

This document is intended for use only as a supplemental resource. The facts of your situation must be analyzed to determine the specific application of this information.

6 Foolproof Ways to Create BIG Sales Tax Problems for Your Company!

By Ned A. Lenhart, MBA, CMI, CPA
TaxConnex, LLC

Ned@TaxConnex.com

Over the past 20 years I have provided a wide variety of sales and use tax consulting services. These services have been provided to large and small companies and to companies with well established tax departments and to companies that have no personnel assigned to the tax function. Regardless of the size or sophistication of the company, most of the phone calls I receive start with the phrase, “I think we have a problem with our sales tax”. In a few cases, they were wrong. In most cases they were right; what they did not realize, though, was the size of the problem.

In this paper, I want to share six of the most common mistakes companies seem to make as they manage their multistate sales tax responsibility. These points are based on my experience as a state tax administrator and as a state tax consultant. The goal of this paper is to illustrate the mistakes and oversights companies have made and outline the ramifications of these oversights. States continue to look for under paid tax revenue and sales tax is often the easiest “low hanging fruit” for an auditor to pick. As you review these points, consider how your business stacks up to what some of my other clients have experienced. Commission of any one of these errors can be costly for your business. Commission of more than one of these errors could be disastrous to your business and could subject you to personal liability.

1. Failing to recognize the full extent of your business’s multistate tax responsibility.

This may be the most common issue that I and other sales tax consultants address on a routine basis. Businesses, both large and small, do not always understand where they have responsibility to comply with sales tax rules outside their home state or why they have that responsibility. This mistake usually comes to the attention of a company after they receive correspondence from a state Department of Revenue asking them to divulge their business activity in that particular state. This document is called a “nexus questionnaire” and its receipt by CFOs and Tax Directors has been directly responsible for elevated blood pressure, shortness of breath, and great anxiety. “How could it be that we have a responsibility for tax in additional states since we don’t have an office in that state?” they inquire.

The common thread that weaves its way through most business issues is that the tax department is often the last to know about new business transactions and expanded marketing plans. While it may make perfect business sense to enter into strategic relationships with other companies located in distant states, these relationships can have far reaching and long term consequences for your company’s requirement to collect and remit sales tax. The liability for past due taxes can go back to your company’s first presence in the state. For some companies this can be a very large and costly error to make. In most cases, the liability will include the past due tax, penalty, and interest. It may also include corporate officer liability.

To avoid making this mistake, you should routinely evaluate your sales tax filings against your business footprint.

This document is intended for use only as a supplemental resource. The facts of your situation must be analyzed to determine the specific application of this information.

The best way to do that is to complete a nexus questionnaire and have it reviewed by a sales tax specialist. Just because you don't have an office in a state does not mean that you don't have a tax filing responsibility in that state. Nexus can be created in some very subtle ways so using a sales tax professional to help you with this effort may be a wise move.

2. Failing to devote appropriate resources to the sales tax function

Even though you may not have a sales tax unit in your company, your company still has a sales tax function that needs to be satisfied. Many small and mid-sized companies have little need to devote a full time employee to the sales and use tax functions of their company. A common issue I hear is that the part-time sales tax person is expected to handle compliance, audits, taxability questions, tax exemption certificates management, in addition to many non-tax issues. For a small company, this may be possible. For most companies, though, the monthly demands of sales tax compliance can consume great amounts of time without adding any real value to the company. As the company adds more products, expands its sales territory, and enters new business relationships, the demands may become too great for the part-time staff.

On more than one occasion I have worked with companies who did not know how bad their sales tax compliance was until the person who did their sales tax left the company or was reassigned. In one situation, the Controller found an entire desk drawer full of sales tax underpayment and late filing notices from a number of states. In another situation, the owner received a personal assessment for underpaid sales tax under the state's corporate officer liability rules. In both situations, the root of the problem was an overwhelmed employee who was asked to handle a wide array of tax issues that exceeded their ability.

The critical point here is that the actions or inactions of one person can have significant and far reaching economic and liability consequences for your company. If you don't know who is handling the various sales tax requirements of your company, then find out. As your business grows, so should the resources you devote to the sales tax function. You may not need to hire a full-time person, but you may need to allocate the responsibility between additional staff. Many companies find that outsourcing the tax preparation to be a very good first step.

3. Expecting your outside CPA or other advisors to keep you fully informed.

A few years ago I came to the stark realization that every client I have had, the large ones and the small ones, already had an outside CPA who worked with them on other accounting and tax matters. Yet, for some reason, I was the one called when a sales tax problem arose. When I asked them why they didn't go to their own CPA, I received a variety of responses.

The response I receive most often is that their CPA is not familiar with the nuances of multistate sales tax and they wanted to work with someone who has that specific expertise. I have occasionally received calls from companies who received "less than accurate" information from their outside tax provider and now realize they have a challenging mess to resolve.

One of the most valuable relationships a company can have is with their outside accounting and legal advisors. When managed appropriately, these professionals can be partners with your business and can help your business navigate through un-chartered waters. This navigation is a two way street, however. You must provide these advisors the best information possible and they must provide you the specific guidance based on the information you provide. If you are expecting your outside tax and legal advisors to help you without first providing them

This document is intended for use only as a supplemental resource. The facts of your situation must be analyzed to determine the specific application of this information.

adequate and timely information about your business plans, you will be very sorry.

