



Gain control of your sales and use tax responsibilities: Common mistakes and current trends

October 3, 2013



Assurance • Tax • Consulting

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Agenda

Topic	Time
Know what you owe	20
Identify opportunities for improvement	20
Control the audit	20

Know what you owe

Many business operations trigger sales and use tax nexus

What are you doing right now that triggers sales and use tax nexus?

- Many ways to arrive at “physical presence”
- Activity or people triggers
 - Employees living in the state
 - Employees providing services in the state
 - Employees soliciting sales in the state
 - Independent contractors providing services in the state
 - Independent contractors soliciting sales in the state

What are you doing right now that triggers sales and use tax nexus? (cont.)

- Ownership or property triggers
 - Own real estate
 - Lease or rent real estate
 - Own inventory located in the state
 - Own or lease other tangible property in the state

Identifying nexus–people questions

- Where are your salespeople going?
- Do you have independent contractor salespeople?
 - If so, where are they going?
- Are you providing on-site services to customers?
 - If so, where?
- Where do you remit payroll taxes?

Identifying nexus–operations questions

- How do you ship your products?
- Do you own company trucks?
 - If so, where are they going?
- Do you provide warranties?
 - If so, do you provide warranty services on-site?
- Does an independent third party provide warranty or maintenance services?
- Do you sell maintenance agreements?
- Do you provide maintenance services on-site?

Identifying nexus–location questions

- Does the state have a specific threshold?
 - Days
 - Dollars of sales
- Does the state follow *Quill*?
 - *Quill Corp. v. North Dakota*, U.S. Supreme Court
 - Customers do not establish physical presence
- How do interpretations of sales tax nexus differ from income tax nexus?
 - Public Law 86-272

Is nexus compliance a business decision?

- Once nexus is established—whether you are aware or not—collecting and remitting sales and use tax becomes your responsibility
- Considerations
 - *Quill* U.S. Supreme Court ruling
 - Public Law 86-272—income tax
- Decisions
 - Whether to register and comply going forward
 - Whether to proactively review and repair looking back

Example 1

Company	Online university
Situation	<ul style="list-style-type: none">• Sales made into every state• Customers receiving both electronic and printed versions of textbooks and other documents• Filing sales/use tax returns in a few states, potential liability in many
Outcome	<p>Conducted nexus research to identify state tax treatment of client's sales and purchases. Determined appropriate tax to report and resolved potential historical liabilities of millions of dollars through nationwide voluntary disclosure</p>

Example 2

Company	Service provider
Situation	<ul style="list-style-type: none">• Entering into a cloud computing agreement with a third party• Company will own some servers and rent or lease other servers or space on servers in a number of states
Outcome	An analysis of the nexus standards of the states where servers were located and of the taxability of the equipment and services provided by the third party identified taxpayer responsibilities. The service provider has paid the appropriate tax amounts to the states and can support their reasons when questioned

Current trends in sales and use tax nexus

- Marketplace Fairness Act
 - Physical presence not required
 - Small business exception

- Click-through nexus
 - In-state referral websites
 - Commissions

- Remote seller reporting
 - Provide list to state
 - Purchaser information and amount

Identify opportunities for improvement

Past remittance errors can yield savings in hard dollars or risk mitigation

Common reasons businesses overpay or underpay sales and use tax

- Bad audit results, so company now pays tax on everything
- Retailers and suppliers were audited by an aggressive auditor and now bill tax to all customers
- High turnover in accounts payable department leads to mistakes on invoices
- Resale and exemption certificates not properly given to suppliers
- Mixed transactions (e.g., taxable vs. nontaxable bundled transactions)
- New taxing jurisdiction nuances
- No tax software system or tax decision matrix

How do you know when to consider a reverse audit?

- Merger and acquisition activity
 - Proactive due diligence
- Recent audit resulted in a no change or large refund or assessment
 - Likelihood of tax overpayments or internal controls failure
- Company seeks a strategic cost-cutting endeavor
 - Improved processes minimize errors
 - Overpayment refunds support bottom line
- In conjunction with any state and local tax audit
 - Possible offsets to interest and penalties
 - Possible longer statute of limitations

Why resolve now?

