

SALES & USE TAX FUNDAMENTALS

STATE & LOCAL TAX FORUM I
SEPTEMBER 25 2013



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Opening Commentary

Patrick Gregory
Managing Director
UHY Advisors



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SCHEDULE OF EVENTS

8:00AM—8:15AM Opening Commentary

8:15AM—9:45AM Sales & Use Tax Fundamentals

9:45AM—10:00AM Interactive Discussion



ATTENDEE CHECKLIST

- ✓ CPE materials
- ✓ Feedback
 - Tear out form in back of attendee booklet
- ✓ Questions
- ✓ Keep a look out for a post-event email
 - Download a copy of the PowerPoint presentation
 - Link to view the video
- ✓ Sign up today for Forums II & III



ABOUT UHY

LOCAL

- More than 40 years of experience
- Practice leaders with Big 4 experience and training
- Offices in Farmington Hills and Sterling Heights employing more than 275 professionals
- Ranked sixth largest professional services firm in Metro Detroit by Crain's Detroit Business
- Sterling Heights office is the largest accounting firm in Macomb County

NATIONAL

- 14 offices across the US
- More than 1,000 professionals
- Ranked one of the Top 20 professional services firms by Accounting Today
- More SEC registrants than CPA firms double our size
- PCAOB reports with no comments
- Unmodified peer review reports

INTERNATIONAL

- Member firms in more than 260 cities in over 85 countries
- Over 7,000 professionals
- Ranked among the Top 25 international accountancy networks
- Revenue of \$622m



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US LOCATIONS

CONNECTICUT

NEW HAVEN

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New Haven, CT 06510
Telephone: 203 401 2101

GEORGIA

ATLANTA

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Telephone: 678 602 4470
Fax: 678 602 4300

ILLINOIS

CHICAGO

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Chicago, IL 60606
Telephone: 312 578 9600
Fax: 312 346 6500

MARYLAND

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Fax: 248 355 1057

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Sterling Heights, MI 48313
Telephone: 586 254 1040
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Suite 108
St. Louis, MO 63143
Telephone: 314 615 1301
Fax: 314 647 8304

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Fax: 212 354 6445

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Rye Brook, NY 10573
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Fax: 914 697 7583

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Suite 2400
Dallas, TX 75201
Telephone: 214 243 2900
Fax: 214 243 2929

HOUSTON

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20th Floor
Houston, TX 77019
Telephone: 713 561 6500
Fax: 713 960 9549

WASHINGTON D.C.

WASHINGTON

1325 G Street NW
Suite 500
Washington, D.C. 20005
Telephone: 202 609 6100



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GLOBAL NETWORK

AMERICAS

Argentina
Brazil
Canada
Chile
Colombia
Dominican Republic
Ecuador
El Salvador
Jamaica
Guatemala
Mexico
Peru
Puerto Rico
United States
Uruguay
Venezuela

ASIA-PACIFIC

Australia
Bangladesh
China (incl. Hong Kong)
India
Indonesia
Kazakhstan
Japan
Korea (Rep. of)
Malaysia

