



Sales Tax Audits and the Audit Process

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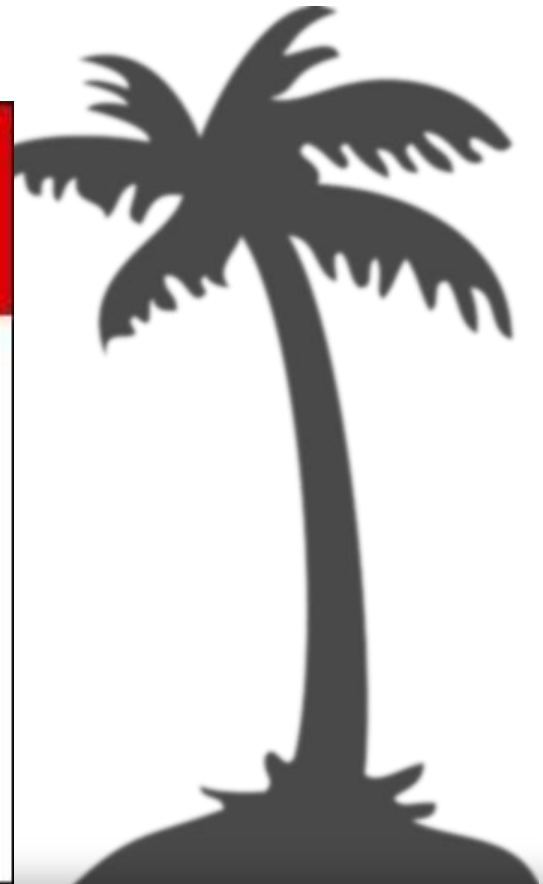
Clifford Turner is an industry veteran with 20 years of sales and use tax experience. He has built and managed sales and use tax compliance operations for two of the “Big 4” accounting firms.

He is supported by a team of seasoned tax professionals including data transformation specialists, former auditors and compliance department managers.

- ▶ **Who administers the tax?**
- ▶ **Why do businesses get audited**
- ▶ **Areas of non-compliance**
- ▶ **The audit selection process**
- ▶ **Types of audits**
- ▶ **Who are the tax auditors?**
 - ▶ Professional, courteous and helpful
- ▶ **The audit process**
 - ▶ What is the objective?
- ▶ **Audit results**
- ▶ **The appeals process**
- ▶ **Tips for dealing with tax auditors**

AUDIT

- now that I have your attention....



Accounting professionals mix up myths and facts

If you don't know what's true about audits and what isn't, how can you ever expect to be ready for one?



Audit True and False	% Believe to be True	% Believe to be False
TRUE: If you are audited, it does not always mean that an error has been made	73%	27%
TRUE: Liabilities uncovered during an audit can affect the valuation of a company	52%	48%
TRUE: Once you are audited, your company is at risk to be audited again	42%	58%
FALSE: They are completed remotely by an auditor	17%	83%
FALSE: Audits only encompass one fiscal year at a time	16%	84%
FALSE: None of these are true	5%	95%

**Who administers
sales & use tax?**



Who administers sales & use tax?

- ▶ **State departments of revenue**
- ▶ **Local municipalities**
- ▶ **State vs. locally administered taxation**
- ▶ **“Home-rule” jurisdictions**
- ▶ **Multi-tax commission**
- ▶ **Streamlined Sales Tax Agreement**

**Why do
businesses
get audited?**



Why do businesses get audited?