- Eliminate potential audit liability
- Improve compliance
- Improve system efficiencies
- Improve cash flow
- Reduce costs
- Increase productivity in payables and tax functions
- Improve customer service
- Minimize potential liability during a sale of business
- Eliminate ASC 450 (FAS 5) issues

Example 1

Company	Retailer with locations in four states
Situation	<ul style="list-style-type: none">• Small accounting staff all located in one state• No prior state audits• Unaware of specific exemptions outside of “sale for resale” to customers
Outcome	Sales tax exemptions existed on company’s equipment purchases, creating opportunity for \$400,000 in sales tax refunds

Example 2

Company	Manufacturer with locations in five states
Situation	<ul style="list-style-type: none">• Multiple state audits resulting in small assessments• Accounting and AP function in single state• Very familiar with home state's sales tax rules
Outcome	Unique manufacturing-related exemptions existed outside home state, allowing company to claim a \$125,000 refund

Current trends in sales and use tax regulation

- States are adding additional sales tax exemptions to create job growth within targeted industries
 - May be overpaying where new exemptions exist
- States are adding or eliminating sales tax exemptions to generate additional revenue
 - May be overpaying or underpaying, depending on changes
- State courts and Departments of Revenue are constantly interpreting sales tax laws and regulations, which could lead to expanded exemptions

Current trends in sales and use tax regulation (cont.)

- States are taking aggressive positions that may directly conflict with their own statutes and informal policies
 - Proactive due diligence prepares you to defend
- Expanding the tax base, increasing tax rates, decreasing or eliminating collection discount
 - Prior processes quickly become dated
- States increasing the number of audits

Control the audit

Don't let the audit control you

Audit triggers

- Company size or presence in state
- Nexus established, company not registered in state
- Recently registered in state
- Business activity questionnaires
- Vendors audited
- High volume of exempt items (sales or purchases)
- Sales tax filer, but no use tax remittance
- Significant swings in remittance amounts
- Sales or use tax refund claim filed
- Enacted legislation or law changes
- Information sharing between jurisdictions

You received an audit notice—now what?

- Confirm entity, tax type and audit period
- Perform a pre-audit review to determine record availability and exposure areas; review prior audit findings (if any) and other entities at risk
- Review information request list and audit process
- Establish timeline (internal and with auditor)
- Evaluate issues (agreed and disagreed items) as audit progresses and determine next steps
- Understand your rights and administrative remedies
 - Supervisor involvement
 - Appeals process (formal, informal, etc.)

Areas reviewed

- Sales
 - Generally, reviewed on a sample basis
 - Exemption/resale certificates reviewed
 - Reconciliations performed
- Purchases
 - Capital or fixed assets—reviewed in detail
 - Expenses—reviewed on a sample basis
 - Selected accounts
 - Accounts payable download

Common areas of exposure

- Sales
 - Missing exemption or resale certificates
 - Interpretation of state rules and regulations
 - Incorrect tax rates
 - Missing invoices
- Purchases
 - Tangible personal property vs. service
 - Lack of use tax procedures
 - Tax matrices
 - Automated use tax accrual process
 - Ambiguity surrounding use of product or service in business
- Other
 - Mergers or acquisitions, new lines of business
 - Dispositions
 - Industry-specific issues

Key tips for the sales and use tax audit process

- Review statute of limitations (waivers)
- Understand audit scope and sampling method
 - Statistical sampling, seasonality
- Provide alternative documentation
- Offset assessment with possible refunds
- Provide only selected general ledger accounts
- Perform customer outreach
- Implement corrective measures
 - System modifications, invoicing practices, etc.
 - Consider automation solutions
- Consider rolling favorable audit results forward to additional periods

Example

Company	Consumer product company
Situation	<ul style="list-style-type: none">• Company is being audited by a state with numerous manufacturing exemptions• Company had paid a substantial amount of sales and use tax on exempt items, but the state had not given any credit for these overpayments• Taxpayer performed an internal review identifying all overpayments
Outcome	The company filed a sales and use tax refund claim that resulted in a refund that more than covered the audit assessment

Trends in sales and use tax auditing

- Increased uptick in sales and use tax audits
- Extended timeframes for audit completion
- Business activity questionnaires or discovery letters
- Taxation of services
- Click-through nexus (Amazon laws)
- Statistical sampling
- Managed audits

Thank you

Please submit any questions using the Q&A tool

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