New Zealand
Pakistan
Singapore
Taiwan
Vietnam

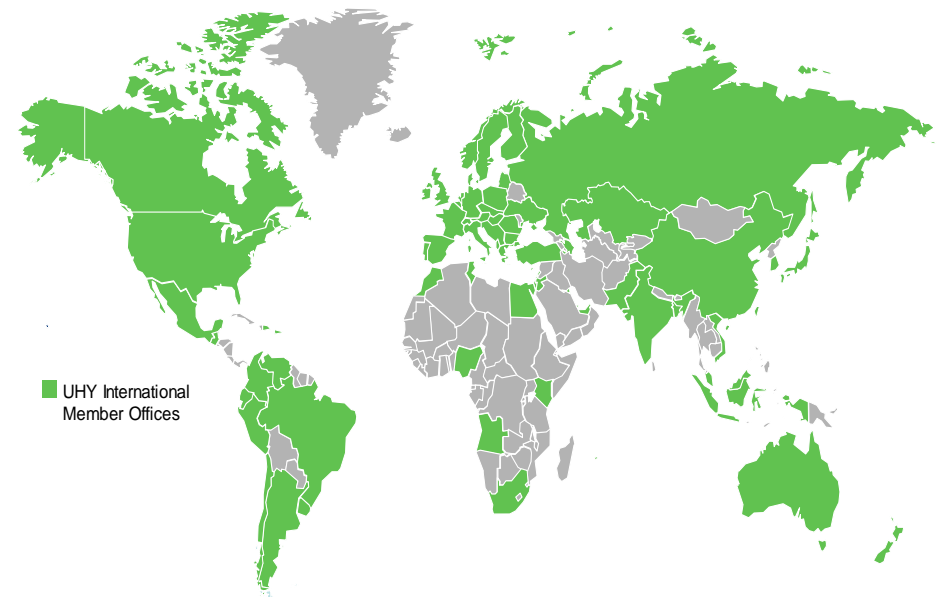
EUROPE

Albania
Austria
Belarus
Belgium
Bulgaria
Czech Republic
Croatia
Cyprus
Denmark
Estonia
Finland
France
Germany
Greece
Guernsey
Hungary
Ireland
Isle of Man
Italy
Latvia
Lithuania
Luxembourg
Malta
Netherlands
Norway

Poland
Portugal
Romania
Russian Federation
Slovakia
Slovenia
Spain
Sweden
Switzerland
Turkey
Ukraine
United Kingdom

MIDDLE EAST & AFRICA

Azerbaijan
Angola
Bahrain
Egypt
Israel
Jordan
Kenya
Republic of Kuwait
Lebanon
Mauritius
Morocco
Nigeria
South Africa
Tunisia
UAE



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SELECT SERVICE OFFERINGS

AUDIT & ASSURANCE

- Audits, Reviews & Compilations of Financial Statements
- Audits of Financial Statements of Employee Benefit Plans & Pensions
- Attestation Services, Including Agreed-Upon Procedures Reports and Service Auditor Reports (SSAE 16 Reports)
- Audit Committee Advice
- Due Diligence
- Financial Forecasts & Projections
- Financial Reporting Assistance

TAX PLANNING & COMPLIANCE

- Federal Tax Planning & Compliance
- State & Local Tax Planning & Compliance
- International Tax Planning
- Transfer Pricing
- Executive Tax & Financial Planning Services
- Expatriate Tax
- Business Formation & Entity Structuring
- Cost Segregation
- Estate Planning
- Research & Development Credits

ADVISORY

- Internal Audit, Risk & Compliance Services
- Management & Technology Consulting Services
- Resource Solutions
- Transaction Services
- Employee Benefits Consulting

FORENSIC, LITIGATION & VALUATION

- Commercial Litigation & Financial Damage Analysis
- Business Valuation
- Financial Fraud Examinations & Investigations
- Business Insurance Claim Measurement & Consulting
- Accountant Malpractice Claims
- Family Law & Divorce Consulting
- Electronic Discovery



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Sales & Use Tax Fundamentals

Susan Wagner
State & Local Tax Specialist
UHY Advisors



AGENDA

- ✓ General Concepts
- ✓ Tax Compliance
- ✓ Audits, Assessments & Appeals
- ✓ Current Issues



TYPES OF STATE TAXES IMPOSED

- Property Taxes
- Payroll Taxes
- Fuel Taxes
- Sin Taxes
- Corporate Income/Franchise Taxes
- Flow-Through Withholding Tax
- Inheritance Taxes
- Estate and Gift Taxes
- Personal Income Taxes
- Local Income Taxes



General Concepts



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HISTORY

No State Level Sales/Use Tax:

- Alaska
- Delaware
- New Hampshire
- Montana
- Oregon

But there are over 13,000 tax rate jurisdictions throughout the country that do tax...

Where does your business operate?



