



LOUISIANA UNIFORM LOCAL SALES TAX BOARD

Policy Advice No. 20-003

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Assessment of Audit Costs for Local Sales and Use Tax

Purpose

This Policy Advice from the Louisiana Uniform Local Sales Tax Board the (“Board”) is to promote uniformity and efficiency in the implementation and allocation of costs for a local sales and use tax audit under La. R.S. 47:337.75. This policy advice is being issued pursuant to La. R.S. 47:3337.102(C)(2) and (C)(5), and in accordance with Board Policy and Procedure Memoranda 50.1 and 50.3.

Question Presented

La. R.S. 47:337.75 allows a local collector to add a penalty to the amount found due on an audit in an amount as itemized by the collector to compensate for all costs incurred in making such examination or audit whenever a taxpayer fails to make a return, makes a grossly incorrect report, or makes a false or fraudulent report. Most sales and use tax audits cover periods where several returns have been filed. How would a collector apply the provisions of this statute for an audit when some, but not all, of the returns were not filed, grossly incorrect or fraudulent?

Executive Summary

A collector has discretion to impose all audit costs when a taxpayer fails to make a return, makes a grossly incorrect report, or makes a false or fraudulent report. Apportionment of audit costs among reporting periods is required when a taxpayer has reasonable cause and is in good faith in making grossly incorrect report(s) for some periods but not others. Apportionment is not allowed when a taxpayer fails to file a report or makes a false or fraudulent report. When required, apportionment of audit costs should be done in a fair and reasonable manner.

The Statute

Louisiana Revised Statute 47:337.75 provides as follows:

§337.75. Examination and hearing costs

A. If any taxpayer fails to make any return required by this Chapter, or makes a grossly incorrect report, or a false or fraudulent report, and the collector, in performance of his duty to ascertain the amount of tax due, makes an examination of books, records, or documents, or an audit thereof, or conducts a hearing, or subpoenas witnesses, then there may be added to the amount of tax found to be due, a specific penalty, in addition to any other penalty provided, in an amount as itemized by the collector to compensate for all costs incurred in making such examination or audit, or in holding such hearing, or in subpoenaing and compensating witnesses. This specific penalty shall be an obligation to be collected and accounted for in the same manner as if it were part of the tax due, and can be enforced either in a separate action or in the same action for the collection of the tax.

B. For the purposes of this Section, the following terms shall have the following meanings:

(1) "Grossly incorrect report" means any report filed where there is a substantial understatement of tax for any taxable period. The understatement is substantial if it exceeds the greater of:

(a) Ten percent of the tax required to be shown on the return for the taxable period, or

(b) Ten thousand dollars.

(2) "False or fraudulent report" means any report filed with the intent to evade taxes, or a willful attempt to defraud or evade taxes that are due.

C. Notwithstanding any other provision of law to the contrary, no penalty shall be imposed under this Section with respect to any portion of an underpayment when a taxpayer has made a grossly incorrect report if the taxpayer shows that there was a reasonable cause for the underpayment of such portion and that the taxpayer acted in good faith with respect to such portion.

D. Notwithstanding the provisions of this Section, in the event the examination or audit was conducted by a private auditing firm the limitations provided in R.S. 47:337.26 shall apply.

E. The amount of specific penalty due pursuant to this Section shall be the same as is provided by law on July 1, 2003, until such laws are amended or provisions of this Chapter are amended to provide with respect thereto.

