

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.

It's Only Sales Tax...How Hard Can That Be?"

By Ned A. Lenhart, MBA, CMI, CPA

TaxConnex, LLC

Ned@TaxConnex.com

When a client asks their tax consultant a question, it's often possible to identify the client's level of understanding about the particular tax issue confronting them. Many client questions are insightful, which tells me that the client has a good grasp of the issues and the options available for resolving their problems. When a client asks me these types of questions, I know I won't need to spend a lot of time covering the subject matter fundamentals; this allows us to move directly to the meat of the project.

During the span of any consultant's career, there will also be those client questions that clearly reveal the client's lack of understanding or their lack of appreciation for the problems confronting their business. When these questions are asked, I know immediately that I may be facing a difficult client situation and a difficult engagement. During my 20 year span as a sales tax consultant, I have been asked plenty of questions by clients. Most questions, thankfully, can be classified as insightful. I've also been asked my share of questions that reflected my client's lack of appreciation for the fundamentals of multistate sales and use tax. Sometimes we could both laugh at their question, and then move on. At other times, they were deadly serious about their question.

In this article, I will share some particularly memorable questions I have been asked over the years. As the adage goes, "there is no such thing as a dumb question", and I hope that these questions, and my response, will prove helpful to you as you seek ways to more carefully manage your company's multistate sales tax responsibility.

Question 1: "It's Only Sales Tax, How Hard Can That Be?"

I will never forget the client meeting where this question was asked by the recently hired Controller of a large manufacturer. I knew he had come from a large service organization where sales tax issues were of lower consequence, but I had assumed he would be more in tune with the multitude of sales and use tax issues confronting his new employer. Also present in the meeting was the Assistant Controller, who had primary responsibility for the sales tax function, and the CFO, who still had fresh battle scars from a recently completed sales tax audit.

When that question was asked, the room fell silent and the CFO asked me to provide a brief primer on all the primary issues, the sub-issues, and the nuances to the sub-issues of the multistate tax issues confronting his company. About an hour later, the new Controller had a much better appreciation for the issues and why his specific attention was needed to resolve many pithy sales tax issues.

So just how hard can sales tax be? The answer will vary dramatically based on the structure of the company, the industry the company is in, and the states where the company operates. Each industry group can have its

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.

own set of unique rules. Manufacturers have issues different from service providers. Manufacturers in California have issues different from manufacturers in Missouri. Computer service providers are taxed differently in Connecticut than they are in Georgia, and communications companies are taxed differently in Florida than in Nevada. Line item invoices can be treated differently than lump sum invoices. Resale exemption certificate management may be a major issue for wholesalers but not for service providers.

Sales tax is a transaction based tax. Each transaction—both purchases and sales—must be analyzed to determine if they have a sales tax impact. If your business is multistate in nature, they you have multistate sales tax issues. I define a multistate business as one that buys products from other states or sells products and services to other states. Under this definition, most businesses are multistate businesses. If you have ever asked yourself this same question, perhaps you need to evaluate more carefully the nuances of your company's business.

Question 2: “I’m just a wholesaler, so why should I be concerned about sales tax?”

My client asked me this question about a month before they were notified of an audited by the Multistate Tax Commission. The MTC auditors were very helpful in educating my client about his multistate sales tax responsibilities, especially when they handed him the assessment for back tax!

My response to my client was that all sales are deemed to be taxable unless there is sufficient proof that the sale is exempt as a sale for resale (or some other exemption). This proof is usually a properly completed exemption certificate for the state where the goods are to be shipped. My client responded that they had certificates from most clients and could get any missing forms they needed. Under audit, however, a different story emerged. Many of the certificates were unsigned, undated, had improper ID numbers, or were from the wrong state. Many only had the FEIN of the purchaser and not the proper state registration certificate. Many of the missing certificates related to sales made to business that were now closed and the purchaser was not willing to issue any certificates to my client. In addition, some clients who were contacted indicated that they did not purchase the property for resale and would not issue a resale certificate because it was not warranted.

I don't remember the amount of the tax, penalty, and interest assessed against my wholesale client, but the amount was substantial. The lesson learned is that sales made to customers where no tax is charged are deemed taxable unless valid resale certificates are received. If you make non-taxed sales and no certificate is received to support these sales, your business can be assessed the tax just as if the sale had been made at retail. If you have made untaxed sales to customers who are no longer in business, then you may not have opportunity to obtain a resale certificate currently. In these cases, you will be assessed tax, penalty, and interest on the sale proceeds. Sales tax is very much a “form over substance” tax. If the substance of the transaction is a sale for resale, but the forms are not available to support that fact, the transaction is taxable.

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.

Question 3: “What am I supposed to do with all the sales tax I’ve collected during the past three years?”

I have been asked this question (or ones similar to it) far too many times during the past 20 years. In most cases, the collected and unremitted tax was very small and was usually caused by some errant software or some temporary personnel who were unaware of the particular rules. In these situations, we can usually include the unremitted tax on the first return filed with the state. In a few cases, the amount of unremitted tax has been substantial; in one case over \$1,000,000.