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HISTORY

At the end of World War I, sales tax existed outside the U.S. in order to assist fiscal systems from post-war expenses and increasing inflation.

The Great Depression of 1930's saw the adoption of sales tax in the U.S. originally thought to be a "temporary measure".

In 1933, Michigan enacted the sales tax. The complementary use tax followed in 1937.



SALES TAX & USE TAX - MICHIGAN

The sales tax is imposed upon the privilege of engaging in business as a retailer.

The use tax is imposed upon the use, storage, or consumption of tangible personal property in the state and upon certain specified services.

Local jurisdictions are not authorized to impose local sales/use taxes but there are some special purpose taxes.



SALES TAX & USE TAX - MICHIGAN

The sales tax is levied on the “gross proceeds” of all persons engaged in the business of making sales at retail by which ownership of tangible personal property is *transferred for consideration*.

- “Gross proceeds” = sales price
- “Tangible personal property” = property that can be seen, weighed, measured, felt, or touched...includes electricity, water, gas, steam and prewritten computer software



SALES TAX & USE TAX - MICHIGAN

“Sales price” includes: seller’s cost of property sold, cost of materials used, costs of transportation to seller, other expenses of the seller, charges needed to complete the sale, delivery and installation charges incurred before the transfer of ownership, credit for any trade-in.

“Sales price” does not include: interest, financing, or carrying charges from credit extended on the sale, IF the amount is separately stated on the invoice, taxes are not included in the price if separately stated.



SALES & USE TAX - MICHIGAN

“Purchase price” includes: total amount of consideration paid by the consumer to the seller.

What is “consideration”? Cash, credit, property, services, for which the item or service is sold, leased, valued in money, whether received in money or otherwise, and applies to the measure subject to sales or use tax.



ELEMENTS OF A SALES TAX TRANSACTION - MICHIGAN

There must be a transfer of ownership

- Between a seller (vendor) and a purchaser (customer)
- Must take place in Michigan
- Must have consideration



HOW DO YOU KNOW WHICH STATES YOU SHOULD FILE IN?

- Situs
- Intrastate versus Interstate
- Nexus



SITUS (SOURCING)

Where did the sale or purchase take place?

- The “where” may not always be transparent but is critical

Which jurisdiction’s law will rule the transaction?

- State, county, city, special tax or all?

Which jurisdiction receives the tax?

- Who do you owe?

What about the sale or purchase of services or intangibles?

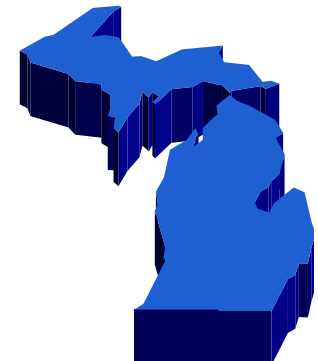
- What are you selling or buying?



INTRASTATE VS. INTERSTATE

Intrastate

- Transaction begins and ends in the same state
- Examples:
 - A customer purchases an item at a local retail store
 - A business located in Detroit purchases a desk from a company in Flint and has it shipped to their Ann Arbor location
- Intrastate = Sales Tax



INTRASTATE VS. INTERSTATE

Interstate

- Transaction begins in one state and ends in a different state
- Examples:
 - A customer orders an item at a Royal Oak retail store and has the retailer ship the purchase to San Francisco
 - A business located in Illinois purchases a desk from a company in New York to be shipped directly to their office in Chicago
- Interstate = Use Tax



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NEXUS

Dictionary definition ...

- “A means of connection; tie; link”

For Sales/Use Tax Purposes...

- U.S. Constitutional requirement has been met with respect to imposing a tax collection responsible on an out-of-state seller
- Nexus between a vendor and a taxing state is a requirement under both the Commerce and Due Process clauses of the Constitution
 - A tax is valid under the Commerce Clause if it is applied to an activity that has substantial nexus with the taxing state
 - Under the Due Process Clause, there must be a minimum “connection” between a state and the person, property, or transaction being taxed



NEXUS / COLLECTION RESPONSIBILITY

Whether an obligation to collect tax to a sale by an out-of-state seller is determined by a combination of federal and state law.

