



# Are you overpaying (or underpaying) consumer use tax?

Automation and improved control can save your company a fortune

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## An aggressive audit environment

It's no secret that taxing jurisdictions across the country are suffering from the economic downturn, and are anxious to close the tax gap. Before asking their constituents for a tax increase, they're deploying sophisticated auditing techniques like statistical sampling to uncover incorrect calculation of consumer use tax.<sup>1</sup> This is especially true when the taxpayer has such a volume of records that it's impractical for an auditor to examine every record.<sup>2</sup> In this environment, it may be a good time to review the processes your company currently has in place to manage consumer use tax. First, a primer.

## Consumer use tax: What is it?

Every state that imposes a sales tax has a mirror-image tax called a use tax. The tax can take two forms: a seller's use tax or a consumer use tax. The seller's use tax is imposed upon an interstate transaction and is collected from the buyer by the seller. The requirement for a seller to collect use tax depends upon whether or not the seller has nexus in the buyer's state. (Nexus is the minimum necessary connection between a business and a jurisdiction in order to trigger the requirement to register and collect tax. Nexus can also be created through click-through nexus, affiliate nexus, economic nexus, and marketplace nexus.) If the seller does not have nexus in the buyer's state, the state then requires that the buyer self-assess the use tax, and remit payment to the state. This is known as consumer use tax. Most states have a consumer use tax at the local level as well as the state level, which adds to the complexity of maintaining compliance.



## Use tax is often a second priority

While most companies have been diligent about calculating, collecting, and remitting sales tax, a systematic approach to dealing with consumer use tax is not as widespread. Most businesses maintain in-house tax expertise or use consulting services to determine the taxability of what they sell. Determining the taxability of what they purchase is typically left to the purchasing or accounting department. This loss of control for the tax department can result in underpayment or overpayment, costing a company a fortune. There are a number of contributing factors that can make this approach costly:

- The volume of invoices processed in a typical accounts payable environment
- The limited amount of information available on the invoice
- The lack of tax knowledge on the part of procurement and accounts payable personnel

## Determining taxability

When determining consumer use taxability, there's a myriad of considerations, including:

- What was purchased?
- Is the product subject to an exemption or exception?
- If the product is shipped to a temporary location, will it be forwarded to another location? Does the state where the item is originally received have a "held in temporary storage" exemption?
- Is the product tax-exempt based on its use?
- How are freight charges taxed by the state with jurisdiction over the transaction tax?
- What happens if there are both taxable and exempt charges on the same invoice?

In addition, there are specific asset and inventory events that should trigger a closer look at consumer use tax liability, including:

- **Asset movement:** If your company relocates an asset from its initial location, its tax status must be reevaluated to determine whether additional taxes are due or any tax credits are available. Many states will give the taxpayer a credit for taxes paid to the jurisdiction where the asset was first located.
- **Inventory removal:** In most states, inventory purchases are tax-exempt under the theory that the items will either be sold to a final consumer or incorporated into the final product that will be sold at retail. As a buyer, you would present an exemption certificate to the supplier to reflect the tax-exempt status of the purchase. But if you remove items from inventory for another purpose — a computer to be used in one of your company's departments or samples to give to customers, for example — you need to reexamine the taxability under the laws of the jurisdiction where you have nexus.

## Other considerations

To further complicate the process, here are two additional scenarios that can affect taxability determination. Both require that a company use an automated system for consumer use tax. But without careful management, both scenarios can result in overpayment or underpayment.

- **Direct pay permits:** Most states allow taxpayers to pay the sales and use tax on their purchases directly to the tax jurisdictions instead of their suppliers. Direct pay permits are often used in the manufacturing sector where it is difficult for the purchasing department to ascertain the tax status of items at the time of acquisition. Many states require the taxpayer to substantiate the adequacy of its record-keeping system. A reliable automated solution that enables the capture and reporting of accurate tax data should help.
- **Evaluated receipts settlement (ERS):** Under the ERS option, no invoice is issued by the supplier and no payment is made by the buyer at the time of purchase. Instead, a purchase order is transmitted to the supplier who ships the goods with a packing slip. When the receiving department enters the packing slip information into the purchasing system, the buyer must wire the total amount due to the supplier, including sales and use tax, within a predetermined number of days.

Given the complexities of the tax laws and the multitude of items most companies purchase and use in different ways, the only feasible way to handle the requirements of consumer use tax is through automation.