Most of these situations were surfaced when a business deal south because the purchaser’s due diligence revealed the under remittance as a deal breaker. In other situations, the new tax director or CFO realized the problem when they took their first look at the financials and saw some unusual tax liabilities on the balance sheet. Regardless of the problem’s cause or the method of detection, this situation is one of the most serious sales tax issues facing a company. It’s serious from both a civil collection and criminal prosecution standpoint.

Collected an unremitted sales tax is like a hot potato; you have to get rid of it as fast as you can and hope a state does not contact you before you have resolved this issue. If a state finds you first, the situation can turn ugly very fast. To compound the situation, most of my clients don’t just have the unremitted tax sitting in a back account somewhere; it’s been spent in other ways.

I have found the best approach to take in these situations is to enter into well crafted voluntary disclosure agreements with the affected states. Even when tax has been collected, I have been able to get most states to abate the penalties for late payment and to forego their right to seek criminal charges against my clients. The state of New Jersey only imposes a 5% penalty, rather than a 25% penalty, when the sales tax has been collected but not remitted.

In dealing with these situations, speed is of the essence. I suggest that clients tackle the largest states first and then moving as quickly as possible through the other states. In many situations, states will provide some kind of payment plan. These usually require 25% down. If a payment plan is needed, penalties may not be abated until all the payments have been made.

There are often time lags built into the process. Some states take 30 days to respond to your letter, then give you 30 days to sign and return their agreement, and then give you another 60 days to send in the money and returns. During this period of time, companies can make the adjustments needed to generate the cash flow to settle the liability. The other important component to consider is that once you register with the state, (even if you have not yet paid the historical liability) you must begin to collect and remit the taxes currently due on those taxable sales. I’ve had situations where a voluntary disclosure agreement would be completed, only to find that the company didn’t start remitting the tax collected after they were registered. I usually refer to these companies as “former clients.”

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.

Question 4: “Can you confirm that I only have to collect sales tax in states where I have an office?”

“I can neither confirm nor deny that you have a filing responsibility only in states where you have an office!” The heart of this question lies in the often misunderstood concept of nexus. Not the hair care product, but the legal term used to indicate when a company has a legal obligation to comply with one or more taxes administered by the state. When a company has nexus, it must follow the tax collection and remittance rules that apply to other companies who have a permanent place of business in that state.

For sales tax purposes, it’s easiest to understand that almost any physical connection your company has with a state can be construed as creating nexus—and thus a filing responsibility for you—with that state. Physical connections can be created directly by your ownership or rental of real property in the state, the presence of inventory in the state, the performance of services in the state, and the systematic presence of salesmen or other employees in the state. The use of your own vehicles for delivery purposes also creates nexus in most states. Physical connections can also be created indirectly through the actions of others on your behalf. This can include the used of independent sales representatives, the use of certain third party warranty companies, the use of certain in-state collection agencies, and the use of other businesses which accept your returns or help in the delivery of your product.

I have often heard clients tell me that they only file in states “where they have an office” since that’s the only place they have nexus. When I hear this, I become immediately suspicious and start probing about how they solicit business and how they handle other direct business activities. This inquiry usually reveals additional states where nexus exists and where additional filings should be made. If you believe you only have a sales tax filing obligation in states where you have an office, you may want to re-evaluate that position.

Question 5: “Why should I hire you, anytime I have a question about sales tax I call the state.”

There are many legitimate reasons to call a state Department of Revenue to ask them a sales tax question. Some of the assistance you receive over the phone is very good, some assistance is marginally helpful, and some assistance is just wrong. At least the Arizona Department of Revenue has the courtesy to tell you (through a recorded message while you are on hold) that the state is not bound by any information you receive from them over the phone. On the rare occasions that I now call a state Department of Revenue, I generally request to by-pass the technical assistance hotline and go right to the audit bureau or to the tax policy group.

There is nothing wrong with calling any Department of Revenue to ask basic questions about rates, filing deadlines, to request forms, or to resolve account specific questions. Where the nature of your call is technical and requires a good (if not thorough) understanding of your business and the specific transaction, you may be challenged to find that the person on the other end of the phone who can help you. Further, if they quickly give you an answer, I would also be suspicious. In these cases, the answer is usually “taxable.”

An experienced fee based sales tax consultant, like other consultants, will play a special role in connecting the law to your business facts. The value in using an experienced consultant is not so they can give you a quick technical answer; rather, they should be used to incorporate the answer into the overall structure of your business and look at the multistate tax consequences of their answer, not just the single state tax

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.

consequences. The person from the Department of Revenue may have a good understanding of their state's law, but they usually have no appreciation for the impact their answer has on your business's overall compliance responsibility. When you deal with many Departments of Revenue over the phone just remember that it's a "buyer beware" situation. If your issue is detailed and technical, hire a professional and have a letter ruling prepared.