At the federal level, the determination revolves around whether a “nexus” between the sale and the state can be established.

At the state level, a determination of whether the seller meets the criteria of nexus in that state exists.

If there is “sufficient nexus”, then a filing obligation may exist.



NEXUS / COLLECTION RESPONSIBILITY

Who is liable for the tax?

- Seller and purchaser have joint liability for remitting the tax
- Seller essentially becomes the state's collection agent
- Seller subject to liability, if, as an agent, he fails to collect the tax
- Primary reporting and payment responsibility for sales tax is on the seller
- Primary reporting and payment responsibility for use tax is on the user, but an out-of-state seller with nexus must collect the tax



DETERMINING TAXABILITY

Does the purchaser have sales tax exempt status?

- Federal Government
- Foreign Governments/Diplomats
- State Municipalities (sometimes)
- Educational Institutions (sometimes)
- Not-for-Profit 501(c)(3) Organizations
- Manufacturing/Industrial Processors
- Sale-for-Resale
- Rolling Stock
- Agriculture
- Native American Reservation Transactions
- Occasional or Isolated Sales (sometimes)



EXEMPTIONS & EXCLUSIONS

Exemptions are expressed in the following ways...

- Explicitly (by law)
- As exceptions to the definition of “engaging in business of selling tangible personal property at retail” or “sales of taxable services”
- Federal and State limitations (constitutional limitations)
- As exclusions from a taxable category:
 - Basis of the nature of the product (exempt organization)
 - The type of transaction (resale)
 - The nature of the entity selling or buying the product (manufacturer or charitable organization)



EXEMPTION CERTIFICATES

A seller must obtain and keep exemption certificates signed by the purchaser as evidence for any exempt sales transaction.

- “Burden of Proof” is on seller
- Must be a “valid” certificate
- Certificates can expire – requirements vary by state
- Federal 501(c)(3) exemption does not necessarily provide state level exemption
- If purchaser does not provide certificate, charge tax



DIRECT PAY PERMITS

Allows for a purchaser to pay the tax directly to the jurisdiction.

- Method of “self-accrual”
- Generally must be authorized by taxing jurisdiction
- Documentation must be provided to the seller
- If purchaser does not provide permit, charge tax

