Chapter 13: Motor Carrier Taxes

A separate specialized team of field auditors is assigned to audit carriers subject to the International Fuel Tax Agreement (IFTA) and the International Registration Plan (IRP) authority, as well as Indiana intrastate carriers. The State of Indiana is a member of both the IFTA and IRP, and as such has an obligation to audit carriers according to the terms of that agreement and plan.

Overview of IFTA and IRP

IFTA is an agreement between the lower 48 states of the United States and the Canadian provinces, to simplify the reporting of fuel use by motor carriers that operate in more than one jurisdiction. Prior to IFTA each state had its own fuel tax system, and a truck needed tax permits for each state in which it operated.

IRP is an agreement providing for registration reciprocity among member jurisdictions. The unique feature of the IRP is that, even though apportionable fees are paid to the various jurisdictions in which vehicles of a fleet are operated, the only plate and cab card issued for each fleet vehicle are the plate and cab card issued by the base jurisdiction. The plan provides for payment of apportionable fees on the basis of the proportion of total distance operated in all jurisdictions by the fleet of which a vehicle is part.

Indiana is required to audit 3% of their registered carriers per year. Currently that is approximately 250 carriers per year.

Audit Procedures

The auditor will send a letter to the customer indicating that they will be contacted within 10 days to schedule an audit. During the scheduling process, the auditor will offer the customer 30 days to prepare for the audit and provide records. An audit can be conducted at the customer's business location, in the office of an appointed Power of Attorney, or at a DOR district office.

The field auditors responsible for conducting these audits follow similar procedures to all those referenced here, reviewing the books and records specific to fuel purchases and mileage traveled in the various jurisdictions by all subject vehicles. Records requested for review during the audit include:

- Mileage/Trip logs for all subject vehicles
- Fuel tickets/receipts indicating location of fuel purchase and gallons purchased

Audit Findings

International Fuel Tax Agreement (IFTA)

As part of the audit process, the auditor will rate the carrier's record keeping process as adequate or inadequate. If the carrier's records are rated as adequate, the audit may result in adjustments to the reported figures, with no adjustments. If records are rated as inadequate either the quarterly MPG's will be reduced by twenty percent or an MPG of 4.0 will be applied. Either of the previous two procedures will result in an increase in taxable fuel consumption and an audit assessment. Jurisdictional tax paid credits will be allowed for gallons that are supported by retail fuel invoice, fuel card statements, or bulk fuel withdrawal records. More information is available on the [IFTA website](#).

International Registration Plan (IRP)

As part of the audit process, the auditor will rate the carrier's record keeping process as adequate or inadequate. If records are rated as adequate, the audit may result in adjustments to the reported figures. If records are rated as inadequate, the assessment will be 20% of registration fees. If a carrier is audited a second time and receives an inadequate rating, the assessment will be 50% of total registration fees. If a carrier is audited a third time and receives an inadequate rating, the assessment will be 100% of registration fees.

The auditor will document appropriate record keeping guidance in the audit report. If records are rated adequate, the auditor may give guidance to improve record keeping. If the record-keeping process is rated as inadequate, the auditor will give specific requirements that must be made to be compliant.

More information can be found on the [IRP website](#).

For records to be rated adequate, reference the "Reporting and Record Keeping Requirements" section below.

Reporting And Record Keeping Requirements

A carrier is required to renew their license on an annual basis. They will file IFTA returns (IFTA-101) on a quarterly basis through the Fuel Tax System. If audited, the carrier will be required to provide distance and fuel records in order for the DOR to verify the distance and fuel reported to each jurisdiction on IFTA returns. A Carrier must keep the records on which returns are based for four years past the filing date of the return.

Carriers register annually with the base jurisdiction. Carriers are required to provide distance records in order for DOR to verify the distance reported to each jurisdiction on the IRP application. Carriers must keep the records on which the registration is based. Depending on when, in a calendar year, a renewal of a registration is due, a carrier may need to maintain records for up to six calendar years.

Distance Records

If distance records are paper trip reports, they should contain the following information:

- Beginning and ending dates of the trip to which the records pertain
- Origin and destination of the trip
- Route of travel
- Beginning and ending reading from the odometer, hubodometer, engine control module (ECM), or any similar device for the trip
- Total distance of the trip
- Distance traveled in each jurisdiction during the trip
- Vehicle identification number or vehicle unit number

If distance records are produced by a vehicle tracking system that utilizes latitudes and longitudes, a record must be created and maintained at a minimum every 10 minutes when the vehicle's engine is on and contain the following data elements:

- the date and time of each system reading
- the latitude and longitude to include a minimum of 4 decimal places (0.0001) of each system reading
- the odometer reading from the engine control module (ECM) of each system reading. If no ECM odometer is available a beginning and ending dashboard odometer or hubodometer for the trip will be acceptable
- the vehicle identification number or vehicle unit number