Further, unless your advisors have specific expertise in multistate sales tax, there may be a significant gap between the advice you need and the advice given. Not all advisors are created equal. If you believe you need specialized assistance, then reach out and seek the help you need. Unless your advisors are fully in tune with your business, don't expect them to be able to provide you with the proactive advice you may actually need.

The one consulting questions I cannot usually answer is "Why didn't my CPA/Attorney tell me this years ago?" The answer is usually a combination of information not being shared with the advisor and the advisor not being sufficient familiar with the multistate tax issues.

4. Failing to think that sales and use tax may be an issue important enough for your consideration.

A common statement I've heard over the years is "It's only sales tax, how hard could that be?" For many managers, this is the philosophy they carry with them as they forge ahead with business deals, acquisitions, dispositions, and strategic relationships with other organizations. It's usually only after the acquisition closes that the sales and use tax skeletons start coming out of the closet. The issues that often arise include un-filed sales tax returns, out of date or missing exemption certificates, collected but unremitted sales tax, unpaid use tax on out-of-state purchases, and a vast array of successor liability issues.

The best way for a business to get itself into the biggest trouble possible with sales tax is to assume that the company's current sales tax system works well and to put it on auto pilot. Sales tax is dynamic; some sources report over 7,000 sales tax rate changes a year. Compound this with the countless rulings, cases, statute changes, new rules, and departmental interpretations that occur and you have a "perfect storm" for a tax disaster if a business does not make a conscious effort to stay in tune with the tax rules affecting its business and its industry.

Sales tax is a transaction based tax. Any transaction your business has could conceivably have a sale tax component. This may be as simple as signing a resale certificate or as complicated as restructuring the deal. The products you sell and the products you buy have tax consequences. Sales tax may also apply to the services you provide and the services you consume. If you sell your business there could be sales tax consequences and if you buy a business there could be sales tax considerations. To avoid an expensive problem, you must commit some effort to the sales tax considerations of each business transaction you conduct.

5. Relying on your automated tax system to seamlessly handle your sales tax calculations

Like all automated systems, sales tax calculation systems are only as good as the information with which they are programmed. Automated sales tax systems must be maintained in a variety of different ways. First, the rates must be updated regularly. Fortunately, this updating function comes standard with all sales tax automation packages. The other components of sales tax calculation systems are not usually automatically updated. This primarily includes the information about how your products and your customers are taxed. In some situations, the sales tax calculation systems are carefully implemented and have been carefully updated for all the product changes and the law changes. When this happens, there are very few issues.

In other situations, the sales tax modules were either not properly implemented or have not been updated with accurate tax rules since they were implemented. The regularity of this review may depend on the products and

This document is intended for use only as a supplemental resource. The facts of your situation must be analyzed to determine the specific application of this information.

services you sell. If you sell products that are almost always taxable, your review may be less frequent. For companies with a wide product mix, particularly those providing services and selling technology related products, the failure to review and update the tax rules in their automated tax system regularly could prove disastrous. As more states begin to tax services that were once exempt and expand their reach to tax technology related products and services, companies can very quickly find themselves in very deep water if they have not reviewed and updated the tax rules in their automated system. To avoid this problem, spend some time reviewing the rules used by your sales tax system.

I recently reviewed an automated sales tax matrix. The matrix has 700 products and services mapped to 45 different states. That is 31,500 different tax decisions. My review revealed over 1,000 errors. In most cases, they were over charging tax to customers. Correcting this coding improved some strained customer relations.

6. Assuming sales tax rules in other states are similar to the sales tax rules in your home state.

For most tax managers this problem may sound a bit ridiculous and overly elementary. For some of my clients, though, this assumption was routinely made and created a very large sales tax problem. For one client in particular, this was not an assumption they made, but an assumption made by their outside advisor and given to them as advice (See problem 3 above).

Perhaps the most important thing to know about multistate sales tax is that the rules are different for each state. The only time you can rely on the rules in your home state is when you have a transaction in your home state. The sales tax rules that apply to a transaction are the rules of the state where the transaction occurs. For some sales transactions, the tax rules in the destination state may be very similar to the rule in your home state. In other case, the rules can be significantly different. As a multistate business, you have the responsibility to know the sale tax rules that apply in the state where you conduct business. Failing to follow this fundamental rule of multistate sales tax may be the fastest way to create a large sales tax liability for your company.

Conclusion

The six items outlined above came from multiple client engagements over a number of years. In many cases, my clients' problems were not isolated to a single issue. In reality, my clients' issues (and perhaps your business's sales tax issues) are a combination of two or three of the problems mentioned above. One problem tends to lead to another and then to another. Once the problem surfaces and you realize how significant it can be, there may be a tendency to just hope it goes away; it never does, though!!

I hope these points have been helpful as a guide as you evaluate the sufficiency of your multistate sales tax compliance systems. If you have any questions or need further assistance in resolving any of these issues in your company please contact us at info@taxconnex.com