- ▶ **Maintain compliance**
- ▶ **Establish a level playing field**
- ▶ **Enhance revenue collections**
- ▶ **Educate taxpayers**

Audit Triggers

- ▶ **Frequent late filings and payments or no filings and payments**
- ▶ **Nexus with no registration**
- ▶ **Resale certificates with no sales tax registration**
- ▶ **Trickle-down from audits of vendors**
- ▶ **Internal whistle-blowers**
- ▶ **No reporting of use tax**
- ▶ **High sales volume**
- ▶ **Large amount of exempt sales**

Areas of non-compliance



Areas of non-compliance

▶ **Unsupported exempt sales and deductions**

- ▶ Sales for resale
- ▶ Exemption certificates

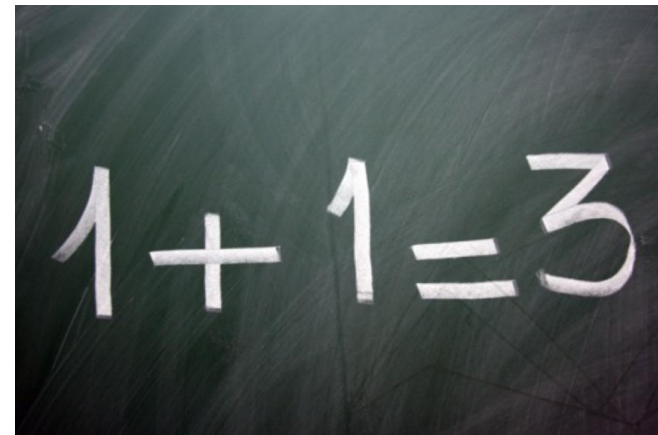
▶ **Unreported use tax**

- ▶ Ex-tax purchases
- ▶ Self-consumption

▶ **Unreported taxable sales**

▶ **Incorrect tax charged**

▶ **Accounting and clerical errors in reporting**



Areas of non-compliance

The sales & use tax Cardinal Sin

- ▶ Tax collected and not reported
- ▶ Civil and criminal penalties
- ▶ Misdemeanor and/or felony

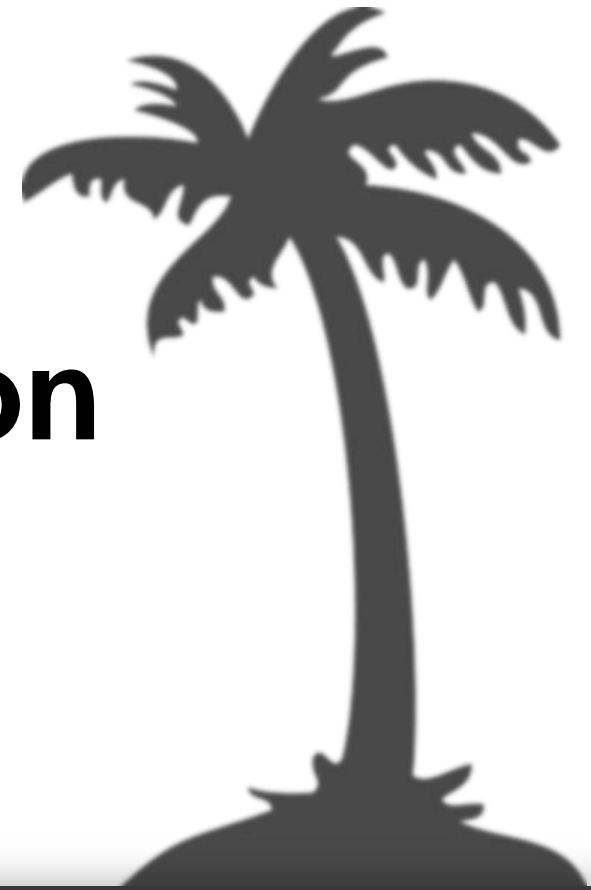


Everyday business activities can complicate sales tax

- ▶ **85% of accounting professionals report that their companies engage in at least one activity that can lead to complicated sales tax calculations.**
- ▶ **Even the most basic, everyday business activities can make sales tax compliance a challenge. And these challenges can lead to mistakes.**

Top 3 Activities Likely to Lead to Mistakes	%
Having customers who are exempt from sales tax	51%
Attending a trade show in the last 12 months	43%
Having a remote sales force	34%