## Automation is the solution

Without a thorough understanding of all the intricacies of consumer use tax, your company could be overpaying or underpaying. Given the complexities of the tax laws and the multitude of items most companies purchase and use in different ways, the only feasible way to handle the requirements of consumer use tax is through automation. There are software applications available that provide tax rule support in conjunction with data element mapping and configuration capabilities. By utilizing general ledger account numbers, project numbers, vendor codes, or usage codes, these applications can make the proper use tax determinations.

When the time for an audit does come, the fact that your business has a system in place for consumer use tax will go a long way toward convincing the authorities that your company doesn't have systemic use tax problems. This will make audits go quicker and help prevent examinations from spiraling out of control. This, in turn, will reduce the administrative overhead associated with the use tax audit and minimize penalties and interest for incorrectly reporting use tax. The bottom line? Automating consumer use tax can dramatically affect your bottom line.



## About the author

Joseph Geiger, Jr., ESQ, CPA, MST, MSA, is a manager of tax consulting with the Vertex Consulting Group. Joe has over 30 years of tax experience in income, property, real estate, fuel, franchise, international, excise, payroll, and sales and use taxes, along with expertise in tax appeals, audit controversy, and reverse audits. Joe graduated with a J.D. from the Temple University School of Law, has a M.S. in taxation and a M.S. in accounting from Widener University, and a B.S. in accounting from the Pennsylvania State University.

Joe has been with Vertex Consulting for over 14 years. Prior to joining Vertex, Joe was a real estate tax manager at Exelon Corporation, the country's largest electric utility, where he focused on property and real estate compliance, tax appeals, and planning. Previously, Joe was a principal tax analyst at Exelon Generation Company, where he was responsible for all indirect, property, and real estate taxes in a multistate environment. Joe was a tax specialist at QVC, where he focused on state and local sales tax strategies, reviewing vendor agreements for tax issues, and managing federal income tax audits. Joe has several years of public accounting experience with two Philadelphia regional firms and was a controller of a mortgage banking company. Joe has been a regular speaker at Vertex Exchange, the company's annual customer conference, and for Strafford Publishing webinars.

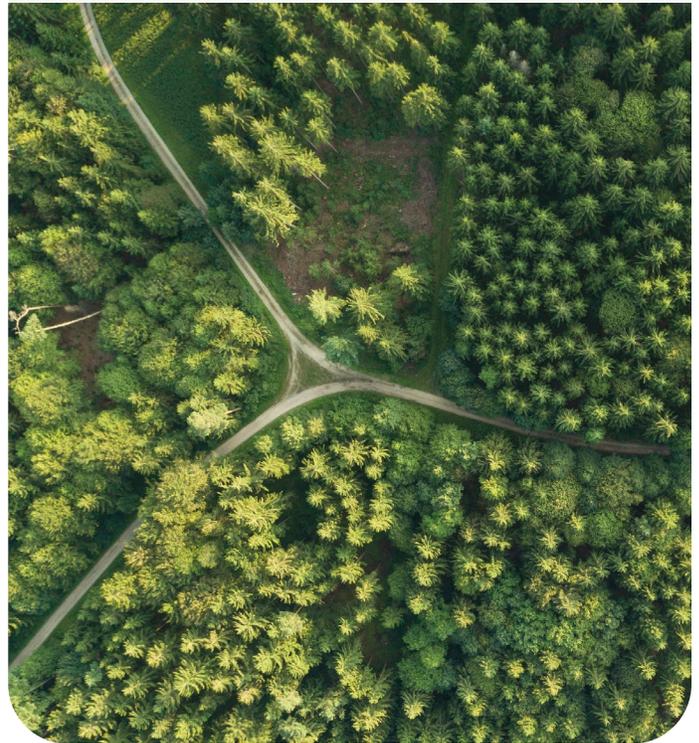
### Endnotes

<sup>1</sup> California State Board of Equalization, "Audit Manual", Chapter 13, Statistical Sampling, 1301.05, 2000.

<sup>2</sup> Florida Department of Revenue, "Tax Information Publication", No. 07ADM-02-Practice and Procedure—Audits by Tax Type—Statistical Sampling of Fixed Assets, 205-067, June 29, 2007.

## About Vertex

**Vertex, Inc.** is a leading global provider of indirect tax solutions. The company's mission is to deliver the most trusted tax technology, enabling global businesses to transact, comply, and grow with confidence. Vertex provides solutions that can be tailored to specific industries for major lines of indirect tax, including sales and consumer use, value-added, and payroll. Headquartered in North America, with offices in South America and Europe, Vertex employs over 1,400 professionals and serves companies across the globe.



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