Fuel Records: IFTA Only

- Carriers will maintain complete records of all motor fuel purchased, received, or used in the conduct of their business, and on request, produce these records for audit. The records shall be adequate for the auditor to verify the total amount of fuel placed into your qualified motor vehicles, by fuel type.
- Retail fuel purchases include all those purchases where fuel is purchased from a retail station or a bulk storage facility that the carrier does not own, lease, or control.
- The base jurisdiction shall not accept, for purposes of allowing tax-paid credit, any fuel record that has been altered, indicates erasures, or is illegible, unless the carrier can demonstrate that the record is valid.
- The base jurisdiction shall not allow tax-paid credit for any fuel placed into a vehicle other than a qualified motor vehicle.
- The base jurisdiction shall not allow a credit for tax paid on a retail fuel purchase unless the carrier produces, with respect to the purchase:
 - Receipt, invoice, or transaction listing from the seller, or
 - credit card receipt, or
 - Transaction listing generated by a third party, or
 - Electronic or digital record of an original receipt or invoice
- For tax-paid credit, a valid retail receipt, invoice, or transaction listing must contain:
 - Date of the fuel purchase
 - Name and address of the seller of the fuel (a vendor code, properly identified, is acceptable for this purpose)
 - Quantity of fuel purchased
 - Type of fuel purchased
 - Price of the fuel per gallon or per liter, or the total price of the fuel purchased
 - Identification of the qualified motor vehicle into which the fuel was placed
 - The name of the purchaser of the fuel (where the qualified motor vehicle being fueled is subject to a lease, the name of either the lessor or lessee is acceptable for this purpose, provided a legal connection can be made between the purchaser named and you)
- The carrier shall retain the following records for its bulk storage facilities:
 - Receipts for all deliveries
 - Quarterly inventory reconciliations for each tank
 - Capacity of each tank
 - Bulk withdrawal records for every bulk tank at each location
- The base jurisdiction shall not allow a licensee tax-paid credit for fuel withdrawn from bulk fuel storage facilities unless the carrier can produce records that show:
 - Purchase price of the fuel delivered into the bulk storage includes tax paid to the member jurisdiction where the bulk storage is located, or
 - The carrier has paid fuel tax to the member jurisdiction where the bulk storage is located.
- The carrier shall produce for audit records that contain the following elements for each withdrawal from its bulk storage facilities:
 - Location of the bulk storage from which the withdrawal was made
 - Date of the withdrawal
 - Quantity of fuel withdrawn
 - Type of fuel withdrawn
 - Identification of the vehicle or equipment into which the fuel was placed

- When alternative fuels are purchased or stored in bulk, these same requirements shall apply, in so far as they are practicable. In instances where, with respect to an alternative fuel, the carrier cannot practically comply with these requirements, they must maintain records that fully document the purchase, storage, and use of that alternative fuel.

Summaries

A monthly summary of the fleet's operations reported on the corresponding quarterly tax return that includes the distance traveled by and the fuel placed into each vehicle in the fleet during the quarter, both in total and by jurisdiction, may be necessary for the efficient audit of the licensee's records. The carrier will need to make such summaries available for audit upon due notice and demand by the base jurisdiction.

Documentation Requests

The carrier will be notified through the initial and confirmation letters of the requested records. Any additional requests for documentation will be requested by the auditor throughout the audit process. Clarification will be provided by the auditor if there are questions regarding requirements for documentation.

Concluding The Audit

DOR will mail an official audit report. The report will include a written explanation of any adjustments to reported information, pages that show calculations of the adjustments and a proposed assessment/refund document. The proposed assessment/refund document will indicate if the result of the audit is a no change, refund or assessment and will include contact information for payment or appeal of the audit results.

Chapter 14: Interim, Post-Audit & Final Conference Procedures

Interim Communications/Conferences

At any point during the conduct of the audit, it may be necessary or desirable for the customer 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 auditor should keep the customer informed of the audit's progress and potential issues being raised. The audit process is expected to be collaborative so that all questions and concerns of the customer are addressed.

Post-Audit Conference

At the conclusion of the audit fieldwork, a Post-Audit Conference may 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.

Final Conference

The final (also called exit) conference will occur at the conclusion of the audit. This conference may occur at the same time as the post audit conference. 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 that 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 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 letters and notices 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. Guidelines to aid the customer can be found on [DOR's website](#).

Chapter 15: 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 should be examined using a sampling method. 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 the customer regarding the sampling plan. It is important for the customer to agree with the sampling method, at least in principle; 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 that 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 team specializes in reviewing and analyzing electronic records to improve the audit process.

Unlike paper records, electronic records can be extracted, sorted, 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 or images 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 determining a customer's tax liabilities may be obtained by the Division of Audit.

Non-Statistical Sampling & Projections

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. Examples of time periods reviewed for a block sample include:

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

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.

Items the Auditor May Consider

The following considerations may assist the auditor in determining whether 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 are invoices 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 three-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 population for the audit period (sales or expenses, usually) to determine the taxable exceptions for the audit period. The auditor should work with the customer to identify and remove outlier transactions. Reaching agreement on the method for projection and signing an agreement letter is preferred but not required. A signed projection agreement indicates agreement with the projection method itself; underlying taxability of items may be appealed.