The audit selection process



The audit selection process

- ▶ **Determined by state or local taxing authorities internal policies and procedures**
- ▶ **Combination of “random” and “targeted” selection criteria**
- ▶ **Taxing authorities often target specific industries**
 - ▶ Cash-based businesses: bars and restaurants
 - ▶ Itinerant merchants: swap meets and conventions
 - ▶ Construction contractors



Joint agency task forces

- ▶ **ABC:** liquor stores and bars



- ▶ **ATF:** firearm dealers and gun shows



- ▶ **Coast Guard:** vessels and brokers



- ▶ **DMV:** vehicle dealers and auctioneers



- ▶ **U.S. Customs:** foreign travel, airlines and cruise ships



- ▶ **FAA:** aircraft



Types of audits



▶ Referrals

- ▶ Anonymous tips from customers
- ▶ Whistleblowers
- ▶ Former employees/spouses
- ▶ Competitors
- ▶ Tax auditors



- ▶ **Correspondence audit**
- ▶ **Field audit**
- ▶ **Combined audit of all taxpayers in a group**
- ▶ **Combined business tax audit**



**Who are the
tax auditors?**



Who are the tax auditors?

- ▶ **Sworn agents of the state or local government**
- ▶ **Third-party agencies authorized by the state or local taxing authority**
 - ▶ Contract auditors
 - ▶ Local municipalities (local tax reallocation)

Who are the tax auditors?

▶ Types of auditors

- ▶ The good
- ▶ The bad
- ▶ The ugly



The Good

- ▶ Provide advanced notification of on-site field work
- ▶ Collaborate with the taxpayer or its representative on scheduling appointments
- ▶ Show up as planned and on time



IMPACT: Good audit experience for the taxpayer, good use of auditor's and taxpayer's time and resources

The Bad

- ▶ Often late if an appointment is scheduled
- ▶ Scatter appointments across unusual or extended time periods based on other audits they are conducting in the same geographic area
- ▶ Often overworked or disorganized (or both)

IMPACT: Poor audit experience for the taxpayer, poor use of auditor's and taxpayer's time and resources



The Ugly

- ▶ Show up without warning
- ▶ Fail to show up as planned
- ▶ Chronically late
- ▶ Require appointments at the last minute and then fail to show up
- ▶ Behavior is intentional and disruptive to the taxpayer or its representative's business
- ▶ Sometimes this is just a REALLY BAD AUDITOR (as opposed to an ugly auditor)



IMPACT: Bad audit experience for the taxpayer, disruption to the taxpayer's business, poor use of taxpayer's time and resources

The Good

- ▶ Good written and verbal communication skills
- ▶ Able to clearly communicate their information/document requests
- ▶ Can discuss their audit methodology, issues and findings in an understandable manner



IMPACT: Fair assessment, good audit experience for the taxpayer

The Bad

- ▶ Poor communication skills
 - ▶ May have language issues
 - ▶ Often have personality issues
- ▶ Lack of confidence in their own audit skills
- ▶ Information and document requests are poorly written, confusing or vague
- ▶ Typically leads to escalation to the auditor's supervisor

IMPACT: Larger (or smaller) assessment, frustrating audit experience for the taxpayer, poor use of auditor's and taxpayer's time and resources



The Ugly

- ▶ Many ugly auditors have good communication skills but choose not to use them
- ▶ Communication may be limited or intentionally nonexistent
- ▶ May be unprofessional (verbally and in written requests and audit findings)
- ▶ Comments may be intentionally misleading
 - ▶ When discussing an audit issue or tax law with an unsophisticated taxpayer

IMPACT: Larger assessment, poor audit experience for the taxpayer



The Good

- ▶ Follows an established audit methodology
- ▶ Has an audit plan and executes the audit according to the audit plan
 - ▶ Audit plan is well organized and fair
- ▶ Tailors a generic audit plan to a taxpayer's specific industry
 - ▶ Provides for a more meaningful examination of the taxpayer's business/books and records
- ▶ Shares the audit plan with the taxpayer and its representative BEFORE the audit begins



