

# SALES TAX SPOTLIGHT



***DILLON TAX CONSULTING LLC***

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## Sales Tax Audits – Are You Ready?

By Michael T. Dillon, Esq.

It's no secret that states are running the most significant budget shortfalls in the Post-WWII era. As a remedy, they can either raise tax rates, increase the base, add more taxes, or heighten enforcement. Clearly the most pragmatic thing, and least politically problematic thing to do is heighten enforcement. And the best way to do this is through sales tax audits, which represent the most-overlooked area of corporate tax compliance, and the largest source of audit revenue for states.

Often times, it seems that companies are going about their business, and a state sales tax audit comes along and really throws them for a loop, resulting in hundreds of thousands – even millions of dollars in unpaid sales and use taxes.

Therefore, CFOs, tax directors and controllers need to be focusing their attention on state and local tax matters to ensure that they are legitimately minimizing their state and local tax risk. They can do so by making sure that they are aware of where their business has a taxable presence and filing

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obligations, and are in compliance with the complex tax rules applicable to income, sales/use, property and other taxes and fees.

To minimize audit risk, “audit thyself” – the most important thing you can do to minimize audit exposure is to proactively review your obligations and your records with your sales tax advisor, to know where your exposure is before an audit occurs, and – to the extent you are audited – manage the auditor’s expectations and document flow. There should be no surprises. It is also critical that you proactively review your nexus, and state tax compliance rules – Are you taxing sales accurately everywhere you have a presence? Are you accruing use tax on purchases on which vendors do not charge sales tax?

Want more? Listen to my podcast:

<http://dillontaxconsulting.com/articles.aspx>

Baltimore Business Journal Podcast (March 20, 2009), *State Tax Compliance and Audits – Proactive Ownership Advice.*



## The Legislative Horizon – Tax Law Expansion?

By Michael T. Dillon, Esq.

A number of states are considering state tax law changes as a means of combatting ongoing budget deficits. Several common changes being discussed, in Maryland as well, include sales tax expansion and affiliate nexus code provisions. Sales tax expansion would involve an increase in the number of services

subject to taxation (think Maryland’s 2007/08 efforts to tax computer services). Taxpayers and state revenue authorities have noted the difficulties in administering sales taxes on multistate services, and sourcing transactions to the appropriate states for tax purposes. In addition, there is a significant and

Please see *Potential Tax Law Changes* on p. 3



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## Ask The Expert

Email Michael T. Dillon, Esq. @ [mike@dillontaxconsulting.com](mailto:mike@dillontaxconsulting.com)

**QUESTION:** *What should I do if I receive a nexus questionnaire or a notice from a revenue authority?*

**ANSWER:** If you've received a nexus notice or a questionnaire, don't ignore this! There is a tendency to put these in the circular file, or to place these in our "TO DO" file, and forget about them. While occasionally these are merely a state's means of "fishing" (see [Sales Tax Audits – Are You Ready?](#), above re: heightened enforcement) there is likely a reason that the state sent this. It may be that the state audited your customer or supplier, or referenced a 1099 you issued to a contractor or a representative. Ignore it, and you may soon find a jeopardy assessment in your mail. While you do want to respond, you want to be careful how you respond. For example, you may simply misunderstand/misinterpret a question, and give more information that the question requires. Some questions may not be applicable, and can be ignored. Often a narrative response will suffice, rather than checking all of the "Yes/No" boxes that may unnecessarily result in further inquiry from the state. After all, the questions are designed to result in a finding of nexus. Some states will share the responses with other states' revenue authorities, so your answers in one state may create further inquiry from other states. Lastly, if you determine that your company has nexus and historical exposure, a state tax expert may be able to negotiate resolution before disclosing the name of the company. In short, proactive consideration and responses to state inquiries will always minimize risk better than any other approach.



## Case Study – Could This Be You?

By Michael T. Dillon, Esq.

Often, I am called in to a new client opportunity at their or their CPA's request after they have undergone a sales tax audit. At this point, the taxpayer finds itself having to react to a taxing authority's inquiry or audit findings. The company is simply "putting out fires" as opposed to proactively meeting and minimizing these obligations, and seeking potential refund opportunities. Reason being – they don't know that they don't know!

After one particular audit, we reduced the \$250,000 assessment to \$0.00 (yes, ZERO). Regardless, the company's complete breakdown in protocol to both identify its obligations, and obtain/retain exemption certificates prompted the need for a Sales Tax Compliance Process Review. A Compliance Process Review is a comprehensive multistate diagnosis

and is a critical first step in order to properly identify and quantify the materiality of the sales & use tax-related issues and opportunities to be addressed in subsequent steps.

As a result, the company learned that multistate compliance issues are systemic and exposure in one state make signal exposure in other. We identified all of the gaps and exposure, registered the company in each state that it had nexus, established sales tax compliance and exemption certificate management processes, and eliminated several \$Million in potential audit exposure.

*"Often a narrative response [to a state nexus questionnaire] will suffice, rather than checking all of the "Yes/No" boxes that may unnecessarily result in further inquiry from the state."*



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## Potential Tax Law Changes (cont'd from p. 1)

valid concern among taxpayers and business groups that such efforts will have a chilling effect on state efforts to create more jobs, perhaps even resulting in businesses relocating to states with lower tax costs.

Affiliate nexus standards, gaining in popularity based on model statutes enacted in NY and CO, presume nexus exists for an out-of-state retailer by virtue of its website linking agreement with an in-state retailer. These laws represent states' latest means of forcing the imposition of sales tax compliance responsibilities on out-of-state online retailers who lack nexus and such responsibilities, something states' see as a tax "loophole", as opposed to a Constitutional limit on their authority.

Many taxpayers and practitioners, including the author, consider such laws to be an unconstitutional effort for states to collect taxes on internet transactions from out-of-state retailers. The unconstitutional claim is based on the fact that states otherwise lack the authority to impose their laws on business that lack a nexus, or physical presence, with the state.

Taxpayers should be aware of the state legislative efforts being made to expand existing taxes, as these efforts often receive less news coverage than new taxes. And they can often be added to other budgetary legislative actions and sneak their way in, as Maryland learned with the "tech tax" passed during the late hours of the night during the 2007 Special Session.

Maryland's General Assembly must convene again in a Special Session this Fall, to realign congressional districts. However, there is already discussion that they may also use the time to expand the sales tax to cover more services and/or online retailers. Analysts project that Maryland loses approximately \$184 Million a year in sales tax revenue from online retailers who lack nexus and collection responsibilities, such as Amazon.com. The State Senate's Budget & Taxation Committee has already met with experts and taxpayer representatives on these items, in an effort to be well-versed in the pros and cons of such measures, come this Fall.



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