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 these characteristics:

- Random selection of the sample items
- The use of an appropriate statistical technique to evaluate sample results including measurement of sampling risk

A sampling approach that does not have these characteristics 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 reviewing 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:

- 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 the format of electronic data, types of electronic accounting records needed, sample periods, etc. The DOR auditor may participate in this discussion.
- The CAS gathers and summarizes customer electronic records data by account and incorporates the data into an "Account Classifications" worksheet.
- The DOR auditor, with input from the customer, determines 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 transaction 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.

Most statistical sampling reviews relate to Sales and Use tax application. 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. Because sample transactions are stratified, the highest dollar transactions are typically reviewed in total for the sampled pool.

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 prior to the selection of the sample, 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 an agreement or contract 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 of tax paid on, purchases covered by the agreement.

Once the DOR auditor and the customer have agreed upon the Use tax percentage, the auditor forwards the completed pull list to the CAS. The product is a signed contract drafted by DOR's Legal Division or Tax Policy.

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 may be conducted to true-up the open period(s). Typically, a true-up is not conducted unless DOR and customer agree to do so at the beginning of the process.

Chapter 16: Field Audit Workpapers

Audit work papers are the summaries, schedules, and worksheets compiled by an auditor while conducting the audit. Many audit working papers are contained within DOR's integrated tax processing system, while others may be created as needed during 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 as warranted during the audit's progress.

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.

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
- Any other comments pertinent to the method or reasoning used to arrive at the facts and figures shown on the schedule.

Other Audit Documents

All working papers, documents, and notes prepared during the course of the audit are considered departmental records, and as such they are subject to DOR's retention policies and schedules. All such items must be retained in the electronic audit file. These items could include:

- All pertinent correspondence to and from the customer and/or authorized representative
- Superseded work papers
- Research material
- Third-party information
- 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 should be carefully preserved.

Chapter 17: Cash Intensive Businesses

Overview

A cash intensive business is one that receives a significant portion of its gross 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:

- Publicly 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, cigarette tax return information, etc.
- Accessing Federal Tax Information (FTI) when necessary

It is necessary for the DOR auditor to verify information on the return. Sometimes the preliminary review of data indicates a potential of under-reported income, Sales tax, etc. and requires additional inquiry by the auditor. 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.

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), as provided by Indiana statutes. 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.

Indirect methods auditor may use to substantiate reported tax return amounts include such things as bank deposit analysis, source and application of funds, cost of goods sold analysis, industry ratios, and cash "T" accounting

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

Chapter 18: 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 either by Audit Operations field staff or by the Business Tax Compliance (BTC) unit.

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

Chapter 19: Quality Assurance and Billing

Procedures for Issuing the Audit Report

After the final conference, the auditor prepares a written report of the findings that produces the Audit Summary Report letter. 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 or regulatory basis for each adjustment. The report accompanied by the audit work papers is submitted for approval. Every completed audit goes through multi-level review procedures to determine its accuracy, fairness, and consistency with other audits of similar situations and customers. Audit Operations' Quality Assurance (QA) team performs the final detailed review to ensure standards are met. The QA team is comprised of veteran auditors with diverse backgrounds and a wide breadth of Indiana tax knowledge and familiarity with DOR's policies and procedures.

Internal Quality Assurance

When the file is assigned to a QA team member, the QA auditor performs a detailed examination of the completed audit report and all relevant supporting worksheets, schedules and exhibits. Reviewers are provided a procedural checklist to guide the review process of 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 audit has been fully reviewed and approved for processing, the audit is "posted" by the QA Auditor, creating financial adjustments to the customer's account(s) in the Indiana Tax System (ITS). A hard copy of the final audit report (the audit summary report letter) along with a cover letter will be mailed to the customer via the United States Postal Service. Taxpayer representatives can also view letters and billing information on [INTIME](#).

In addition to the audit report and cover letter, DOR will issue a notice of proposed assessment (NOPA, or bill) for each year in the audit period where a tax deficiency is determined. That notice will include any applicable penalties and interest.

Penalty may be imposed at 10% of the assessed tax and the interest rate varies per year. Refer to [Departmental Notice #3](#) for further information on calculating interest. 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 customers may submit [secure messages through INTIME](#).

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 for Payment (DFP).

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 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.

Options to Pay the Audit Bill

The most efficient way to [pay an audit bill](#) is on [INTIME](#). Select "make a payment" in the "Payments" section on the landing page, then in the "Bill Payments" panel, select the option to pay with bank account (no fee) or debit/credit card (fee).

Customers may also pay in person, by phone, or by mail. Checks and money orders should be made payable to the Indiana Department of Revenue and mailed to the address on the notice received.

DOR also offers several [payment plan options](#) for both individuals and businesses. To [establish a payment plan](#), the amount of tax due must be more than \$100 for individuals and more than \$500 for businesses.