IMPACT: Fair assessment, good use of auditor's and taxpayer's time and resources

The Bad

- ▶ Either has an audit methodology and plan but fails to execute, or has no audit plan
- ▶ Audit is often conducted on a haphazard basis with little thought or planning
- ▶ May be unfamiliar with the taxpayer's industry and its unique tax rules that require a specific audit approach
- ▶ Duplicates information and documentation requests, must re-perform inadequate testing, may miss important audit areas

IMPACT: Larger (or smaller) assessment, poor use of auditor's and taxpayer's time and resources, can be a disruption to the taxpayer's business



The Ugly

- ▶ Often has his own audit methodology and personal agenda (frequently to get the most money from the taxpayer with the least amount of effort)
- ▶ An audit plan may exist but efforts are focused on noncompliance and entire areas are skipped because they are considered too time consuming
- ▶ Audit process is intentionally skewed to maximize the assessment and minimize the auditor's time
- ▶ May have an unsophisticated taxpayer do the auditor's work

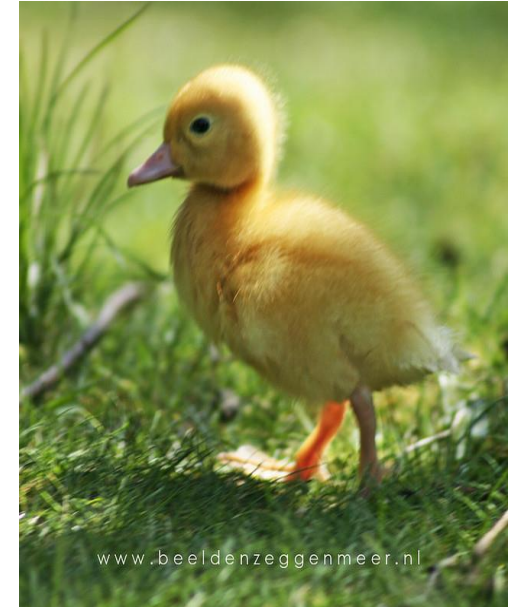
IMPACT: Larger assessment



The Good

- ▶ Has a strong knowledge of the state's tax rules, laws and regulations
- ▶ Has an excellent understanding of audit procedures
- ▶ Apply knowledge of in the audit process
- ▶ Often are seasoned auditors with extensive tax audit experience
- ▶ Junior auditors may also be knowledgeable about their state's tax rules but may lack significant tax audit experience.

IMPACT: Fair assessment, good audit experience for the taxpayer, good use of auditor's and taxpayer's time and resources



Knowledge and application of tax rules

The Bad

- ▶ Have a poor knowledge of their state's tax rules, laws and regulations
- ▶ May have an incomplete understanding of audit procedures
- ▶ Often new auditors with little to no tax audit experience and/or auditors with language issues
- ▶ Some senior auditors may be knowledgeable about their state's tax law rules but awkward in applying their knowledge in the audit process

IMPACT: Larger (or smaller) assessment, poor audit experience for the taxpayer; poor use of auditor's or taxpayer's time and resources, can be a disruption to the taxpayer's business



The Ugly

- ▶ Often have a strong knowledge of their state's tax rules, laws and regulations
- ▶ Often have an excellent understanding of audit procedures
- ▶ Usually seasoned auditors with extensive tax audit experience
- ▶ May use knowledge to skew the audit results to maximize the assessment and minimize the auditor's time
- ▶ You rarely find a junior "ugly" auditor