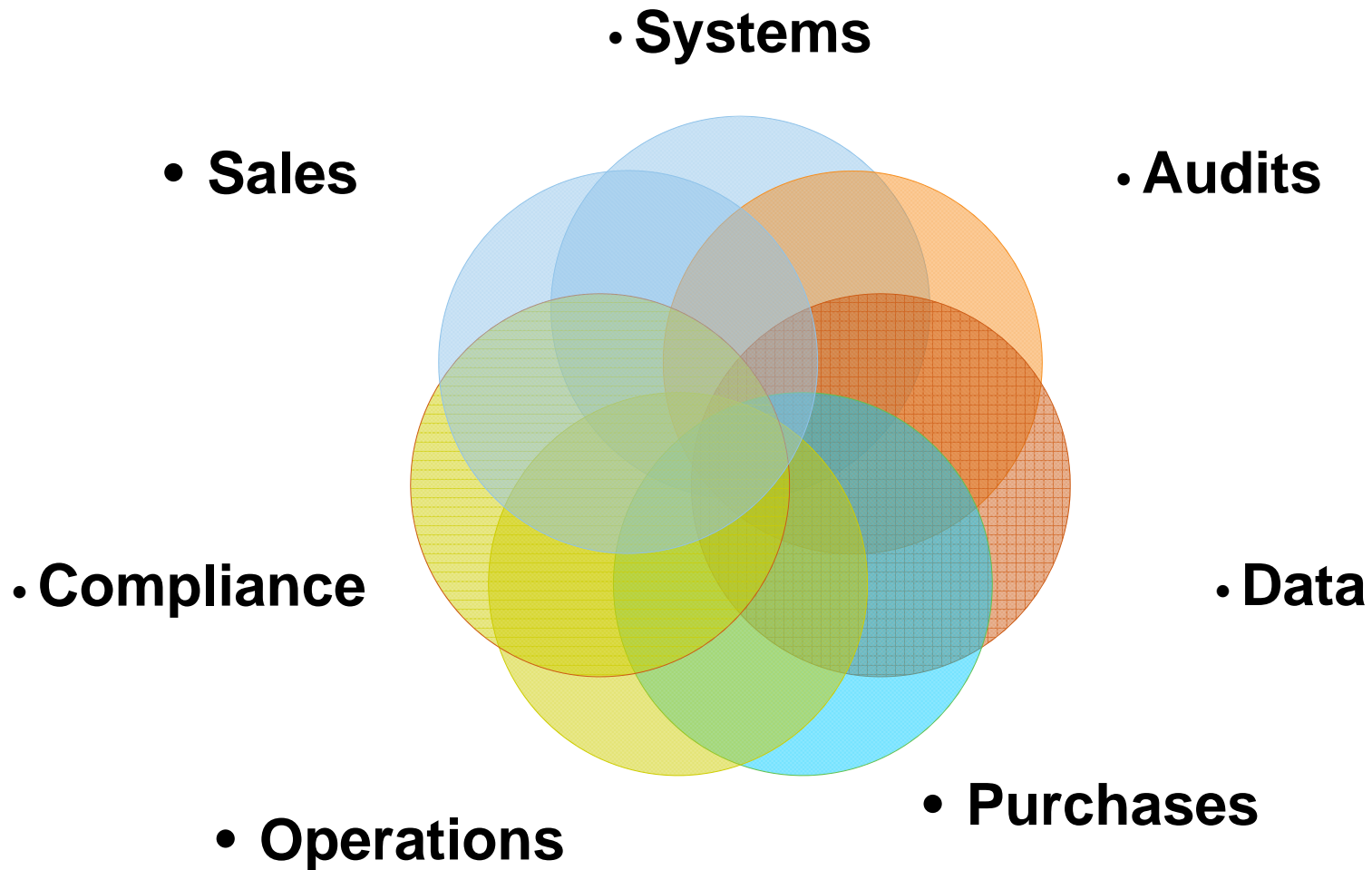


Tax Compliance



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TAX COMPLIANCE



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LICENSING AND REGISTRATION

- Sales Tax License
- Use Tax Registration
- Penalties for failure not to register



RETURNS AND PAYMENT OF TAX

Returns can be due on a monthly, quarterly or annual basis, depending on filing thresholds

Pre-payments can be required

Electronic Filing

- Varies by state

Electronic Funds Transfer

- Remit payment on-line
- Threshold requirements
- Varies by state



RETURNS AND PAYMENT OF TAX

- Penalties and Interest
 - Late filing
 - Deficiency of tax
- Early Payment Discount
- Amending Returns
- Refunds
- Record Keeping
- Selling or Quitting a Business



Audits, Assessments & Appeals



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WHY AUDIT?

- In order to administer and enforce the law
- Books, documents, data, etc. may be examined
- Law requires and dictates the records that must be kept
- Corporate officers and responsible parties of flow-through entities may be assessed upon failure to pay taxes due



NOTIFICATION TO AUDIT

- Generally notified by mail
- May receive a “nexus questionnaire”
- Desk Audits
- Managed Audits
- Statute of Limitations



KEY AREAS IN AUDIT

- Non-Recurring Items
- Large Dollar Items
- Test Period Cutoff
- Sales
- Purchases
- Internet Sales & Purchases
- Credit Card Purchases (Procurement Cards)
- Capital Assets
- Exemption Certificates
- Tax Returns



NON-RECURRING ITEMS

- Fixed Assets
- Sale or Purchase of a Business
- Journal Entries
- Changes in records, data collection, new systems
- Unusual events



ACCRUAL ACCOUNTS

- Use Tax Accruals
- Does the Accrual Support the Tax Return
- Are accruals system generated – understand the flow of data



TEST PERIOD CUTOFF

Review the dates of several invoices or purchases – make sure none are before or after the audit period.