Analysis & Response

Before discussing audit costs specifically, a note on penalties in general is warranted because the assessment of audit costs to a taxpayer or dealer is considered a penalty pursuant to

La. R.S. 47:337.75. (See La. R.S. 47:337.75(A), "...then there may be added to the amount of tax found to be due, *a specific penalty*, in addition to any other penalty provided, in an amount...to compensate for all costs incurred in making such examination or audit..." (Emphasis added)). In the realm of tax law, statutes imposing penalties or sanctions are to be interpreted strictly against imposition of a penalty.¹ This means where a tax penalty statute is susceptible of more than one reasonable interpretation, the construction less onerous to the taxpayer must be adopted.²

Paragraph A of §337.75 provides three different factual scenarios in which audit costs may be imposed by a local collector: 1) where a taxpayer fails to make a return; 2) where a taxpayer makes a "grossly incorrect report"; or 3) where a taxpayer makes a "false or fraudulent report." Paragraph B(1) of §337.75 in turn defines "grossly incorrect report" as an understatement that exceeds ten percent of the required tax or ten thousand dollars, whichever is greater. Paragraph B(2) of §337.75 defines "false or fraudulent report" as one filed with the intent to evade taxes, or a willful attempt to defraud or evade taxes that are due. In each of these three factual scenarios, a collector has the discretion, but is not required, to assess all audit costs.³

In using the phrase "*all costs* incurred in making such examination or audit" in Paragraph A, §337.75 sets out a general rule that if a collector chooses to add audit costs as a penalty, those audit costs must be fully assessed and may not be apportioned between report periods in an audit

¹ *Claiborne Sales Company, Inc. v. Collector of Revenue*, 233 La. 1061, 1069 (La. 1957); *Allstate Indemnity Company v. Wooley*, 2006-1388 (La. App. 1 Cir. 5/4/2007), 961 So. 2d 1189.

² *Allstate*, supra, citing *Contract Mgmt. Services, Inc. v. State ex rel. Dep't of Labor, Office of Employment Security*, 98-2010, p. 6 (La. App. 1 Cir. 11/5/99), 745 So.2d 194, 198; see also *Yesterdays of Lake Charles, Inc. v. Calcasieu Parish Sales...*, 2015-C-1676 (La. 2016) 190 So.3d 710 (When there is reasonable doubt as to the meaning of a tax law, the courts should construe the law against the taxing authority and in favor of the taxpayer.).

³ When used in a statute, the word "shall" is mandatory and the word "may" is permissive. La. R.S. 1:3.

or otherwise reduced or adjusted.⁴ Paragraph C of §337.75, however, then provides an exception to that general rule:

C. Notwithstanding any other provision of law to the contrary, no penalty shall be imposed under this Section with respect to any portion of an underpayment when a taxpayer has made a grossly incorrect report if the taxpayer shows that there was a reasonable cause for the underpayment of such portion and that the taxpayer acted in good faith with respect to such portion.

Pursuant to Paragraph C of §337.75, in the case of a grossly incorrect report, audit costs cannot be imposed with respect to any portion of an underpayment where a taxpayer has reasonable cause and acted in good faith with respect to such portion. By way of example, suppose a taxpayer undergoes an audit for a six months of sales tax returns which reveals a \$75,000 total underpayment, with each month's return being understated by more than \$10,000 making all six returns meet the definition of a "grossly incorrect report." For three of the months, however, the taxpayer had reasonable cause for the underpayment and acted in good faith.⁵ This means that for portion of the \$75,000 underpayment related to that three months of the audit period, audit costs may not be assessed. However, the portion of audit costs attributed to the other three months in

⁴ §337.75(D) and La. R.S. 47:337.26(E) do provide a limitation on the costs that may imposed on a taxpayer when the audit was conducted by a private auditing firm. In that event, the cost to the taxpayer shall not exceed thirty percent of the amount of the additional taxes determined to be due as the result of the audit.