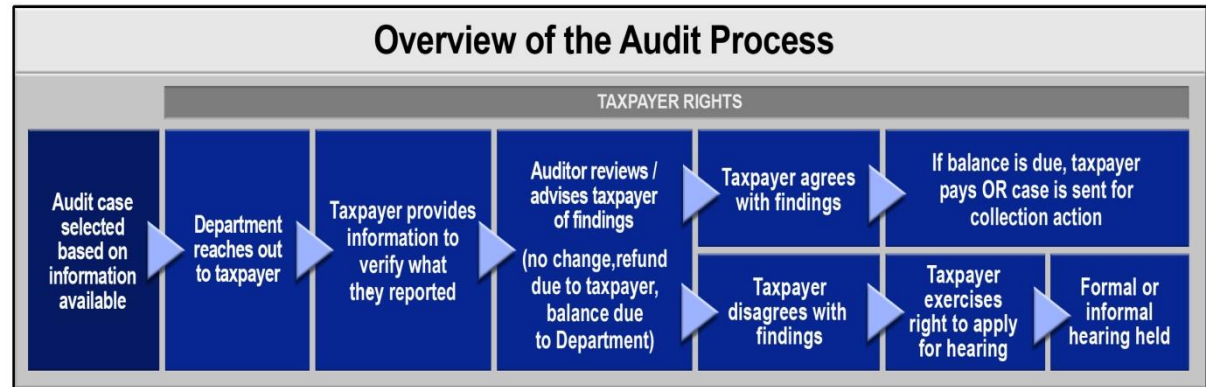
IMPACT: Larger assessment, poor audit experience for the taxpayer can be a disruption to the taxpayer's business

The audit process



The audit process

- ▶ Notification of intent to audit
- ▶ Waiver of limitation
- ▶ Initial information request
- ▶ Field audit
- ▶ Exit conference
- ▶ Audit report
- ▶ Notice of assessment, refund or waiver



Accounting Professionals Don't Understand How Long an Audit Takes

On average, those who have worked for a company that has been audited report that the process took **39 days**.

However, **76%** of those who have never worked for a company that has been audited think that the whole process would be done in less than a month.



Among those who have worked for a company that has been audited:
When your company was audited, approximately how long did the whole process last? Among all: If your company were audited today, approximately how long do you think the whole process would last?

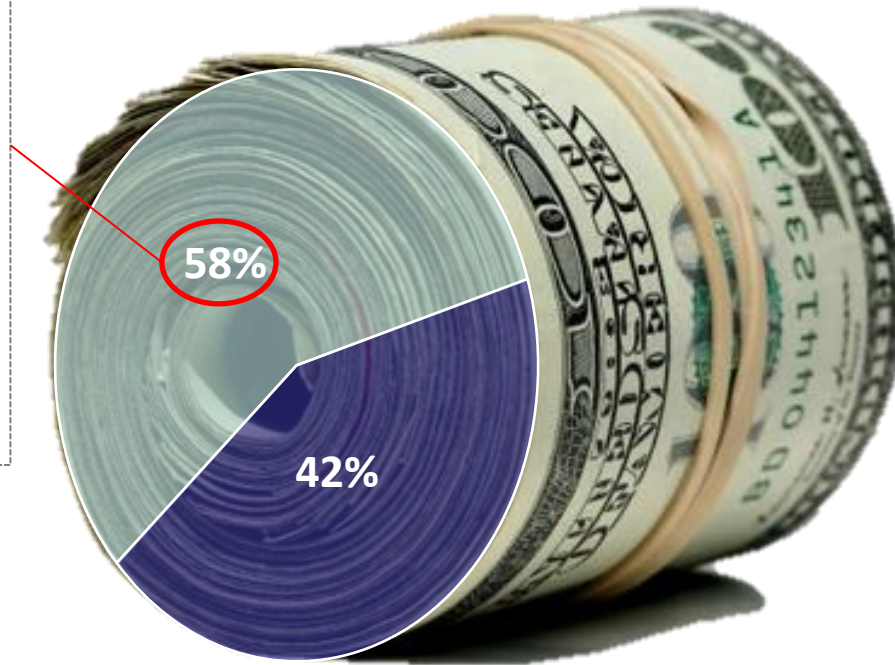
- ▶ **Deficiency assessment**
- ▶ **Notice of refund**
- ▶ **“No Change” audit**
- ▶ **Audit waiver**

How much does an audit really cost?