Know whether the audit period or audit sample could be impacted by an unusual event that could skew the sample or data

- Change in business operations
- New systems versus legacy systems
- Change in internal procedures



SALES

- Run the numbers to see if you would be better off removing a particular customer from the sample (or other unusual event)
- Any bad debts during audit period
- Documentation of exemptions
- Proof that tax calculated on invoice is correct
- Documented support for the tax returns filed



PURCHASES

Run the numbers to see if you would be better off removing a particular purchase from the sample

- One time purchase
- Unusual event

Is the purchase exempt? Document why.

Generally all capital asset purchases for the audit period will be reviewed

- Fixed Asset System Reporting
- Depreciation Schedules
- By general ledger account



DATA & DOCUMENTATION

- Auditor has right to ask for documentation
- Burden of Proof is on taxpayer
- Ability to walk auditor through the system generated calculations to support sales, purchases, accruals, tax return
- Legacy or archived systems should be addressed when the audit begins (or other issues that would impact data retrieval)
- How accessible is the data – audits “look back” to the past
- In-house tax policy to address data and documentation procedures as they pertain to audits



AUDIT HISTORY

When was the last audit? What was the result?

Review prior audit workpapers before starting new audit

Adjustments? Why?

Corrections as noted by auditor – have they been made?



AUDITS, ASSESSMENTS & APPEALS

Audit Assessment Procedures Vary by State

Pay Attention to Time-Line on Appeal Assessments

Can generally work with auditor to adjust work papers prior to an assessment being issued (recommended)

Avoid Jeopardy Assessment and Tax Lien/Levy

- Once received require immediate attention
- May obtain a “courtesy hold” until resolution

Burden of Proof on Taxpayer that an assessment is unwarranted!



APPEAL PROCEDURES

- Can Vary By State and Tax Type
- Taxpayer Bill of Rights
- Informal Conferences
- “Pay to Play”



WHAT TO DO?

- Depends on Amount of Assessment
- How will the Assessment Effect Future Audits
- How Strong is the Case – Can You Defend It?
- Realize that penalties and interest are accruing
- What other costs will be incurred?
- Do you need legal counsel?
- Work with the auditor before the final assessment – try to avoid appeals – negotiate a settlement



AUDITS, ASSESSMENTS & APPEALS

Voluntary Disclosure Agreements

- Must be a “non-filer”
- Agreement with state to bring taxes current
- Limited “look back” period
- Penalties may be waived, interest is not

Tax Amnesty Programs

- Similar to Voluntary Disclosure Agreement
- Generally have a limited window of opportunity
- Often limited to a particular tax
- May waive both penalties and interest



Current Issues



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TAX PROJECT

Streamlined Sales/Use Tax Project

- Began in March 2000
- Established to simplify sales/use tax collection
- Attempt to “standardize” the definitions and taxability of items
- Encourage voluntary collection by out-of-state vendors
- Effective in Michigan in 2004
- Frequently updated



CLOUD COMPUTING

- What is it?
 - Provision of remote access from a central service provider to computing applications, platforms or infrastructure
- Defined as a “service” by U.S. Government
- How is the service sold?
 - Software as a Service (SaaS)
 - Platform as a Service (PaaS)
 - Infrastructure as a Service (IaaS)
- What is the actual transaction? What is the “true object”?
 - What are you buying? Tangible property vs. service vs. intangible
- States are still trying to understand technology and tax treatment



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INTERNET SALES / REMOTE SELLERS

- Current legislation
- Nexus “redefined”
- Compliance Nightmare?
- Are you ready?



CONTACT INFORMATION

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INTERACTIVE DISCUSSION

Q&A



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ATTENDEE CHECKLIST

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CONCLUDING THOUGHTS

Thank You!



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