⁵ La. R.S. 47:337.75 was first enacted as part of the implementation of the Uniform Local Sales Tax Code (ULSTC) in Act 73 of the Regular Session of 2003. Act 73 notes that §337.75 "is all new law." See Act 73 at page 121. While the provision had not existed at the local level prior to the enactment of the ULSTC, §337.75 was based almost verbatim on La. R.S. 47:1605 which was already in effect in the administrative provisions for the collection of state taxes. Paragraph C of R.S. 47:1605 (which is identical to Paragraph C of §337.75) was added via Act 1032 of the 1999 Regular Session. The original version of House Bill 2110 (which became Act 1032 of 1999) provided that no audit cost penalty was to be imposed for the portion of an underpayment where the taxpayer had reasonable cause *or* was in good faith. House Bill 2110 was amended by the Senate to require good cause *and* good faith. Thus, both just cause *and* good faith are required under La. R.S. 47:1605(C) and §337.75(C) for a taxpayer to avoid imposition of audit costs.

which the taxpayer had no good cause or good faith may be imposed. In this situation, the collector may assess only a portion of the audits costs to the taxpayer, not “all costs” of the audit.⁶

Paragraph C of §337.75 does not apply to instances where a taxpayer fails to make a return or where a taxpayer makes a false or fraudulent report.⁷ Assume a taxpayer files mostly accurate (not grossly incorrect) returns for five months but in the sixth month an employee critical to the proper filing of returns is absent due to sickness resulting in a failure to file for one month. It could be argued that the taxpayer had reasonable cause and acted in good faith with regard to the sixth month; but in this scenario Paragraph C of §337.75 would not apply due to the failure to file. Accordingly, audit costs, if imposed, could only be assessed in their entirety. In this scenario a collector could choose to exercise the discretion afforded in Paragraph A of §337.75 and not impose an audit cost penalty at all.⁸

⁶ See testimony of Representative William Daniel, sponsor of HB 2110 (Act 1032 of 1999) before House Ways and Means Committee on May 11, 1999. Q: “Would you allow some discretion by the Secretary of Revenue for that or just kind of give them the exemption fully?” A: “Well, I guess it would have to be discretionary by Revenue because it says if there is reasonable cause for the underpayment of such portion and the taxpayer acted in good faith with respect to such portion. So the office of Revenue would determine if it was good faith.” House Ways and Means video, 2:20-4:30, https://house.louisiana.gov/H_Video/VideoArchivePlayer?v=house/1999/may/0511_99_WM. In addition, it stands to reason that Paragraph C would operate in such a fashion as to allow the collector to apportion audit costs to report periods where there was a lack of good cause or good faith. If the imposition of audit costs were an “all or nothing” proposition under La. R.S. 47:1605(C) and §337.75(C), then a taxpayer who had reasonable cause and good faith for underreporting on only a small portion of a tax underpayment could avoid imposition of any and all audit costs on the entirety of the underpayment by virtue of reasonable cause and good faith on a small portion.

⁷ See *Duncan Oil, Inc v. Calcasieu Parish School Board*, 2017-488 (La. App. 3 Cir. 2/28/02018), 239 So. 3d 367 (Affirming Board of Tax Appeals award of examination and hearing costs on the maximum percentage authorized under §337.75 where taxpayer failed to file any returns.). Further, the original version of HB 2110 (Act 1032 of 1999) allowed an exception to the assessment of audit costs in all three situations involving either a failure to file a report, a grossly incorrect report, or a false or fraudulent report. HB 2110 was amended in the House Ways and Means Committee so that Paragraph C of R.S. 47:1605 applied only to grossly incorrect report.

⁸ This factual scenario should be differentiated from one involving a serial non-filer as was the case in *Duncan Oil*, supra, or in a situation involving a false or fraudulent return.

Method of Allocation

Should a collector be faced with a situation that qualifies for apportionment under §337.75(C), a question may arise as to the methodology for allocation the audit costs. Since §337.75 is a penal statute and must be construed strictly, audit costs should be apportioned in a fair and equitable manner based on a reasonable method A Supplement is attached to this Policy Advice providing examples of potential methods for the apportionment of audit costs.

This Policy Advice is written to provide guidance to the public and local tax collectors. It is a written statement issued to apply principles of law to a specific set of facts. This Policy Advice does not have the force and effect of law and is not binding on the public or local tax collectors. It is a statement on the Louisiana Uniform Local Sales Tax Board's position and is binding on the Board until superseded or modified by a subsequent change in statute, regulation, declaratory ruling, or court decision.