Over half (58%) of accounting professionals **agree** that a company usually only owes uncollected taxes after an audit.

This is incorrect.

You don't just owe what you have not collected. Auditors look at a transaction pool representative of the business – so you could potentially end up paying much more.



- ▶ **Deficiency assessment**
 - ▶ “Normal” collection activities
 - ▶ The “Marshal”
 - ▶ Judgment
 - ▶ Tax lien
 - ▶ Permit revocation
 - ▶ Bond revocation

Accounting professionals underestimate the cost of an audit

It costs **\$130,820** (on average) to manage an audit according to those who have worked for a company that has been audited.

However, **84%** of those who have never worked for a company that has been audited think it would cost their company \$100,000 or less.



- ▶ **Informal process**

- ▶ Auditor's supervisor

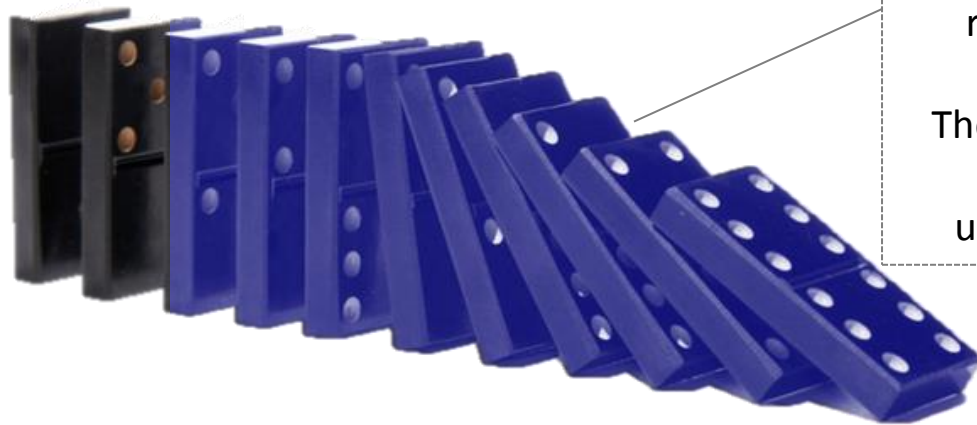
- ▶ **Formal process**

- ▶ Conference with hearing officer
- ▶ Appeals conference
- ▶ Additional appeals options

Tips for dealing with tax auditors



Audits can negatively affect office culture



78% of accounting professionals who have worked for a company that has been audited report negative effects to office culture.

The costs associated with an uncomfortable working environment can often be understated but must not be overlooked.

Questions to ask the auditor BEFORE the audit work begins

- ▶ Verify the taxpayer and permit under audit and the audit period
- ▶ Supervisor's name and contact information
- ▶ Audit plan
- ▶ Testing plan
- ▶ Timing (what is the average length of the auditor's audits?)
- ▶ Is the auditor readily available to conduct the audit if the books and records are available?
- ▶ Auditor's experience
 - ▶ How long as an auditor?
 - ▶ Any professional designations (CPA, etc.)?
 - ▶ Has the auditor ever conducted an audit of similar businesses?
- ▶ Confidentiality
- ▶ Document retention

Things to observe and document about the auditor during the audit

- ▶ Initial contact and notification of audit
- ▶ Responsiveness to taxpayer requests
- ▶ Reasonableness of requests
- ▶ Professionalism
 - ▶ Timeliness
 - ▶ Communication
 - ▶ Knowledge
 - ▶ Accuracy
- ▶ Document handling

Questions?



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